


International Assignment Services

International assignment perspectives*

Volume 3



*connectedthinking

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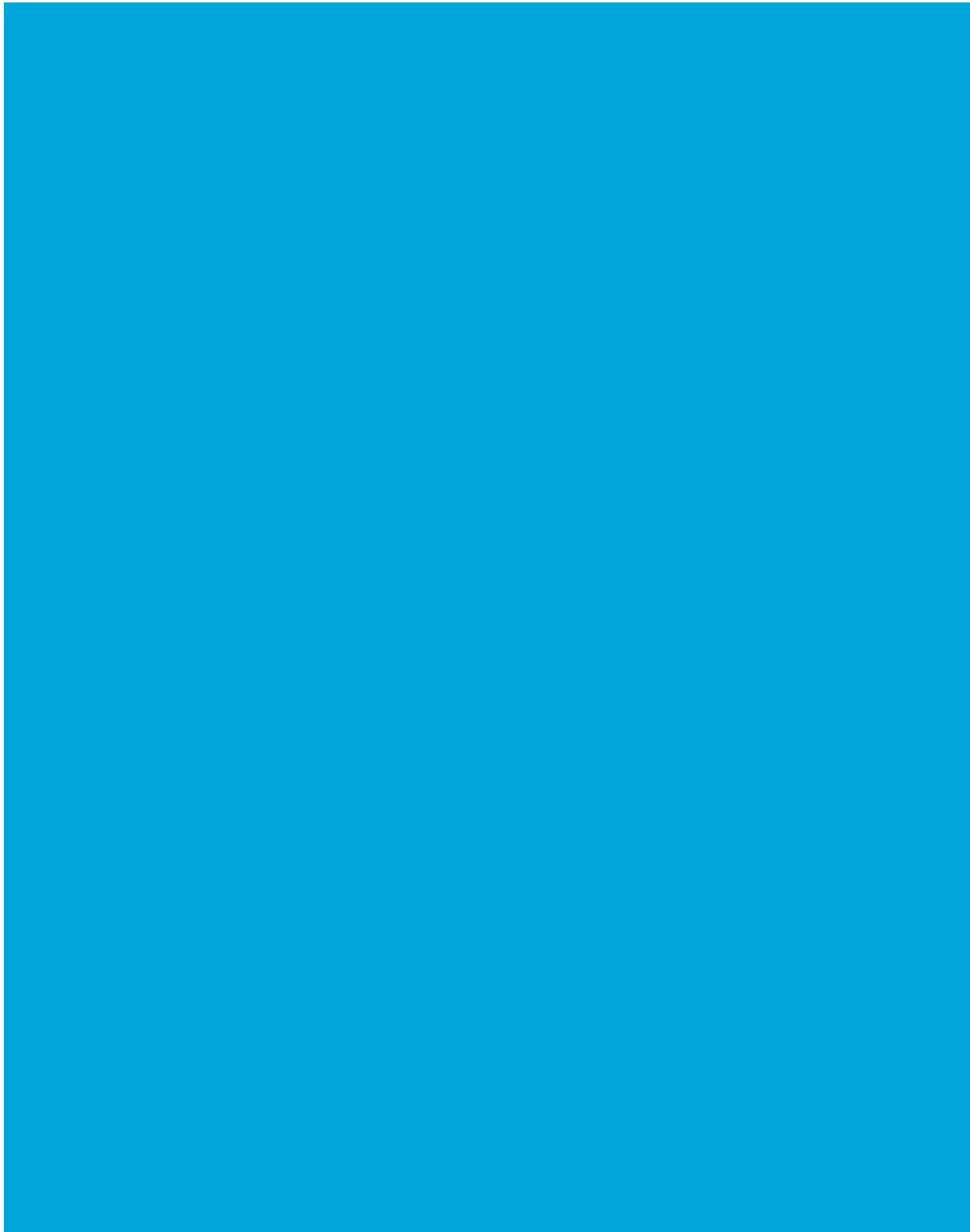
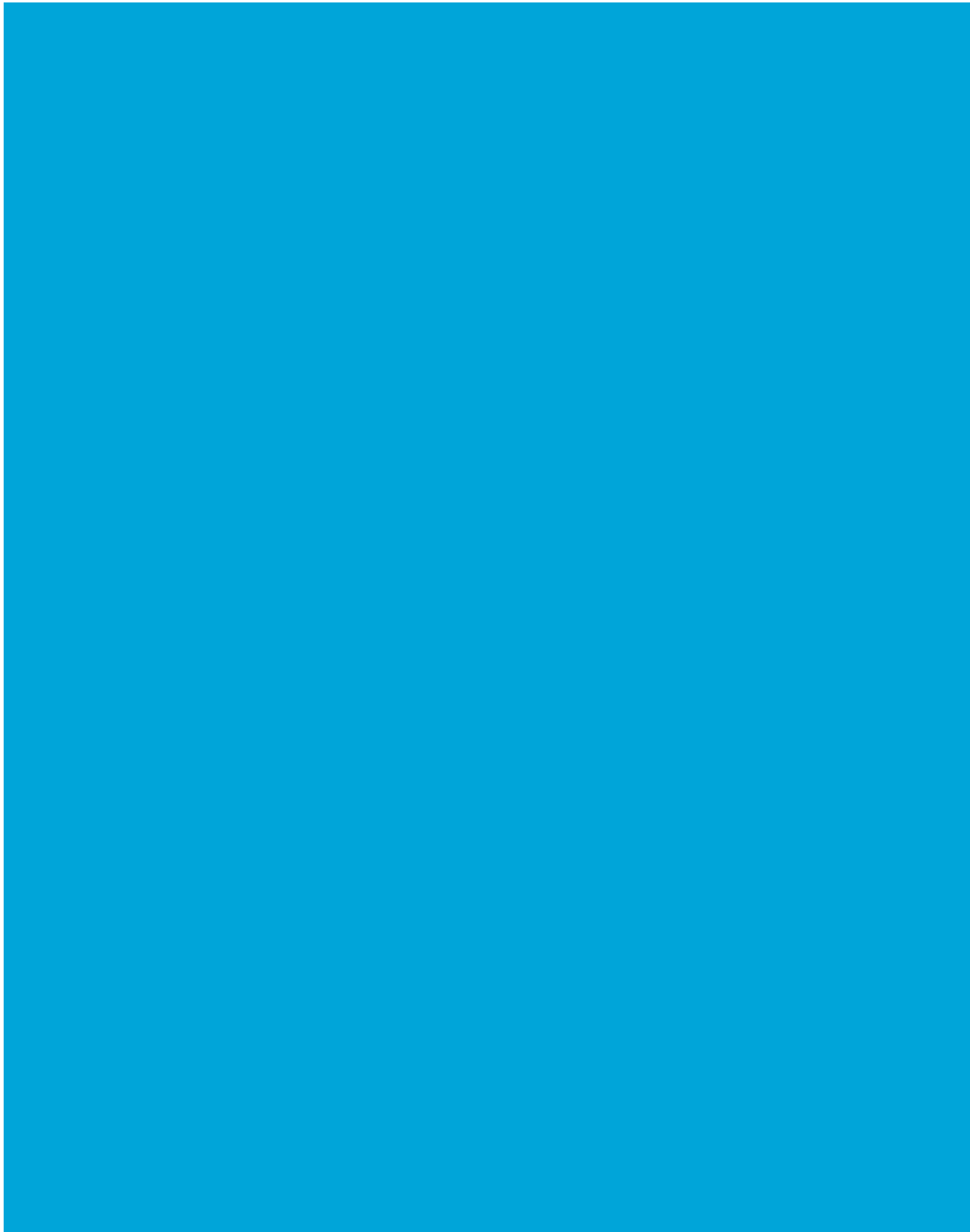


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Foreword

In today's economic climate, companies are struggling to find ways to adjust short-term, day-to-day operations that will help them ride out the storm. As multinational organizations review their existing programs and processes, cost containment is a growing concern that may place international assignment programs under scrutiny. In addition, government actions across various territories may increase the challenges facing multinationals.

On the flip side, globalization remains one of the largest trends affecting business, and business growth in emerging markets shows no signs of slowing down. Now, more than ever, it is essential that companies remain strategic by carefully evaluating the overall impact of any potential changes to an organization's existing global mobility program before taking action. When seeking ways to keep company finances above water in the short term, they must also maintain a competitive edge and sustain alignment with global strategies in order to meet long-term business objectives.

In light of this uncertain business environment, it is the people in the organization that can make the difference between a successful business and one that fails. In fact, according to PwC's 12th Annual Global CEO Survey, 97 percent of CEOs around the world agree that having access to key talent will be critical for long-term business growth, so companies need to be careful not to make reactive decisions that may jeopardize their long-term ability to compete. Success demands not only the steps needed to survive in the interim, but also the building blocks—people, agility, reputation, innovation—that drive future results.

Regulatory complexity across various territories, increased compliance considerations, the effect of underwater equity on incentives and growing technology issues, such as the need for increased data privacy, only add to the existing economic challenges facing HR leaders working to address the needs of today's international assignees. How effective an organization is at addressing these issues will determine how successfully they manage mobility.

International assignment perspectives—Volume 3 is a collection of thought leadership articles that explore current issues requiring the attention of today's HR leaders and tax directors who manage a globally mobile workforce. We hope you find the third edition of *International assignment perspectives* an insightful and innovative read that presents answers to your key questions and provides a strategic framework for addressing today's challenges in international assignments.



William F. Owens, Jr.
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Managing your international assignment costs in a downturn

Carrie Jones and June Bood

When the CFO asks how much your expatriate program costs and how it aligns with your strategic priorities, does your company have answers? If not, you're not alone. Many otherwise sophisticated and efficient organizations may mismanage their expatriate programs.

In times of growth, like most of the past two decades, cost leakage may occur virtually unnoticed against a backdrop of strong returns. But in a time of short-term economic paralysis and long-term uncertainty, it becomes imperative to remember that an expatriate typically costs several times as much as a local employee. At the same time, most organizations still view international assignments as central to business and professional growth plans. They use these assignments in foreign markets, not just as business opportunities, but also as development opportunities for talented employees.

Thus, despite the ongoing global economic turmoil of the last year, companies are not terminating or repatriating large numbers of international assignments. Nevertheless, CEOs and CFOs are asking tough questions about the return on investment of expatriate programs. In a time of economic distress, when "cash is king," international assignment costs can make an attractive target for tactical expense reductions.

The less stringent management of international assignments during times of plenty may have allowed costs to spiral unnecessarily, still there are many ways (e.g., compensation, tax management) to cut costs without sacrificing the benefits of international assignments and talent retention.

For example, traditional expatriate compensation models, such as basic tax equalization and free local housing, are proving both costly and unnecessary in today's global workplace. This article examines these and other means of reducing expatriate costs without resorting to widespread repatriation or localization, which can place companies with extensive international operations at a competitive disadvantage when the global economy begins to rebound.

We also want to encourage companies to set clear business goals for their international assignment programs and aggressively pursue those goals through a consolidated mobility management structure. In the process, companies can not only enhance the quality of their operations, but also effectively manage their risk, as inconsistent oversight of international assignments can be a strategic reputational risk and a source of tactical cost overruns.

Cash is king: Cutting short-term mobility costs intelligently

Companies with the resources and patience to approach this economic downturn as a catalyst for better management of their international assignments will find options for reducing costs that do not involve dismantling or localizing most or all of their expatriate programs.

Most basically, companies need to identify their expatriate employees, where they work, what they're doing and the status of their assignments. In the healthy economic times of recent years, expatriates could easily extend assignments and remain in the host country without being required to demonstrate achievement of the assignment objectives. Considering that expatriates generally cost three to four times that of a local employee, simply repatriating an assignee who has achieved his or her assignment objective provides an immediate cost savings.

Companies should also identify the employees who are not on a formal expatriate assignment, yet are internationally mobile. These "stealth" expatriates, such as short-term business visitors who may have overstayed their assignments or commuters from one country to another, may trigger social security liabilities and other risks a company hasn't adequately prepared to mitigate.

Indeed, PwC is seeing expansion of the stealth expatriate population¹ as some companies seek to reduce costs through freezing formal international movement, even though the need to move people remains. Business units within these companies are enabling movement on an

ad hoc basis, creating policies and procedures to help employees move to the locations where they're needed outside the auspices of the general mobility program. This practice carries significant tax, immigration and reputational risk and should be monitored.

Tax equalization and planning

Traditionally, tax equalization has served as a necessary tool for convincing employees to accept international assignments as it ensures that employees pay no more in taxes than they would have paid if they stayed at home. In today's economic climate, however, employees are becoming increasingly open to accepting a local country or "localplus" package, which can allow them to take advantage of lower local tax rates or benefit from available housing or schooling allowances.

Existing tax equalization programs also may not provide the flexibility necessary for program administrators and the needs of the company. For example, tax equalization is effective for the traditional A-B-A assignment, where an employee is assigned to a single host country for a set period of time and returns. However, we are seeing that much of today's global mobility is following a more complicated A-B-C-D-E type pattern, with expatriates moving from one host country to another, from one tax jurisdiction to another, thereby increasing administrative complications and possibly tax burdens. Companies that can move away from tax equalization while still convincing employees to accept assignments may find significant savings. PwC's experience on this topic indicates that is increasingly possible.²

Housing

Companies often provide free host country housing for employees on international assignment. This benefit may represent an unnecessary cost because, in many cases, expatriates are able to secure rental income for their home country residences.

A number of companies also are beginning to require that expatriate employees contribute to the cost of their housing through a housing deduction or some other mechanism. At the same time, companies are stepping up general support functions for families—such as schooling—as a way to better attend to employees' social needs.

Forecasting and accruals

Mobility managers should rigorously forecast the cost of assignments and make sure those costs are communicated to the finance department and business unit leaders in order to avoid surprises and C-suite skepticism.

Aggressive management of the accruals set aside to cover the costs incurred by an expatriate assignment will help return any excess funds to the treasury when the costs of each assignment are reconciled. Failure to rigorously track accruals and spending can maroon money unnecessarily within the international mobility function. This is becoming increasingly important as many countries are proposing and implementing tax rate increases. We have seen proposed and legislative tax increases in the US, UK, Australia and others in 2009.

Exchange rate management and COLA

Many expatriate programs promise the expatriate employee a guaranteed exchange rate, which is reviewed yearly or every six months. Recent volatility in exchange rates—the British pound fell by about a third against the dollar between June 2008 and January 2009, for instance—highlights the importance of exchange rates in the costs of international assignments. Companies need to consider this volatility in their plans and evaluate the possibility of adjusting the exchange rate on a quarterly basis.

Companies also can review their cost-of-living-adjustment policies. With much of new international mobility aimed at developing markets, expatriates are increasingly working in low-cost countries. In these cases, it may be appropriate to adopt a negative COLA policy.

¹ "Aligning business strategy with international mobility in the current climate," PwC webcast, March 3, 2009.

² *Ibid.*

Long-term strategies: Managing talent, not transactions

Overseas assignments have become increasingly sought after by ambitious and high-performing employees. At the same time, as companies evolve beyond multinational to truly global operations, competition for top talent grows ever fiercer.

However, PwC's experience indicates the mobility functions of many companies today focus almost entirely on administration of specific assignments, rather than talent development and support for overall business goals. This tactical approach serves neither the needs of the company nor the expatriates. As mentioned before, fewer expatriates are following the traditional fixed A-B-A model of assignment. In the future, there will be far less tethering of employees to central offices. Rather, successful mobility programs will launch employees within the organization and help them manage their career progression through multiple assignments in multiple markets in service of long-term business goals coupled with close monitoring of return on investment.

However, mobility programs can only be successful in this regard if companies embed mobility policy and decision-making within their human resources, finance and C-suite management teams. Ideally, mobility will be the source linking these different functional areas in the service of business strategy. Today, however, responsibility for managing and setting goals for international assignments typically is diffused throughout an organization within different countries, offices and spheres of authority.

Understanding what enables a successful assignment

PwC has a long history of surveying their clients on things such as the key contributors to managing successful international assignments. In general, survey results have shown that simply throwing money at expatriate workers does not guarantee a successful assignment. In fact, PwC's experience indicates that strong familial support played a larger role in guaranteeing success than straight compensation. This insight points to the importance of identifying and meeting the specific needs of each international assignee within a framework that supports the business goals of the organization.

To some extent, expatriates are having at least their financial needs addressed outside the intended business framework because many companies do not have centralized written policies to guide compensation, allowance and other considerations. This vacuum of consistency and control allows employees to negotiate their own packages on an ad hoc basis, which can create not only inconsistent and opaque costs but also administrative challenges. Negotiating to the highest exception of loosely enforced policies has become the norm for many international assignees.

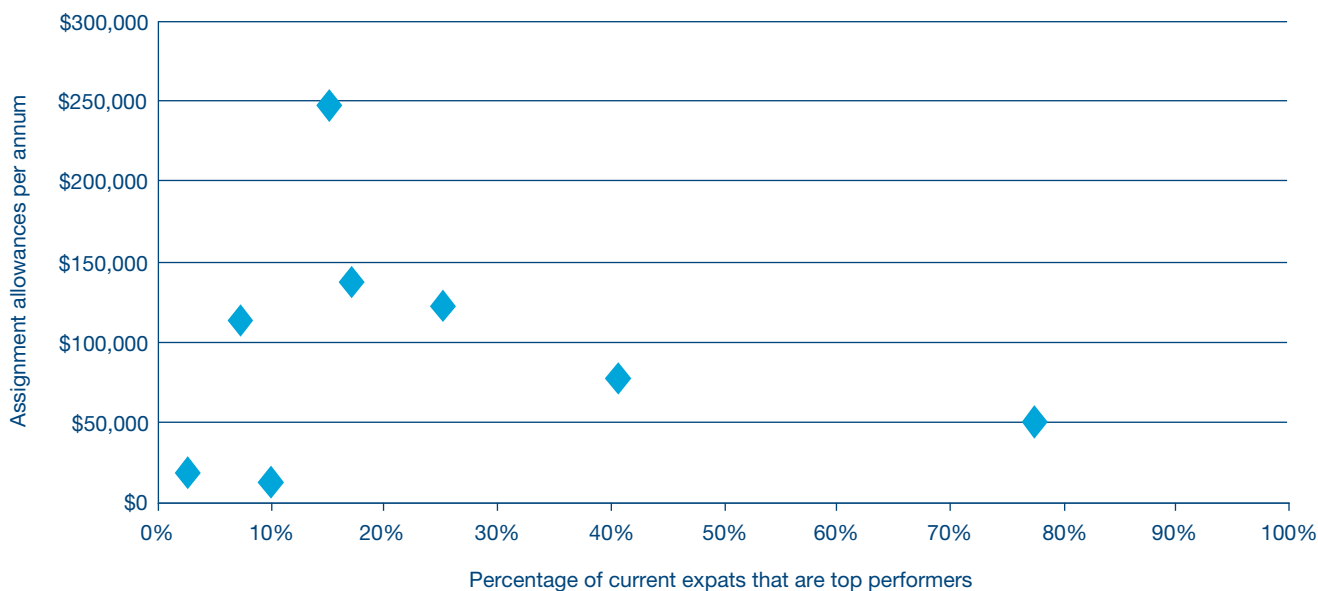
Recognizing that one size does not fit all, a possible solution is to create a strong base package for international assignments spelling out core corporate policies for mobility, backed by appendices applicable to specific countries and employee circumstances. These appendices would address such things as cost-of-living allowances, housing norms, tax planning, family support and other key items.

From the company's perspective, it is critical to measure long-term performance and retention of expatriates' postrepatriation experience. PwC research indicates that up to 40 percent of employees repatriated to their home countries leave their company within the year. Today, most companies do not adequately link performance, revenue generation and other objective metrics with their investment in international assignments. Furthermore, survey results suggest there is not a correlation between the cost of an expatriate and his or her performance.³

Failure to identify comprehensively the value of an employee's assignment can lead to poor decision-making and potentially long-term business damage. Companies who cut back on international assignments aggressively may lose top performers to competitors who approach this crisis more strategically. Repatriations or localizations may also hamper the quality of existing operations by diminishing a company's presence in important future markets or forfeiting the value of the assignment investment from excessive employee turnover.

³ Compiled by research performed jointly by PwC and the Cranfield School of Management.

Correlation between expatriate costs and expatriate performance levels



Embrace sound, benchmarked management and policies

It is suggested that companies consider the following recommendations for addressing the issues discussed in the previous section when contemplating an overhaul of their mobility programs. These recommendations include:

- Securing senior management participation in creation of a comprehensive international assignment policy. Senior managers who participate in shaping the policy are more likely to uphold its objectives and to commit the organizational and financial resources necessary to implement policy changes.
- Creating a written policy to serve as a “touchstone” that provides ready information and guidance to all parties involved in the international assignment program, including human resources professionals, business unit leaders, payroll managers and the assignees. A written policy ensures that exceptions are minimized and company and assignee needs are universally met.
- Centralizing the assignment management function, forecasting assignment costs and providing strategic input. A dedicated international human resources group can add greater value to the company by reducing transactional inefficiencies and focusing on the more strategically important aspects of the assignment program, such as geographical emphasis, leadership development and company performance.
- Considering the benefits of outsourcing key aspects of the international assignment program. Leading companies evaluate the opportunity to outsource those aspects of their international assignment program which they do not perform competitively.

These are just some of the recommendations that may work for your organization and the current economic slowdown is a unique opportunity to closely examine the effectiveness of your international assignment program.



The year in review

Philip Miller, Amy Dieffenbacher and Simon Cross

Please note that this article was written to provide an overview of important tax law changes in 2008, many of which take effect in the current year. It is, of course, important to realize that the global tax landscape is ever-evolving and it is evolving quickly in 2009. To this end, we continue to provide global tax updates through our periodic International Assignment Alerts, and invite the reader to visit www.pwc.com for additional information on recent developments.

Unlike anything experienced in recent history, the global business landscape in 2008 spurred significant tax changes that affect internationally mobile employees and their employers. Countries updated their tax laws and compliance processes to raise additional revenue and attract needed foreign talent and investment.

This article highlights some of the year's tax law changes. In each case, we have attempted not only to highlight the new rules for the selected countries, but also to explain the expected ramifications for employers and employees.

Europe

United Kingdom

In 2008, the UK government enacted new legislation concerning residence and remittance basis rules for taxation of non-UK income, as well as share plans, effective from April 6, 2008. These changes affect all employers who have expatriate employees working in the United Kingdom, and all employers should consider the impact of the changes on their policies and on those employees.

Residency: When an individual is visiting the United Kingdom for a temporary purpose (for purpose of determining residence), a day in the United Kingdom is defined as any day he or she is present at the end of the day. This will give a higher count of days than the previous practice, which was to ignore days of arrival or departure.

Taxation of non-UK income: Historically, non-UK domiciled and not ordinarily resident taxpayers have not been liable for UK income and capital gains tax on most types of overseas income and gains, provided these were not remitted to the United Kingdom. This is known as the remittance basis of taxation.

Every transaction in a mixed-fund bank account, an account containing more than one type of income or gains, will now need to be considered if any remittances have been made from the account to the United Kingdom to determine what those remittances comprise. Therefore, prior to an assignment in the United Kingdom, special consideration should be made to properly structure and distinguish bank accounts to separate existing capital as well as UK and non-UK source income. Doing this will minimize UK tax and streamline the administrative costs of reviewing each bank account transaction.

Additionally, taxpayers claiming the remittance basis of taxation will forgo their personal allowance or income tax (nil rate band) and the equivalent annual exemption for capital gains tax. This means that the UK tax liability on whatever income and gains are still subject to tax will increase.

On the matter of foreign tax credits between the United States and the United Kingdom, since the 2001 UK-US double-tax convention came into force, HM Revenue & Customs (HMRC) has disputed many double-tax relief claims under which the United Kingdom would have to allow credit for US taxes paid. HMRC is engaging in further correspondence with the IRS to resolve the issue.

HMRC also has been reviewing how it will apply UK tax to bonus income and other cash payments that may be earned over more than one tax year.

Immigration rules: The UK government also has shaken up its immigration rules. Key points employers need to consider are:

- Employers that do not apply for and receive a sponsorship license, which allows them to recruit skilled migrants, will face difficulties in accessing overseas talent and will not be able to extend existing work permits.
- They must comply with the working requirements for all employees, regardless of whether the individuals are domestic or international employees.
- If they do not comply with immigration law, employers face prosecution and financial penalties.

Ireland

Staying attractive: In February 2008, the Irish government announced the establishment of a commission on taxation. The commission is charged with reviewing the structure, efficiency and appropriateness of the Irish tax system.

The terms of reference of the commission, and in particular the government's commitment to maintaining a low taxation burden and guaranteeing the 12.5 percent corporate tax rate, recognize the central role that tax policy has played in attracting inbound investment and creating prosperity and employment in Ireland. Many multinational firms, including some large US companies, have established their European headquarters in Ireland.

Changes for 2009: On November 20, 2008, the government announced proposed changes for the 2009 tax year. Income tax rates will remain the same (top rate of 41 percent). However, to generate revenue, an income levy has been introduced that will apply at progressive rates from January (1 percent on income up to Euro 100,100, then 2 percent on the next Euro 150,020, and 3 percent on any excess).

As part of a number of "green" initiatives, including a new levy for employees whose employers provide car parking spaces and "tax-free" bicycles for employees who cycle to work, the taxation of company cars will move to a carbon dioxide emission-based system for new cars provided from 2009. The proposals will see an increase in the taxable car benefit where carbon dioxide emission levels exceed 155 grams. The taxable benefit goes up to 40 percent of the original market value of the car where the emission levels exceed 190 grams.

The rate of capital acquisitions tax (gifts and inheritance) has been raised by 2 percent, to bring it in line with the new higher 22 percent capital gains tax rate.

When an employee receives a benefit in return for a reduction in salary, it will now be regarded as an unapproved salary sacrifice arrangement, and the forgone pay will remain liable to withholding taxes. Certain flexible benefit plans and pension contribution arrangements are impacted, while other arrangements including unpaid leave, course and exam fees, and medical insurance benefits in-kind are unaffected.

Tax residency: A significant change has been made in the method used to count days of presence in Ireland for tax-residence purposes. Under the new rules, it will be necessary to include any day in which an individual is present in Ireland at *any time*, as opposed to the UK “end-of-the-day” rule described above that previously applied in Ireland. An individual will be considered a resident if present in Ireland for 183 days or more in a given year, or 280 days or more in that year and the preceding year combined.

Assignment relief plan: A new assignment relief bill aims to attract key talent from overseas. It applies to qualifying individuals who come to Ireland to work for at least three years.

The relief generally applies to expatriate employees coming to work in Ireland from countries outside the European Economic Area (outside the European Union, Iceland, Liechtenstein and Norway). As such, it will be of particular benefit to employees from the United States, Canada, Australia, China, Russia and Japan, among others.

If passed, the new relief program will apply to assignees who earn more than 100,000 a year, and, where qualifying criteria are satisfied, they will be eligible for tax relief on up to 50 percent of their employment earnings above that amount.

The existing requirement that overseas employers are required to operate withholding taxes on all earnings related to Irish duties will continue. The key feature and limitation of the proposal is that assignees must be employed by a company that is incorporated and is resident in a country or jurisdiction that is not a party to the EEA agreement, but with which Ireland has a double-tax treaty.

The relief will only be available to employees without domiciles in Ireland, and individuals must:

- Become tax residents in Ireland and exercise employment there for at least three years

- Have been employed by an associated company of the Irish entity to which they are assigned prior to arrival in Ireland
- Continue to be paid by the overseas employer
- Have been residents in a relevant overseas jurisdiction
- Have exercised the greater part of their employment in that jurisdiction

These new provisions will be well-received by US multinationals in particular. It remains to be seen whether the exclusion of expatriates from EU countries will need to be revisited.

France

New tax regime for “inbounds”: In modernizing its economy, France made several legal changes to attract more talented individuals. This reform should enhance France’s appeal as an assignment destination from both a tax and a financial point of view.

Among the new provisions, the “inbounds” tax regime has been developed. It includes passive income, a new exemption of affiliation with the French state pension scheme, and an exemption of French wealth tax on inbounds’ assets outside France.

The inbounds’ tax regime applies to employees establishing French tax residence (not just for individuals temporarily assigned to France) who have not been considered French tax residents during the five years preceding the transfer. It will remain in effect until December 31 of the fifth year following the beginning of their French duties.

The new regime allows inbound assignees to exempt 50 percent of certain passive income, with limitations. Compulsory affiliation with the French social security system for those who work in France does not apply to the state pension schemes, under certain conditions.

In addition, the tax regime that allows for an exemption of salary supplements in connection with a move to France and for an exemption of part of the remuneration based on foreign workdays has been extended, with certain limitations.

Workweek duration: In 2008, the law regarding “the Renovation of Social Democracy and the Reform of Working Time” was approved. Although the standard working time remains at 35 hours a week with a ceiling of 48 hours maximum per week, some provisions in the law allow space for adjustments under certain conditions, giving greater weight to in-house collective negotiation (as opposed to national union negotiation).

Asia

India

Rate changes: India’s Finance Act for the 2008-09 fiscal year includes several proposals. India has revised its individual income tax rates, decreasing those for lower-income individuals. And although the top individual tax rate remains constant, additional surcharges on income will be levied, and they are earmarked for education purposes. The short-term capital gains tax on shares held up to one year and traded on the India stock exchange was raised from 10 percent to 15 percent. The effective tax rate on these short-term sales, including surcharges, will be 16.995 percent.

Fringe benefits tax on stock plans has been retained; however, the tax authorities have clarified that it is a tax on the employee. This may help in the claim of foreign tax credits in home countries for expatriates working in India, potentially reducing overall tax cost (subject to the home country laws).

Provident Fund contributions: Also, India modified its Provident Fund rules for the first time since 1952. Under the new amendment, every international worker who is employed to do any work in relation to any establishment in India is required to be a member (that is, pay into the

Provident Fund) effective October 1, 2008, unless he or she is an “excluded employee.” An excluded employee means one who is contributing to a social security program of his or her country of origin, either as a citizen or resident, with which India has entered into a social security agreement on a reciprocal basis.

This amendment requires expatriate employees and the employer to contribute equally toward the Provident Fund scheme, leading to incremental assignment costs.

Australia

Review of system: As anticipated, the newly elected labor government’s first budget in May 2008 initiated a broad review of Australia’s tax system. The federal government is embarking on the review with the stated aim of creating “a tax structure that positions us to deal with the demographic, social, economic and environmental challenges of the 21st century.” Personal tax cuts were legislated immediately for the year ending June 30, 2009.

Fringe benefits: Legislation also has been passed to improve the integrity of the Fringe Benefits Tax (FBT) law. The FBT exemption that applied to certain work-related items has been tightened to ensure that it applies only to items that are provided by an employer to an employee for work purposes, such as employer-provided laptops and mobile phones. The previous FBT exemption for work-related items did not require that their actual use be work-related.

Employee share schemes: Two legislative changes also were made to the taxation treatment of shares or rights acquired under an employee share scheme (ESS) with respect to shares and rights acquired from July 1, 2008.

The first change is to the election requirements to access the choice of two tax concessions available to taxpayers who acquire qualifying shares or rights under an ESS. This change is designed to ensure taxpayers appropriately report income in their tax returns.

A taxpayer must choose either the taxed-upfront concession (where the rights or shares exceed A\$1,000) or the tax-deferred option. The latter will be the default election if none is chosen.

The second change is to remove double taxation that arises in relation to certain ESS that use an employee share trust. This change will improve the flexibility of prescribing shares or rights to employees under an ESS by providing the trustee (or beneficiary) of the trust with capital gains tax relief when an employee, on the exercise of rights, becomes absolutely entitled to the shares held.

Pensions, Medicare: While a temporary resident lives in Australia, the superannuation will still be able to grow rather than being swept out annually. Also, the person will continue to be able to take his superannuation when he leaves, less the 35 percent withholding tax for departing Australia superannuation payments (DASP).

The controversial aspect of new laws passed by Parliament in late 2008 requires employers to notify the Immigration Department upon the departure of a temporary visa holder from Australia. Immigration must notify the taxation commissioner, who in turn serves notice on the trustee of the Australian superannuation fund so the Australian Taxation Office (ATO) can be paid. Of course, the former temporary visa holder may already have withdrawn the money within that six-month period (subject to the 35 percent DASP withholding tax). The Australian government is legally not able to seize the money, but may hold it under unclaimed superannuation laws. At any point in the future, the former temporary visa holder may still claim the money, subject to the 35 percent DASP withholding tax.

If a former temporary visa holder obtains permanent residency, he may transfer the money from the ATO, which is required to pay interest on it. What is of concern for temporary visa holders is that once the money is transferred to the ATO, they are denied the same concessions at retirement as Australian citizens and permanent residents.

The new Medicare levy thresholds, from July 1, 2008, for single and family income are now A\$70,000 and A\$140,000, respectively. A one percent Medicare levy surcharge on taxable income and reportable fringe benefits applies to single persons or couples when they do not have adequate private hospital insurance and their incomes exceed the thresholds.

A new withholding tax regime has been introduced to reduce the rate of withholding on distributions to foreign investors of Australian source net income (other than dividends, interest and royalties) of Australian managed investment trusts. It covers distributions made from managed investment trusts directly to foreign residents or through intermediaries (including custodians).

China

The financial services sector in China has been growing rapidly and significantly, fueling competition among cities. They are offering incentives to attract banking, securities and insurance companies. Local authorities in Beijing, Shanghai and Shenzhen have introduced such measures, which also will benefit certain individuals working for the financial institutions.

Qualified individuals include senior executives, individuals with managerial roles and professionals with experience working for the security house, bank or insurance company. Depending on the city, incentives to qualified individuals may take the form of housing subsidies, refunds of individual income tax paid or other perks.

Hong Kong

“Totality” view for time apportionment: Recently, the Hong Kong Board of Review handed down a decision on time-apportionment claims (Case No.D32/07), which has become a commonly disputed area between the Inland Revenue Department (IRD) and taxpayers. The board was of the view that the “totality of facts” test should be applied in reviewing time-apportionment claims.

The taxpayer's assertion was that the employment contract was negotiated and concluded overseas, allowing for a time-apportionment claim, so that income of overseas workdays was not taxable in Hong Kong. The board's position was that, although the letter of acceptance was signed by the taxpayer outside Hong Kong, this was of "little significance or effect." The board concluded that all substantive acts leading to the employment offer were taken in Hong Kong.

The taxpayer further appealed to the court, and the appeal will be heard this year. Although the judgment is yet to be known, the board's decision reveals that the "totality of facts" approach will be used in reviewing time-apportionment claims. It is therefore essential to have sufficient evidence justifying the employing entity to have its central management and control outside Hong Kong, especially for multinational corporations that have established global or regional "employment vehicles" to house international assignees.

Employers also should review the documentation in relation to the process of secondment (e.g., from the point of negotiation, to the arrangement of remuneration payments, to the application for Hong Kong work visas, etc.). They should be mindful that although both the IRD and the board tend to adopt the "totality of facts" approach, all documents in relation to an assignee (such as work visa application and SFC license application) should be carefully drafted to ensure the wording supports the assignee's non-Hong Kong employment for time-apportionment claim purposes. It is worthwhile to spend time planning before sending an assignee to Hong Kong.

Income tax cuts: With a better-than-expected budget surplus, Hong Kong announced cuts in its salaries tax and a 75 percent waiver of 2007-08 salaries' tax payments (capped at HK\$25,000). For 2008-09, the marginal tax rates will remain the same as in 2007-08; however, the tax bands have increased. The standard tax rate is reduced to 15 percent. The waiver of 75 percent of the salaries tax and tax under personal assessment for 2007-08 (subject to a ceiling of HK\$25,000) will be deducted from the taxpayer's final tax payable for the year.

Share benefits: With the increasing popularity of remunerating employees by share award benefits, the IRD provided detailed guidelines on the taxability of such benefits, which should be useful to taxpayers and their employers. Employers should revisit their current reporting positions on share award benefits and make the appropriate changes, if necessary, on such benefits awarded to their employees in the future. For employees departing from Hong Kong, they may consider electing the "deemed vesting" option of their unvested share award benefits; otherwise, a tracking system should be put in place to report share award benefits vested.

Vietnam arrangement: In December 2008, Hong Kong entered into a comprehensive double-tax arrangement (DTA) with Vietnam, the fifth jurisdiction having such a comprehensive DTA with Hong Kong. Taxpayers who are tax residents of one contracting side would be exempt from individual income tax on their employment income in the other contracting side provided that: 1) they do not spend more than 183 days in any 12-month period in the other contracting side; 2) the remuneration is paid by or on behalf of an employer who is not a resident of the other contracting side; and 3) the remuneration is not borne by a fixed base or a permanent establishment that the employer has on the other contracting side.

Singapore

Employer filing of income data: Under the Auto-Inclusion Scheme (AIS), employers provide their employees' income information for a tax year to the Inland Revenue Authority of Singapore (IRAS) electronically. The AIS will be compulsory for employers with more than 100 employees from year of assessment 2009 (income year 2008), and implementation for smaller companies will be completed in phases over the next three years.

The AIS may pose challenges to employers whose payroll is maintained outside Singapore with respect to obtaining complete salary information from their overseas counterparts before the filing deadline of March 1. However, IRAS has indicated that extension of time to file might be granted on a case-by-case basis.

Equity-based compensation: In general, gains from stock options and other forms of equity-based compensation granted with respect to Singapore employment are taxable in Singapore. Over the years, a number of tax incentive schemes have been put in place to enhance the treatment of such gains. In 2008, the IRAS published updates to three circulars that set out tax concessionary treatments, by virtue of which these schemes will now be repackaged under one umbrella incentive.

The changes highlighted in the circulars provide an excellent opportunity for employers to reassess the implications of the schemes' benefits (such as tax exemption, tax deferral or a combination of both) and how they can take advantage of these.

Not Ordinary Resident Scheme: Singapore has announced enhancements to the Not Ordinary Resident (NOR) Scheme aimed at attracting talent to Singapore. Enhancements include:

- Changes to the qualifying criteria for the time-apportionment concession—An employee must have a minimum employment income of S\$160,000. However, in some instances, the employee (though otherwise eligible) may be better off by not applying for the NOR time-apportionment concession.
- Changes in eligible compensation for the time-apportionment concession—It has been extended to include all in-kind benefits, not just cash-based remuneration.
- Changes to the qualifying criteria for the tax exemption of an employer's contribution to a nonmandatory overseas pension fund or social security scheme—Employee must have a minimum employment income of S\$160,000.

However, in some instances, the employees and employers, though otherwise eligible, may be better off by not applying for these new benefits. First, they should do a cost and benefit analysis to determine any potential tax savings.

United States

New deals with Germany, Belgium: Of interest to many international assignees, the United States entered into a new treaty with Belgium and a treaty protocol with Germany.

The protocol to the US-Germany treaty includes provisions of immediate impact to assignees from Germany working in the United States who continue to participate in certain German pension plans. It is important to note that employers of such individuals may need to make adjustments to their US payroll process to reflect this change.

Both the United States and Germany will permit an employee to deduct contributions to certain foreign plans within the same limitations as contributions to domestic plans, provided certain requirements are met. The rules also will extend tax relief to certain "cross-border commuters" who participate in a qualified retirement plan in the country in which they are employed.

Under the protocol, that relief is provided only if the competent authority of the country where the individual is working agrees that the pension plan generally corresponds to a pension plan recognized for tax purposes in the other country.

Under the new treaty with Belgium, an individual generally will be subject to tax in a taxation year on employment income earned in the other country if he or she is present in that country for more than 183 days in any 12-month period commencing or ending in that taxation year.

Similar to the German protocol, the new Belgium treaty also includes provisions related to cross-border pension participation.

Effects of HEART Act: On June 17, 2008, President Bush signed the Heroes Earnings Assistance and Relief Tax (HEART) Act into law. Intended to provide tax relief to certain military personnel, the act also imposes a

so-called “exit tax” on certain US citizens and long-term permanent residents who terminate citizenship or long-term permanent resident status.

The IRS exit-tax provisions subject individuals terminating long-term permanent residency to tax on the net unrealized gain on their worldwide property as if such property were sold for fair market value on the day before the expatriation date. Gain from the deemed sale is taken into account at that time without regard to other tax code provisions. Any loss from the deemed sale would generally be taken into account to the extent otherwise provided in the code.

The code also provides that certain interests in deferred compensation items and specified tax-deferred accounts may be treated as taxable on the day before expatriation, with certain exceptions.

The exit tax may be either beneficial or harmful to individual expatriates, depending on their circumstances. Expatriates with substantial appreciated assets, deferred compensation or tax-deferred accounts may be subject to significant additional and/or accelerated US taxes. Certain rules also apply to gifts or inheritances received by US citizens or residents from individuals who have expatriated.

Another revenue offset of the HEART Act is a provision intended to prevent US contractors from circumventing US payroll taxes by hiring employees through offshore companies. Under the provision, a US citizen or green card holder working abroad for a non-US employer may be subject to US FICA tax.

US parent companies whose controlled foreign entities participate in government contracts should review those employees to determine the presence of US citizens and residents. Immediate action may be necessary to ensure new FICA requirements are met.

Reporting on foreign accounts: The IRS recently issued a revised form, *Report of Foreign Bank and Financial Accounts*, that must be filed by any “United States person” who has a financial interest in or signature or

other authority over any foreign financial account(s), including bank and securities, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year.

Some of the major changes to the new form and accompanying instructions include:

- The term “United States person” has been expanded to include a citizen or resident of the United States or a person in and doing business in the United States.
- The term “financial account” has been clarified to include mutual funds as well as debit card and prepaid credit card accounts in the “other account” category.

The changes to the form may increase the administrative burden on current filers, as well as increase the number of filers with its broadened provisions.

Social security with Denmark: The previously signed social security totalization agreement between Denmark and the United States went into effect October 1, 2008. The agreement provides that United States and Danish employers and employees may restrict contributions to only one social security system on the same income. The agreement also states that individuals who have divided their careers between the United States and Denmark can now combine their work credits in determining benefit eligibility.

Parting thoughts

It would be highly understated to say that new challenges emerged in 2008. Businesses around the world are currently facing challenges unlike anything in recent history, and those challenges continue to take shape with each passing day. For multinational companies with a globally mobile workforce, compliance and reporting accuracy will be more important than ever. Understanding the newest tax law changes that have taken place across various territories, and the potential ramifications these changes may have for employers and employees alike, will help to maintain global mobility program and process efficiency while minimizing risk.



Redefining the people frontier: Human resources in emerging markets

Carol Neumeister, Fabia Bernarde and Ruxandria Stoian

With many large organizations contracting or thinking about contracting in the face of financial pressure, farsighted companies recognize that they still need to grow if they are to thrive in the long term. Although the situation is volatile, changing almost day to day, much of this necessary growth is likely to take place in emerging markets. Where developed nations are feeling the impact of recession, emerging markets—especially newer ones—appear to be somewhat less vulnerable.

In fact, there is a considerable amount of M&A activity taking place on the local level. In Brazil, as one example, local banks are merging and becoming stronger. While the rest of the world is distracted by the recession, mergers are making these entities more attractive candidates for acquisition when the economy recovers. Smart organizations will pay attention to these changes in the local landscape and be poised to act when the time is right.

Even today, expansion is still taking place. The process may be a bit slower than in recent years, with investment dollars funneled gradually into new projects. But organizations recognize that, in order to expand at a time when traditional outlets may be contracting, they must find places where there is either a huge pool of potential consumers or lower-cost labor. In the best scenario, there would be both, as is the case with many of the newer emerging markets.

As a result, many organizations are currently targeting markets in relatively underserved parts of Asia and in Eastern and Central Europe.

The role of HR

These markets are not a monolithic bloc, although some factors appear to be fairly universal. Studies have shown that, in low-wage countries, only a small percentage of university graduates with general degrees are equipped to work in a multinational company, and graduates with technical degrees can be similarly unprepared. There are vast differences among the markets in terms of economic structure, access to capital, consumption patterns, educational achievement and cultural expectations. Whether the differences are global, existing between low-wage and high-wage nations, or individual, from one country to another, HR can and should play a key role in communicating the differences and smoothing accommodation.

Expansion into the newest emerging markets presents a set of distinct challenges, many of which can be addressed by HR. While the organization's core HR team is essential in overseeing HR operations and communicating with management, local HR expertise is equally essential when it comes to understanding local laws and customs. For example, Brazil enacted legislation in 2007 relating to social security contributions, but a recent review found that nine out of 10 organizations had failed to understand the change and therefore had accrued credits. HR is now working to recapture the accrued credits, and to reorganize HR policies to protect companies from future questioning by the authorities.

We've identified several key areas in which HR can make a difference during the process of expanding into new markets (see chart below). At every step in the start-up or acquisition process, during both due diligence and implementation, HR can address specific issues ranging from site selection through recruitment and retention. Bringing HR to the table as early in the process as possible can help to avoid potential missteps and produce better long-term results.

Key steps in expanding into new markets

Site selection

Evaluating the local talent pool

Labor laws and regulations

Visas and work authorizations
Employment terms and employee entitlements

Staffing determination

Using expatriates

Recruitment and retention

Offer letters
Salary and benefits

Site selection

As PricewaterhouseCoopers found in a recent survey of CEOs, the global war for talent has shifted its battleground to emerging markets. As multinationals work toward gaining share in these markets, the competition for people grows more and more intense. The inevitable conclusion is that the availability of labor must be a key ingredient in selecting appropriate locales for expansion.

As the report concludes, "It's no wonder that all of the CEOs we interviewed mentioned people as a key constraint and a potential differentiator."

India and China have been first-choice locations for some time, due to the enormous untapped consumer base in both countries coupled with their low labor costs. However, while the consumer base is still present and still relatively untapped, labor costs are steadily rising due to intense competition for talented workers. The wage gap, long a source of strength for multinationals expanding into global markets, is rapidly narrowing—although the recession is slowing the pace. In Romania, when the economy was booming, management-level salaries were catching up to Western Europe. Salary costs rose by 15 percent in one year alone, putting huge pressure on companies. With the slowdown in the economy, salaries look much more appealing and companies deciding to enter Eastern Europe in 2009 can do much better salarywise than was the case in 2008.

Nonetheless, there may be issues associated with finding and retaining workers. Highly skilled local talent may be lured to higher-paying jobs in developed nations. As local governments grow, they often hire workers away from the private sector. Organizations frequently invest in training employees only to find that turnover is significant—and costly—as those employees move on for more pay or sometimes even for seemingly minor fringe benefits. Leadership development efforts, while desirable, need to be undertaken even though they may sometimes seem to backfire.

In the face of these pressures, the “next India” may be elsewhere in Asia, perhaps Vietnam, or somewhere in Central or Eastern Europe, such as Romania. It will be an emerging market, formerly overlooked and out of the limelight, with burgeoning consumer demand and large numbers of workers available at relatively low cost.

The decision on where to locate is rarely easy. In evaluating potential sites for expansion, organizations need to address several key determinants early in the due diligence phase. How large is the potential pool of talent? Does the education system consistently replenish that pool? How much flexibility is there for future growth? Are there special considerations that may come into play? For example, many Romanians who were living and studying abroad are returning home. These “half expat-half local” individuals, with international skills but salary requirements in between locals and expats, represent a good potential labor pool for companies expanding into Romania.

Even earlier in the process, it may be helpful to start by conducting an Internet search and contacting the local chamber of commerce, if there is one, for basic data on the specific locale. This course can be followed up by engaging a local HR consulting firm to provide the background information necessary for due diligence. Local HR talent can be helpful in this respect even before final site selection.

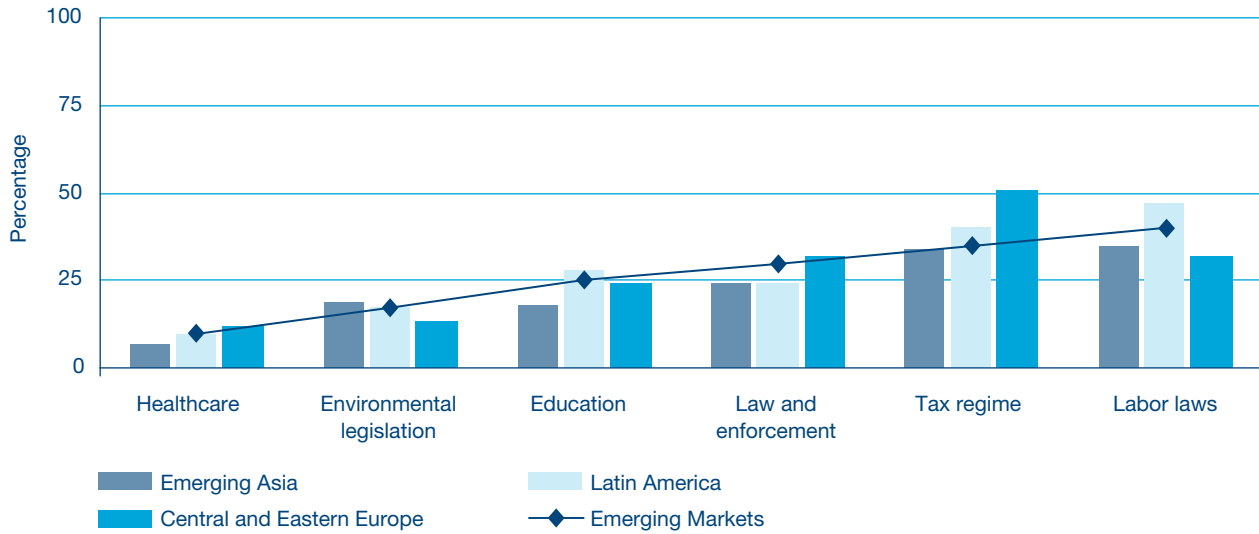
After site selection and during implementation, the entity’s HR team should be involved in making sure that there is a local HR presence to handle and integrate staff within the broader context of the corporation. The local people will know how to recruit local talent, review and evaluate resumes, and interpret policies and procedures. The local policies and procedures must be integrated with the parent company, an especially critical step in an acquisition where the newly acquired subsidiary entity may have been operating under different rules.

Even where rules are similar, developing clear written policies can forestall challenges by the authorities. Such policies, put in the context of understanding local laws, can even reduce payroll costs. In Brazil, the price of a company car must be included in payroll, with social security contributions and labor benefits paid on this amount. It may be possible to reduce or avoid the payroll cost associated with the use of company cars with an appropriately documented corporate policy.

Labor laws and regulations

Cultural and political norms have a powerful impact on business enterprises but laws and regulations can be more onerous. In PricewaterhouseCoopers’ 11th Annual Global CEO Survey, labor laws were viewed as the most important area in which governments could make improvements in emerging markets as a whole and in Latin America in particular. The tax regime was next on the list for emerging markets, with Central and Eastern Europe posing the most concern. Other areas in which governments could make improvements, in declining order of importance, included law and enforcement, education, environmental legislation and health care.

Which of the following areas in which the government could potentially improve would you consider to be the most important area?



Source: PricewaterhouseCoopers 11th Annual Global CEO Survey

Labor laws are critical in many countries because they are often very protective of employees and, as a result, a potentially significant strain on the budget. These laws should be taken into account when costing and planning an acquisition. In Romania, labor laws require 90 to 100 days between notification and layoff. Moreover, employee contracts are widespread and usually promise larger benefits than the law provides. For example, where the law requires that one month’s salary be paid to terminated employees, employees governed by labor contracts may wind up with six to 12 months’ salary. This arrangement is not likely to affect organizations starting new companies but can be a significant element in the takeover of an existing privatized company.

Brazilian law is very protective of employees, making the cost of employment very high. It is not against the law to terminate employees—a circumstance that gives employers needed flexibility in curtailing superfluous

or unprofitable operations. But when an employee is dismissed without cause, the employer must pay a penalty of 50 percent (40 percent to the employee and 10 percent to the government) of the amount held for that employee in a government-maintained Employment and Severance Benefit Fund. That Fund, standing in lieu of nonexistent government unemployment benefits, is created by mandatory employer contributions of 8 percent of each employee’s remuneration each month.

HR can make entities aware of these distinctive laws, regulations and practices. It can help to distinguish between fixed salary costs and additional premiums and/or bonuses that may be customary and expected. Organizations may not be permitted to terminate employees, for example, or may be constrained by collective bargaining agreements. If severance is possible, collective bargaining agreements may enlarge benefits established in local legislation.

In the area of law and enforcement, in general, farsighted organizations look beyond initial acquisition and expansion to the possibility of future closings. In such an eventuality, can employees be let go free of future obligations? Health care, pension benefits and unemployment compensation must all be considered in light of the eventual possibility of terminating individual employees or shutting down or downsizing an entire operation.

Staffing determination

Initial staffing raises another set of questions. The local talent pool must have both breadth and depth so that current staffing needs and planned future growth can be accomplished. But this is not always the case. As the CEO survey reported, “Companies succeed or fail because of the people they employ—from the executive suite to the factory floor. While emerging markets are home to vast and inexpensive labor pools, the depth of talent with the skills and experience to face global competition is often much thinner.”

As a result, it is often essential to assign home-office employees to work in the new locale, at least in the short term. If an organization wants to assign expatriate employees to a start-up venture in a new location, as is frequently the case, an appropriate mix of local hires and expatriates should be determined and a transition plan put in place at the outset.

Expatriates are typically at the executive and managerial level, assigned to establish the local operation and integrate it into the corporate framework. These employees are costly, not only in salary terms—they will inevitably have higher salaries than local talent, a discrepancy that should not be made evident in order to avoid disgruntled local employees— but in terms of infrastructure. They must be provided with adequate housing, education for accompanying children, periodic trips home, and so on.

While it is typically far too expensive to use executive-level expatriates for the long term, each situation is different and must be assessed accordingly. In Brazil, executive expatriates typically stay from two to five years, so that companies abroad can keep a close eye on the business. Managers are more likely to stay for two to three years. Someone used to the culture can hit the ground running while others may need more time to acclimate. In each case, the parent organization must decide how much control it wants over the local situation. Can adequate supervision be provided via occasional business trips? Or is a more permanent or semipermanent presence necessary to ensure success?

Expatriates are frequently used, at least at the outset, to harmonize operations with headquarters. In the case of acquisitions, expatriates can be trusted to see if there is anything that is being done badly that needs to be corrected or, conversely, if there are best practices that can be integrated into the US operation.

If expatriates are to be utilized, there is another complex set of laws and regulations to heed. Salaries and benefits must be addressed but particular attention must be paid to work authorizations, visas and tax considerations. Some of the specific questions include: Can expats be treated differently from local hires? Does the process for securing work authorizations differ for employees from different countries? What are the requirements for visas and how long will they take to obtain? Use the wrong kind of visa—there are three that guarantee the right to work in Brazil—and the foreigner may be deported while the company may face problems in obtaining new visas in the future.

If expatriates are to be used, HR plays a vital role in understanding and implementing all of these details as well as the complexities of using non-citizen staff and integrating them with local employees. One method that works well in bringing local employees up to speed involves selecting potential local managerial talent at the outset and sending that team abroad for six to nine months. Then, when it is time for the expatriates to leave, there is a local team in place that has been trained abroad.

Recruitment and retention

During the due diligence phase, corporate HR, with the help of local HR talent, should review the broad demographic and educational environment as well as details of collective employment agreements and other potentially limiting factors.

In one target company in Latin America, as an example, due diligence revealed that a golden parachute had been signed guaranteeing the payment of millions of dollars to executives in the event of either retirement or dismissal without cause. Such a provision can be extremely costly and its existence needs to be factored into the negotiations.

In another Latin American example, companies sometimes contract employees as autonomous workers or through outside legal entities, in an effort to avoid the payment of payroll taxes and the obligation to provide vacations and other benefits. Or they may use profit-sharing plans, pension plans or stock options in an effort to bypass both payroll charges and labor rights. This may not be an ideal approach from a risk perspective. In countries where the practice is actually illegal, it can also be very expensive for an unwary organization. During due diligence and long before implementation, HR should investigate and inform organizations about such irregularities as well as about rights and obligations already established between executives and the company to be acquired.

In preparing offer letters, local law and customs should also be addressed. Letters may have to be in the local language, include specific terms, and meet a standard format. There may be legal requirements concerning probationary periods, overtime and other elements of the job offer. Employees may be required to sign a formal contract. All of these details can be ascertained by HR during the due diligence phase. Benchmarking is important, along with comparing the cost of local administration and outsourcing certain functions.

If a venture is to succeed, HR will go beyond the strict realm of laws and regulations and pay attention to local culture and customs. Employees of high-tech companies

in the Silicon Valley area of California, for example, may be accustomed to wearing jeans to work and to receiving stock options in partial compensation. In the more formal culture of Eastern Europe, jeans would be unheard of. And stock options, while incentivizing in the United States from a tax standpoint, may not be understood in other locations where employees prefer cash. It can be a mistake to assume that what works in one location will work in another. Local HR consultants, if brought in early, can prevent such inadvertent but potentially dangerous mistakes.

Once into implementation, of course, HR will be charged with developing local HR and benefit policy documents, producing a mandatory staff handbook and documenting disciplinary procedures. At this point, too, contracts can be drawn up with vendors for services—such as payroll—that can reasonably be outsourced.

In order to recruit good professionals—and to retain them—organizations should develop an attractive and well-designed remuneration package for each category of employee. In addition, a career path should be formulated and presented to potential and current employees.

A last word

Expanding into new markets, especially into the untried territory of the newest emerging markets, is a complex endeavor but a necessary one in this era of global competition. Your organization must decide if it wants to be at what we call the “bleeding edge,” to act as the leader, set up training programs for employees, and run the risk that competitors will steal them from you.

Whether your organization decides to be first off the mark in entering a newly emerging market or follow a few steps behind, the complexities inherent in the move can be reduced if HR becomes involved during the earliest stages of selecting appropriate countries for expansion. HR can play a critical role during due diligence and implementation of specific projects. HR can help your organization establish a culture in which every employee in an international workforce makes decisions that reflect and enhance your core business strategy. All of these actions are especially critical in a period of economic turmoil.



Understanding and managing data privacy

Rich Zook and Ben Bahrenburg

Many topics in this article deal with country-specific data privacy legislation. This article is for general information only and is not intended to constitute legal advice. Country-specific data privacy related questions should be directed to local country legal counsel.

Data privacy laws first began to appear more than 30 years ago, but they have proliferated during the past 10 years as concerns about identity theft and individual rights continue to escalate. Today, more than 1,000 global data privacy laws are in effect, making it difficult to know if your email answering the CEO's assignment question violated one of them, let alone maintaining compliance with these myriad regulations on an organization-wide basis.

Managing data privacy across a global workforce can be a complex and challenging process. The heart of any data privacy program consists of securing personally identifiable information (PII). For global organizations with employees on international assignments, this information often is needed in multiple countries by multiple organizations.

Global legislation landscape

The data protection legislation enacted by the European Union (EU) often is considered the global standard for data privacy. Data privacy legislation was first introduced in the EU in 1995 under EU Directive 95/46. This directive became law within the 15 member states in October 1998. The law gives the 15 national data protection authorities the power to sanction violators in a variety of ways, from significant fines to injunctions to stop processing data until the offender complies with data protection regulations. Many countries reference EU Directive 95/46 when establishing their own national regulations.

In Asia, data privacy legislation is still developing. Countries such as Hong Kong, South Korea and Japan have mature general data protection legislation that is broadly consistent with the EU data protection directive. Other Asian countries, such as the Philippines and Thailand, are in the drafting stages of their privacy bills.

Though the United States lacks comprehensive national privacy legislation, numerous data privacy laws exist. Aspects of data privacy often are covered under industry-specific legislation, such as the Health Insurance Portability and Accountability Act (HIPAA) or the Fair and Accurate Credit Transactions Act (FACTA). Some states have additional regulatory requirements, such as the California Online Privacy Protection Act or Californian Fair Information Practice Principle.

Key principles of data privacy

Because most countries have their own data privacy legislation, the biggest challenge for most multinational corporations is to grasp when to apply a specific regulation. While significant variations exist in data privacy laws around the world, the underlying principles upon which the legislation is based center around the following elements: the definition of covered information; collection based on specific purpose and intent; accessibility by the individual; opt-in/opt-out measures; limitation of data retention; and data accuracy. The following paragraphs provide brief descriptions of these data privacy elements:

The definition of covered information

Many laws have different coverage provisions based on defined categories of information. The most important of these categories is information classified as personally identifiable information (PII). Data privacy legislation imposes specific handling requirements on data categorized as PII.

The handling of PII may differ based on specific regulations, but the defining characteristics of what constitutes PII are similar. Common examples of information defined as PII include:

- Full name (if not common)
- National identification number
- Telephone number
- Street address
- Email address
- IP address (in some cases)
- Vehicle registration/plate number
- Driver's license number

- Face, fingerprints or handwriting
- Credit card numbers
- Digital identity

Collection based on specific purpose and intent

Data privacy laws set rules regarding usage of covered information and the extent of disclosure required when sensitive information is released. This principle outlines what data will be provided and the context in which it will be used.

Globally mobile employees often are impacted by this principle. For example, their employer will generally need to collect pay-related information from one or more company offices across country borders to process payroll or annual earnings statements. To comply with applicable data privacy regulations, the purpose of the disclosed data and the countries involved will help determine whether employee authorization is required and the extent of the disclosure.

Accessibility by the individual

Most countries' data privacy legislation includes provisions for employees to have access to their PII. This ensures transparency of the data that is collected and shared. The strongest legislation regarding accessibility to PII is the EU data protection directive, which outlines specific access and verification points.

Addressing the accessibility rules for globally mobile employees can be challenging when data is stored in more than one country. Required under most data privacy legislation, the global mobility process has several natural points in which to provide access. Common steps in the process include an assignment letter and pre-departure meetings, both of which provide opportunities to discuss and share PII policies and procedures.

Opt-in/opt-out measures

The concept of opt-in or opt-out is similar to many email newsletters that include the ability to either continue to receive communications or stop communications. This principle allows the individual the right to determine if they are prepared to participate in a program or process that discloses PII data.

For globally mobile employees, the assignment letter is a natural point in the process to explain the opt-out provisions associated with PII data sharing. Requiring an employee's permission for sharing PII data often is included in assignment letters to streamline the process.

Limitation on data retention

In addition to defining the data governed by these regulations, the period of time in which the data is kept often is specified. For example, the EU enacted a directive on mandatory retention of communications traffic data. It requires the retention of all communications for a period between six months and two years.

Depending on the purpose of the data, additional retention requirements also may apply. Examples would be retention requirements for regulatory, tax or residency purposes.

Data accuracy

Responsibilities surrounding the accuracy of the data collected often are defined. Providing employees the ability to review their data is critical to managing this aspect of data privacy. A process should be established to allow employees to review their PII and validate its accuracy. Since this information is shared with a variety of different locations and vendors, a process for PII data updates also should be established.

US response to EU data protection directive

When processing personal data in the EU, under the EU data protection directive, the individual must be assured that:

- Data will be collected and processed for specified, explicit and legitimate purposes determined at the time of collection.
- Data will only be processed after employees have given their consent.
- Data is adequate, relevant and not excessive in relation to the purpose for which it is collected.
- No sensitive data, such as ethnic origin, political beliefs, health or sexual preference, will be collected or processed unless it is relevant for a specific assignment and where employees have given their explicit consent.
- Data will be accessible and processed in strict confidentiality by authorized staff within the firm.

Assignees and other travelers frequently require their PII be transferred from one country to another, which exposes that exchange to several regulations, most notably the EU's data protection directive. Personal data can only be transferred outside of the EU if the destination country meets an adequate level of protection defined in the data protection directive's Article 29, *Working Party on the Protection of Individuals with Regard to the Processing of Personal Data*, guidelines.¹

The United States responded to the EU's data protection directive by instituting the "safe harbor" concept. Safe harbor is a provision that reduces a company's risk under the law based on performing good-faith actions. These principles allow for a US company to become certified and comply with the EU data protection directive. Every

¹ http://www.cdt.org/privacy/eudirective/EU_Directive_.html.

12 months an organization needs to be recertified by providing evidence of due diligence around the safe harbor principles.

The seven safe harbor principles are:

- **Notice**—Individuals must be informed that their data is being collected and how their data will be used.
- **Choice**—Individuals must have the ability to opt out of the collection and transfer of their data to third parties.
- **Onward transfer**—Transfers of data to third-party organizations may only occur if those organizations have followed adequate data protection principles.
- **Security**—Reasonable efforts must be made to prevent loss of collected information.
- **Data integrity**—Data must be relevant and reliable for the purpose it was collected for.
- **Access**—Individuals must be able to access information held about them, and have the ability to correct or delete inaccurate information.
- **Enforcement**—There must be effective means of enforcing these rules.

Just as the United Kingdom and Germany have legislation that extends the EU data protection directive, the United States recently enacted legislation that places additional requirements around the tax-preparation process. In 2008, the US Treasury amended Section 7216 of the Internal Revenue Code (IRC), placing additional restrictions on information sharing as part of the tax-preparation process.

Section 7216 expands the definition of PII to include any information obtained in the context of preparing a US income tax return. While the §7216 regulations do

not specifically define what is included in the definition of “information,” it is generally accepted that this term is broadly defined to include financial (e.g., income/ deduction) information, tax (e.g., identifying numbers like SSNs) information and demographic information. For this purpose, demographic information might include such things as the individual’s name, address, employer, job title and even the days spent within a particular country. The regulations require that an individual’s informed written consent be received prior to the disclosure of any “tax return information” to a third party, or for that information to be used in any other way than in the preparation of a US income tax return. This consent must be received prior to the delivery of the tax return to the taxpayer for his or her signature. Since PII data must often be shared across borders to enable the preparation of either home or host country tax returns, this change in US regulations greatly impacts the global mobility process.

Additional consent is required if the tax information is to be disclosed to preparers outside of the United States. This restriction requires that tax preparers obtain consent when performing returns for individuals inbound or outbound to the United States.

What happens when laws conflict?

With the variations in global legislation, conflicting guidance often can surface. These conflicts are commonplace in global mobility, since employee data, generally, is maintained in multiple countries and by multiple parties.

A common conflict occurs when moving data from an EU member country to the United States. The EU data protection directive requires an additional level of certification to safeguard data privacy. However, US legislation regarding acts such as whistleblowing, as outlined in Section 301(4) of Sarbanes-Oxley, are in conflict with EU provisions.

Another area of conflict includes e-discovery laws. These laws cover the regulatory requirement to alert individuals and governmental organizations when a data privacy breach occurs. These differences can greatly impact third-party reporting and disclosure requirements.

Though the movement of data between countries can be as simple as sending an email, complying with the legislative requirements can be quite complex. It is a best practice to seek the employee's consent and provide a description of the data to be shared and the purpose for sharing the data. Companies should also look for opportunities to align their data privacy policies with those of their key global mobility third-party partners.

Responsibility and impact

A common issue that accompanies safeguarding PII is whether responsibility lies with the company or the individual. Consequences such as identify theft and legal sanctions make data privacy everyone's responsibility.

The impacts for organizations and individuals can be severe. A data privacy leak damages organizational reputation and customer turnover. In our experience, organizations that experience privacy breaches are much more likely to experience abnormally high customer turnover rates.

Countries are quickly adopting legislation that requires the reporting of any data privacy breaches. Between 2006 and 2009, the number of countries with this requirement jumped from three to 25. We can expect this trend to continue as different countries refine their data privacy regulations.

The significant consequences from failing to implement appropriate privacy and data protection safeguards have elevated these issues to the board and senior

executive levels. Organizations must now include privacy, security and information risk management concerns in their strategic planning process to avoid significant consequences such as:

- Legal sanctions, fines and penalties instituted by government agencies
- Reputation risks and class-action lawsuits
- Loss of trust and competitive advantage
- Disruption of marketing and research activities
- Prolonged investigation or cessation of international data transfer

Depending on the data privacy violation and the jurisdictions impacted, a company could lose its right to conduct business in that country. For example, if employee records are exposed, a company could lose its safe harbor certification, which may eliminate its ability to exchange employee data with EU members.

In the Americas, Europe and several Asian countries, corporate responsibility is enforced through privacy legislation and regulation. The best form of risk mitigation is to have a clear corporate privacy strategy with proper audits and controls.

The data privacy protection process

Global mobility often is the first to handle international organizational data privacy concerns. The model outlined below shows an effective data privacy approach consists of three components: identify, enforce and validate. These fundamentals apply to all industries and organizations.

Identify	Enforce	Validate/Feedback
Who is at risk	Individual consents	Process audit
Jurisdictions involved	3rd Party agreements	3rd Party independent validation
Informational requirements	Leverage technology	Annual employee training

Identify

The identification process is a strategic step that determines the people, jurisdictions and information that has the probability of creating data privacy concerns. By narrowing your focus to a specific set of mobile employees in a set number of jurisdictions, it will allow you to determine the level of coverage required to be compliant.

The first step in any data privacy program is to identify the employees who will be impacted. Global mobility programs are in a unique position since a majority of their activities impact multiple jurisdictions' data privacy regulations. Populations most at risk would be individuals relocating between one or more different regions. Examples would include employees moving between the United States and an EU member country or between an EU member country and an Asian country.

After identifying the population impacted, the next step is to identify the jurisdictions involved. Since each jurisdiction can have its own data privacy regulations, this will help identify all compliance requirements.

Part of identifying jurisdictional data privacy requirements is determining what employee data is required and its regulatory impact. For example, an expatriate on assignment to the United States would have additional restrictions around data obtained in the tax-preparation process under §7216.

Organizations should have documented data privacy policies that provide specific guidance regarding PII. The information gathered in the identify phase should be checked against this policy to establish that all organizational concerns have been satisfied.

Enforce

Enforcement of the organizational policy is critical to the success of a data privacy program. As employees move across the globe, the laws covering their data greatly increase in complexity. Leveraging technology and agreements such as consent forms and third-party agreements are critical to managing the compliance process.

Individual consent can be the most important safeguard in complying with data privacy regulation. In most global mobility situations, some level of personnel- and compensation-related information is kept and shared between the home and host locations. Legislation such as HIPAA and the EU data protection directive require that consent be given before PII is transferred between countries or provided to third parties. Collecting the correct individual consents helps to protect the organization and streamline the assignment process. The required consents should be outlined in the organization's data privacy policy and should be periodically reviewed against the jurisdictional requirements.

The global mobility process leverages third-party vendors for everything from moving to tax preparation. To provide services to impacted employees, these vendors require PII, so data privacy requirements often are part of the contracts with these vendors. Many vendors also require individual consents before delivering their services.

Technology is not only a timesaver, but it can help to enforce your data privacy policy. Tools such as document management systems can be used to store and track individual consent forms. Other tools allow the encryption of emails or the secure transfers of information to and

from vendors. With a seemingly endless amount of technology options, a general rule of thumb applies: If a document that contains an employee's PII can be accessed in one click without a password, that document most likely is not secure. Passwords, encryption and other precautions are a must in dealing with PII in a global regulatory environment.

Validate/Feedback

The validation process is sometimes thought of as a policy audit. This step provides a review point for both the policy and enforcement processes. Each year, an organization's data privacy policies and procedures should be reviewed to ensure they meet the regulatory requirements for the jurisdictions requiring access to employee PII data.

As data privacy laws are enacted or changed, data privacy policies and processes need to be reevaluated. A recent example of legislation that impacts global mobility is the change to §7216. This change placed additional data privacy requirements on any information collected as part of the preparation of a US tax return. To meet such requirements, organizations must be prepared to reevaluate their processes and also validate that their vendors are in compliance with new legislation.

Education is an important part of the validation and feedback stage. Data privacy education should be provided to all employees involved in the process. For those running global mobility programs, guidelines for handling new data privacy regulations can stop issues before they occur. For mobile employees, training on the services that require their PII can help reduce questions. Educating employees on how to protect their PII likely will be the single most important step taken to safeguard data privacy.

Further recommendations

By its nature, global mobility often produces complex data privacy issues. Though global data privacy regulations can seem inconsistent or even impossible to efficiently navigate, several best practice strategies can be leveraged to achieve success. There are several natural places in the global mobility process where data privacy education and controls can be used. These areas include:

Building data privacy into your policies

Most organizations that handle international assignments or travel have well-defined policies regarding compensation packages, payroll and tax considerations. Data privacy standards and processes should be incorporated into these policies. Just as compensation elements are clearly detailed, so should data privacy expectations. The policy should clearly document what PII will be shared and the purpose behind doing so. Since all major data privacy legislation requires some kind of opt-out provision, spelling out the steps to opt out of sharing data should also be included in the policies. Since selecting to not share data can limit services or internal processes, these considerations should also be documented.

Assignment letters

Most international assignments or trips begin with an assignment letter or a letter of understanding. These documents provide an excellent opportunity to document what PII data will be shared and get the individual's written consent to disclose it as required. The pre-assignment process also is an excellent time to discuss the procedures required to opt out of sharing PII and to share the data privacy policies that will apply during the assignment.

Look for alternatives to email

Though email is a vital part of doing business, it does not always provide an adequate level of data privacy protection. Additionally, just as organizations are required to keep a copy of assignment letters and other related documentation, legislative requirements also compel some organizations to maintain records of emails. Secure web portals, file sharing or collaboration websites, and data encryption are options that assist with this issue.

An organization with a detailed international data privacy policy can leverage technology solutions to streamline the process of securely sharing data. There are many solutions available from vendors such as Microsoft, Oracle and IBM to assist with this process. When selecting a vendor and product, make sure they support the correct regulatory requirement for your organization's industry and country. These requirements impact a product's auditing, encryption and authentication mechanisms.

Vendor relationships

Global mobility programs deal with vendors for relocation, travel, payroll, tax-preparation services and more. Your existing organizational data privacy policies should extend to these vendors.

When selecting service providers, establish that they have the correct level of certification under the regulations that apply to your industry and population. For example, if you have individuals relocating from Europe to the United States, your service providers should be safe harbor compliant in order to allow PII to be shared.

Data privacy education

No data privacy program or policy will be effective without adequate training. Data privacy responsibilities extend to organizations and the individuals they employ. Providing guidance and training through a data privacy education program helps satisfy both responsibilities. These programs also are vital to training global mobility professionals in best practices for handling regulatory requirements. These programs also help teach employees how to safeguard their own PII.

Effective educational programs communicate an organization's data privacy policy expectations regarding PII and the guidelines in place to safeguard this data.

Meeting the challenge

There is little question that data privacy regulations present a challenge to the global mobility process. An organization's global mobility function should be a strategic partner when developing data privacy guidelines and standards to help ensure global compliance issues are taken into account. Establishing well-documented processes in the global mobility function will allow you to better manage data privacy compliance. Finally, educational programs for globally mobile employees should be leveraged to communicate data privacy requirements and foster individual responsibility.



IRS foreign resident compliance initiatives

Susan Stanley and Clarissa Cole

IRS emphasizes foreign resident compliance

Recently, the IRS increased its emphasis on Foreign Resident Compliance (FRC) and expatriates (expats). The primary reason for this is because the IRS views international taxpayers as a critical component to closing the international tax gap, which is the difference between the amount of tax that taxpayers are required to pay and the amount that is actually paid voluntarily and on time.

Additionally, a new division was formed within the Office of the Deputy Commissioner (International) to increase the scrutiny of US taxpayers assigned to overseas locations (assignees) and those permanently residing abroad. This initiative is having a material effect on the corporate tax and human resources personnel who assign corporate professionals throughout the world.

Consequences of increased focus on expats

As the IRS considers ways to address instances of noncompliance, reconcile this portion of the gap and develop its international strategic initiatives, it has designated international assignees as a primary focus.

It is important to note that the tax gap does not appear to be generated by international assignees from large multinational companies. There seems to be a distinction between assignees with returns prepared by major firms with a high level of technical accuracy and other long-term expats or taxpayers with offshore accounts. Despite this difference in the foreign resident population, this entire group of taxpayers may still experience the impact of these IRS initiatives since the IRS tends to

place all expat taxpayers in the same FRC category. The unintended consequences of this universal increased focus may include:

- Delayed refunds
- Denied exclusions and extensions
- More difficulty obtaining penalty abatements
- Additional scrutiny on nonfilers

Zeroing in on expats—the key issues

One of the primary results of the newly established Office of Foreign Resident Compliance is an increase in examinations of assignee returns. This increase in audit activity may not only result in additional administrative burdens, but also may yield a corresponding increase in the cost of audit defenses as errors and discrepancies are found by the IRS within this entire filing population.

In particular, the IRS is scrutinizing the following areas where perceived abuses are commonly found:

- Foreign tax credits (FTC), both current and carrybacks
- Foreign earned income exclusions (FEIE)
- Penalties including decreased abatements for late filing and payment
- Nonfilers and the increased use of information matching

Foreign tax credit—reviews create delays

FTCs may allow US taxpayers to avoid or reduce double taxation. In 2006, US taxpayers claimed more than \$90 billion of FTCs on US individual and corporate tax returns. Because of the significant dollar amounts associated with FTCs, the IRS has increased reviews of such credits in terms of withholding, redeterminations and limitations. Also, the IRS has singled out FTC carryback refund claims and is taking the following actions:

- Holding FTC carryback refunds for six to nine months while a service-center reviewer performs math checks.
- Performing office audits on all refunds more than \$100,000, regardless of other indicators such as the taxpayer's compliance history, high tax treaty country taxes and return preparer status.
- Only allowing groups specializing in FRC to perform these more detailed examinations. Therefore, even though the taxpayer's records and representative may be in Phoenix, the IRS will only agree to those issues being examined in actual IRS field offices located in Puerto Rico; Austin, Texas; and several Southern California locations. This disconnect between location of the taxpayer, representative and agent has created additional communication issues and delays.

The result of any of these actions may be a delay in the FTC refund that is ultimately due back to an assignee's company according to tax equalization arrangements.

Foreign earned income exclusion and related extensions—increased scrutiny

Examinations of the FEIE have been primarily focused on the first and last year that the FEIE is claimed, where potential issues most frequently reside. Examinations of eligibility of the FEIE are relatively easy to substantiate.

However, as a result of the relocation from Philadelphia to Austin of the IRS service center that processes expat returns, several systemic problems associated with processing Form 2555 related to FEIE have been noted:

- **Denial of the Section 911 exclusion:** Although Treas. Reg. Section 1.911-3(f), examples 3 and 5, cites examples of a US citizen who establishes a tax home and bona fide residency in a foreign country during part of a year and prorates days and income to be excluded for that year, taxpayers are still receiving notices denying this rightful prorated exclusion.
- **Denial of an extension of time to file based on Form 2350:** Form 2350 specifically states that the "period of extension will generally be a date 30 days after the date on which you expect to meet either the bona fide residence test or the physical presence test." An overseas filer who is granted a discretionary extension creates little to no additional burden to the IRS, and extensions were formerly granted on a routine basis. The uptick in denials of this type of request increases the burden on both the taxpayer and the return preparer.

The service centers may perform a correspondence audit on simpler or smaller expat returns, which creates its own set of problems and delays. However, the larger issue associated with the service center migration is the number of incorrect arbitrary disallowance notices for the FEIE based on incorrect interpretation of the law. Again, the ultimate effect of these systemic problems is an increased cost to respond to IRS notices and perform audit defense, as well as a delay of any refund due to the assignee.

Penalties—abatements more difficult

The IRS has taken an increasingly hard stance against penalty abatement due to reasonable cause, especially with regard to late filing. Expats are particularly vulnerable to late filing because their records may be scattered. In any penalty argument, a taxpayer must show that ordinary business care and prudence was exercised in attempts to meet obligations. Related to penalty abatement, there are two important trends to note:

- The IRS increasingly is considering excellent compliance records when abating penalties in the first year of occurrence. Subsequent or multiple year penalties are extremely difficult to abate due to reasonable cause.
- Relocation is not considered a reasonable cause.

The stricter application of reasonable cause standards to penalty abatements ultimately increases the likelihood of penalties and the cost of noncompliance to either the assignee or the company.

Nonfilers—risk for “nonauthorized” assignees

The IRS is particularly concerned with expat and inpat nonfilers. There are situations where localized hires, expats or inpats are not provided tax-preparation services by their employer. The end result of a nonfiler case could be increased cost to the employing company in terms of the IRS collection process as well as corporate reputation.

When a nonfiler is identified, an IRS revenue officer notifies the international taxpayer that a return is due. If a return is not produced in the requested time period, the officer may prepare a substitute for return (SFR), which is based on any filed W-2s, 1099s, 1042s or K-1s. No foreign earned income exclusion or foreign tax credit will be computed and there is little to no input considered from the taxpayer. After an SFR is created, a reasonable cause argument for not filing the original return likely will not be considered. Tax is assessed based on the SFR and the collection process begins. If an actual return is submitted with a lower amount of tax due, the tax assessed from the SFR will be adjusted after a review.

The IRS has recently taken a much tougher position on voluntary disclosures, penalty abatements and Foreign Bank Account Report (FBAR) penalties as a result of the UBS scandal, in which a senior banker with the Swiss banking giant admitted creating sham offshore trusts and destroying evidence of US clients' offshore accounts to conceal their assets. The initiative, announced on March 23, 2009, affects all taxpayers with offshore accounts who have not complied with return and FBAR filing requirements. Unfortunately, the broad reach of these instructions will ensnare expats who do not fit the criteria and possibly discourage voluntary disclosures among those who have made innocent mistakes.

Meeting the challenge

The IRS's recent scrutinization of all expat taxpayers, regardless of their compliance history, has led to significant frustration and costs to compliant taxpayers and tax-return preparers. Common issues include a significant increase in the number of notices issued to US individual taxpayers working overseas and a lack of in-depth training for IRS personnel now handling such issues.

To combat these frustrations, increased training of IRS personnel would allow the IRS to focus efforts on issues that have a greater impact on the tax gap. Until the IRS has worked out some of the kinks in its processes, the tax compliance and controversy processes for US taxpayers assigned abroad and the companies that employ them will be more challenging than ever.



Acquisitions: Actively managing IA program integration

Mike Branca and Adrien Cotta

The economic crisis has changed the business climate in ways never seen before. Lack of available financing, the global recession and other challenging business conditions have forced numerous companies to seek bankruptcy protection or outside assistance to remain solvent. These actions, as well as attractive corporate valuations, have sparked an unprecedented number of corporate acquisitions in the last several months, and this trend is likely to continue over the next year.

If your company will soon acquire a new entity, it is likely that it will acquire the target's existing international assignment (IA) program. The size and complexity of the acquiree's IA program can have a material impact on the cost to the acquirer, so it is crucial that appropriate due diligence be performed as soon as possible to assess the issues and potential exposures to the acquiring company. This article provides an overview of the various issues that should be considered when integrating acquired IA programs and how to effectively approach these issues.

In general, prior to an acquisition's public announcement, it is unusual for an IA program manager to be involved in the early stages of a due diligence review. In fact, it is not uncommon for IA program managers to first learn of an acquisition after a public announcement from an internal source, such as the company's CEO, or even an external news source, such as *The Wall Street Journal*. However, even if IA program managers are not involved in the early due diligence process, they can offer invaluable predeal assistance to M&A due diligence teams by making the teams aware of the critical areas involving the acquiree's expatriate employees and IA program. After the deal is announced and ultimately closed, these critical areas need to be closely monitored to help ensure the successful integration of the expatriate program.

Before the deal

Limited information, extremely tight deadlines and "all-nighters" are generally the norm for due diligence teams assessing the merits of a potential acquisition target.

When the IA program manager is not a member of this predeal due diligence team, the program manager should advise the team to consider some of these documents and policies in its analysis:

- Inventory of expatriate employees in the various host locations
- Copies of individual employment contracts for key expatriate employees
- Copies of IA and tax equalization policies
- Copies of standard and nonstandard severance plans
- Equity compensation agreements, including change-of-control provisions
- Preliminary Internal Revenue Code Section 280G (golden parachute) analysis
- Copies of IRC §162(m) (certain excess employee remuneration) compliant executive bonus plans

Although this list does not comprehensively cover all IA factors that can materially impact the cost and exposure to an acquiring company, access to these items in the predeal due diligence process can help identify critical issues that may lead to postdeal cost surprises or risk exposure. Proactive IA program managers should meet regularly with due diligence M&A teams to confirm that these IA factors have been reviewed.

As companies become more global, exposure from cross-border international employees becomes greater and the materiality of issues and costs related to these employees may become more significant. Utilizing information such as the items listed above will help the acquiring company assess the need to potentially reduce its purchase offer or use tactics such as holdback or clawback provisions to protect or cap costs when it is not possible to quantify the full extent of the target's related international assignee costs.

After the deal closes: Integrating an IA program

Detailed information about an acquiree's IA program can be difficult to obtain until after the deal closes because there may be strict rules related to sharing information between companies. However, companies that are able to quickly integrate IA programs are, in general, more successful in minimizing business disruptions, evaluating significant issues and avoiding major problems and costs down the road.

Many of the key documents and policies reviewed in predeal due diligence also factor into a successful postdeal integration of an IA program. These components should be considered during integration:

- Inventory of international assignees
- Policy reviews
- Severance, change-in-control provisions
- Payroll compliance
- Employee compensation, benefit programs, equity issues
- Outside service providers

Inventory of international assignees

The first step in the integration process is to understand the acquired company's expatriate population. The quality and completeness of your appraisal of the acquiree's global expatriate employees and the relevant demographic details related to their cross-border activity serves as the foundation to a successful, efficient integration. Though it may sound simple, properly compiling a comprehensive inventory of all cross-border employees can be challenging. Questions to ask include:

- How do you define an expatriate employee? (You should not assume that your definition is the same as the target company's definition.)

- Do you need to worry about informal business travelers?
- What about consultants who travel for short projects?
- Assuming the scope of an expatriate can be defined, how is a list of names built and validated?

While there are no universal answers to these questions, in our experience, the first step is to determine which individuals have responsibility for managing cross-border employees. These individuals usually work in the HR or tax departments, and some companies may have a global coordination team or group of regional coordinators. Often, however, an ad hoc coordination policy exists where business managers and expatriates may or may not regularly liaise with coordinators. In fact, in many companies, some proportion of assignments can be classified as "stealth" or "under-the-radar" assignments.

When an acquiree lacks a central coordination team, more creative and labor-intensive methods need to be employed to track its expatriates. Possible methods include:

- A payroll-based identification method (e.g., a company may provide a particular kind of allowance such as a per diem or COLA, which can be used as a marker, to all its expatriates)
- An expense-based method (e.g., seeking evidence of airplane receipts via a company's travel agency, or hotel receipts via expense reports)
- Timesheet or registry/sign-in reports (especially if these are electronic)
- Client contract reviews (to learn where business is being conducted)
- Travel department details of cross-border travel or immigration service provider details

The next step is to define what constitutes an “expatriate” and identify the types of cross-border employees that exist at the acquiree. Common types include: traditional long-term expatriates; consultants on short-term client projects or working on an as-needed basis; expatriates on unpredictable assignments where the length is not known at the outset (e.g., could be two months or two years); frequent business travelers; leaders with regional responsibilities requiring travel across multiple territories; employees on training assignments; employee-driven relocations; “stealth” or “under-the-radar” expatriates; or permanently or indefinitely relocated employees.

After cross-border employees are identified, key data about each individual should be gathered. This data can include: contact information; point of origin and host country or countries; start date and end date, if available; type/purpose of assignment; and policy (e.g., tax equalized or not, short term or long term). The demographics of the population will then influence the next steps in the integration process.

When defining “expatriate,” parameters that weigh the risks involved may need to be set. Creating an unrealistic goal can increase the risk of indecision and noncompliance. This may lead companies to decide on a cut-off of a certain number of years to look back, based on the assumption that trailing liabilities should start to diminish or become less frequent the longer ago an assignment ended. A minimum length of assignment also may be set, and assignments shorter than the minimum would be considered to generate tolerable risk levels. These thresholds may be modified based on the type of assignment and the countries involved. Setting these types of parameters may make companies more compliant on a global basis because they won’t fall into the trap of making their variables so detailed that they fail to act efficiently.

Policy reviews

Expatriate policies of the acquiree include all aspects of compensation, benefits, employment rights issues and tax issues specific to cross-border employees. When working through these expatriate policies, the acquiring company should consider how the policies impact tax compliance, tax planning, accounting and benefits issues. Potential questions and areas of concern include:

1. Tax compliance

- Who pays the taxes for each expatriate? Is there documentation for this (expatriate policy or individual assignment letter), or some other form of expectation or practice that expatriates rely on?
- Is there a status report available which tracks individual income tax returns filed versus expatriates eligible for services?
- For which years do individual income tax liabilities exist and have these been paid? If unpaid, are they the company’s liability and how much are they?
- Do any late penalties and interest relating to unpaid liabilities need to be accrued for (including, in the US tax system, consideration of whether the IRC §409A penalty applies)?
- Are there outstanding tax equalization settlements due between the company and the individual from past years? (Again, in the US system, consider §409A implications as there could be a significant penalty if such a payment is paid too long after the year to which it relates.)
- Determine who is subject to per pay period hypothetical withholdings and record what amounts have been paid in the year to date so that these can be credited when tax equalization settlements are finalized after the year-end.

- Determine what hypothetical withholding amounts are currently in force, including the marginal rate to be applied to nonrecurring payments, so that payroll can be instructed how to continue the program.
- Determine any audit activity in progress for any employee in home or host countries and estimate any potential liabilities attached to these employees.

2. Tax planning

Tax planning should be addressed to ensure any previously implemented savings can be continued or whether opportunities for tax savings can be achieved for the integrated assignment population. Issues to consider include:

- Certificates of coverage, which eliminate host country social taxes and need to be placed on file with their dates of expiration so that they can be extended where appropriate
- Tax rulings or special expatriate regime agreements or policies
- Tax positions and favorably structured benefits packages which minimize or eliminate taxes on housing, travel and subsistence costs
- Secondment agreements or intercompany agreements dealing with how costs and revenues are shared between entities, mitigating permanent establishment issues and upholding tax treaty positions

3. Accounting

- Have accruals for estimated tax costs been reconciled versus tax and tax equalization balances paid or received?
- Are there tax cost projections for existing assignments that can be used to estimate any accruals that need to be accounted for?

4. Benefits

- Have policies regarding provision of housing, transportation and other typical expatriate allowances been clarified?
- How will the target company's policies be followed postintegration? Will previous policies be grandfathered or will the target company's employees be immediately transferred to the acquiring company's policy?
- Have severance and repatriation policies for expatriates been reviewed? Has the impact of severing employees while outside their home countries been considered?
- Have other benefits or rights such as vacation and employment law issues been reviewed?
- Are there differences in medical and retirement coverage?

In some cases, if neither an expatriate policy nor individual assignment letters exist, then individual practice and expectations will need to be clarified before the questions and issues listed above can be addressed. Where a policy does exist, or company practice has been determined, there will typically be some differences between the policies of the acquiree and the acquiror. These differences may result in significant, inherited tax liabilities. For example, the differences may relate to a personal income or equity compensation cap that limits the company's liability on transactions of a personal nature. In these types of cases, "grandfathering" old policies may be appropriate for retention purposes if a particular employee would otherwise incur unsupported costs postacquisition due to the acquiror's less favorable policy.

Some of the most common tax equalization differences giving rise to challenges are:

- Target company does not tax equalize or is silent— There could be company or employee preexisting liabilities.

- Personal income cap—The amount of the limit varies widely or there may be no limit.
- Definition of personal income for cap purposes—This may include certain kinds of stock transactions, such as exercises, and is likely to be very specific about equity-settled transactions, real estate transactions, etc.
- Protection versus equalization—In some policies, the company does not take any benefit arising in relocations to a lower or zero tax jurisdiction, commonly termed tax protection.
- Partial tax equalization—There is a wide variation between what types of allowances and benefits are delivered free of tax to the employee.
- Tax allocation methodologies—The methods of determining how taxes are shared in the years in which tax equalization begins and ends differ greatly.
- Trailing liabilities—Are policies clear regarding responsibility for trailing liabilities?
- Severance payments—Are severance payments discussed in the policy and do these go into sufficient detail to determine who bears the tax on payments that may arise during the acquisition?
- Local country supplements—Do country-specific addenda covering local issues such as treatment of social benefits, unusual taxes and treatment of customary local allowances apply?
- Miscellaneous policy variances—The coverage and scope of policy in areas of pension benefits, social benefits, social taxes, severance payments, stimulus payments, family-related items, real estate transactions and rental property treatments can vary or not exist in written form.

Severance, change-in-control provisions

Severance payments for expatriates can create unwelcome tax surprises for the company. Severance payments may have multiple components, and often a country's tax laws identify and treat the components separately. Even where these are treated correctly for payroll purposes in the country where the payroll is located, companies commonly overlook the tax impact in the other countries where the individual worked. A common issue is that severance payments are structured so that they achieve beneficial tax treatment in the home country, but they are not likely to receive the same treatment in the host country.

Another factor to take into account when determining the proper tax treatment is length of service. If individuals have worked in multiple countries over their employment terms, each country's laws and practices must be taken into account to determine potential tax implications. Payments to expatriates should be structured and timed to minimize taxes. Where such taxes are unavoidable, it should be determined if and how double-tax relief can be obtained and who is responsible for the taxes before committing to the payment.

The following factors relate to severance issues and play a role in determining potential tax liabilities:

- Breakdown of components related to a severance payment
- Severance deed and relevant paragraphs in original contracts and assignment letters detailing payments in the event of a severance
- Expectations and practices for receipt of payments
- Change-in-control provisions, level of employee, size of payment, clawback provisions

- Residency status in assignment countries
- Travel to other countries over entire term of employment
- Timing of payments pre- or post-termination of employment or pre- or post-tax year-end
- Treaties between countries dealing with residence, rights to tax and relief for double tax

Similar to severance payments, change-in-control provisions can yield unexpected tax impacts when payments are made and taxes are potentially due in two or more jurisdictions. Specific rules governing these payments need to be considered in the home and host locations. As a starting point in determining potential tax impacts, consider taking these actions:

- Examine change-in-control provisions for each country.
- For US tax purposes, where golden parachute payment provisions exist, perform a §280G analysis for key employees.
- Obtain a summary of §162(m) compliant executive bonus plans.
- Obtain details of deferred compensation and consider if deferral rules apply in the host country or if there is potential for double taxation.

Payroll compliance

When an expatriate remains on a home country's payroll, the company often is obligated to operate a second payroll in the host location. These payrolls are commonly referred to as "shadow" payrolls. Typically, they are necessary when pay is delivered to the employee from the home payroll, but a tax liability arising in the host

location needs to be accounted for and taxes remitted to the tax authority. Often, the shadow payroll is set up and run separately from the regular payroll for domestic employees, and different rules or practices may apply to how shadow payrolls are run.

Failure to operate a shadow payroll properly and in a timely fashion may lead to payroll penalties. In extreme cases, companies can end up footing the bill for withholding tax liabilities long after the assignment. In such a scenario, companies may be unable to obtain credits (for example, in the case of a terminated employee). Validating that the acquired company is current with their shadow payroll reporting and tax obligations will be a critical factor to determining the extent of material liabilities for the target company's IA program.

There are many pitfalls in successfully managing a payroll compliance transition. Items to work through include:

- Identifying where host country shadow payrolls are already in existence
- Obtaining details of who operates the payroll, how the taxes are paid and how data collection is managed
- Obtaining details of the taxes remitted so far this year, itemized per expatriate, and a schedule of due dates
- Determining all sources of compensation for shadow payroll reporting, especially expatriate allowances, benefits such as housing, education, travel and subsistence, taxes or other liabilities borne by the company, and amounts delivered via home country payroll, expense reimbursements and in-kind benefits
- Where no shadow payroll is in place in a particular host country, determining if one is or was needed (accruals may need to be made for past gaps)

Employee compensation, benefit programs, equity issues

At acquisition, the international aspects of expatriates' remuneration structures, such as executive payments and bonus plans, deferred compensation, severance packages, and unvested or unexercised stock-related compensation, may be overlooked. However, it is important to consider the potential ramifications of expatriate issues because they may have significant tax implications. For example, the accelerated vesting of stock options or restricted stock, or the receipt of payments in return for the cancellation of unvested stock-related instruments, can give rise to one or more host country tax liabilities if there is foreign travel from the date the original instruments were granted. Any retention aspects attached to these payments, such as clawback provisions, can change the tax treatment of payments and the way they are sourced substantially. Occasionally, a mismatch may occur between the treatment in different jurisdictions. These mismatches could result in unrelieved double taxation.

To gather the necessary data to identify and quantify possible host-country tax exposures, several actions can be taken, such as:

- Obtain equity plan documents and identify all plans that are available to employees.
- Obtain lists of unvested and unexercised stock options and unvested restricted stock awards per expatriate employee.
- For US plans, check IRC §83(b) status for each restricted stock award of expatriates.
- For non-US plans, identify subplans and learn about their tax-approved features in the host location. Identify any differences in grant pricing practices, vesting schedules and option terms.
- Determine payroll withholding and reporting rules for each host location for stock-related transactions and change-in-control related payoffs.

- Determine how much tax has been withheld in the year of acquisition in the host location.
- Learn what methods were used by the acquiree to comply with cross-border withholding requirements for both temporary foreign assignments and permanent transfer employees that have worked in multiple jurisdictions during their employment.
- Obtain details of accelerated vesting of stock options or restricted stock, and payments in return for the cancellation of unvested stock-related instruments, particularly in connection with the change in control. Information obtained should include details of retention aspects, clawback provisions or other features that anticipate future services.

Outside service providers

Outsourced service providers that are engaged by a company in connection with its IA program can be an excellent source of information during the information-gathering stage of an integration process. Typically, there will be several service providers that administer expatriate services for the acquiree and acquirer. These providers may include a relocation provider, an expatriate tax provider, a legal/immigration provider, and others. It is not uncommon for service providers to have more access to centralized information about the existing expatriate population, as well as areas of risk and exposure, than the company itself. This is especially true if there is immediate redundancy at the acquired company.

Successful integrations generally include cost-effective and efficient outside service provider transitions. Understanding the extent of services being provided by outside vendors is crucial to a successful transition, and investigating the following items will help accomplish this goal:

- List of vendors used by the acquiree to administer its international assignment program
- Copies of engagement letters or service level agreements with vendors

- Summaries of outstanding fees for all services provided as well as an accrual or estimate of unbilled services to complete work
- Summaries of any in-process services or services that providers intend to complete

The bottom line: Cut costs and limit disruptions

After an acquisition, the integration of an IA program can be challenging and complex. Whether the acquiring company is dealing with a robust program of 1,000-plus assignees or just 10 assignees, the exposures and risks for cost surprises can be significant. In fact, in our experience, larger expatriate populations often have more active, comprehensive processes in place to minimize material cost surprises. Companies with small or limited IA programs sometimes create more surprises during the integration process because their programs received less attention.

In today's harsh economic conditions, the pressures to get lean and reduce costs continue to mount. Simultaneously, the environment is ripe for acquisitions. When a company acquires a new organization, the short- and long-term success of the deal can hinge on efficiently integrating the acquiree's IA population. By actively managing the IA integration process before and after a deal closes, acquisitive companies can smooth these challenging transitions by lessening costs and limiting business disruptions. Ultimately, the right approach can make the difference between a successful integration managed to a conclusion over a fixed timespan and a lengthy, uphill struggle characterized by multiple loose ends and no clear finishing line.



Tax compliance challenges: Equity-based compensation in Asia

Joni Edwards

As the economic landscape undergoes dramatic changes, organizations face the dual challenges of retaining the high-performing employees needed for long-term growth while also reducing headcount and managing costs. While juggling these interests, organizations also must ensure the appropriate recognition of expenses and corporate tax deductions. To meet these challenges, many organizations adopt equity-based compensation as their long-term incentive solution. But, as with any solution to a complex problem, implementing or updating a compensation plan on a global scale requires careful planning and analysis.

Focusing on the Asia-Pacific region, this article explores the concerns organizations face as they craft global equity-based compensation plans. Critical issues include the institutional weaknesses in equity plan administration that stem from turnover or cost-cutting; plan obsolescence in the face of frequently changing tax or regulatory rules; and intraplan consistency given inconsistent rules from jurisdiction to jurisdiction.

Institutional knowledge base

This year, many organizations in Asia are using conventional approaches to contain costs, such as severely reducing hiring and eliminating positions. However, the resulting turnover in key company roles (tax, HR, payroll) has led to a loss of important institutional intelligence that weakens the understanding of existing equity plans and associated country-specific compliance concerns including reporting, income tax withholding and corporate/employee tax compliance.

Implementing or updating an equity plan requires appropriate documentation to bolster the organization's knowledge base, especially in the current cost-containment environment. The most efficient way to ensure quality equity-plan documentation is by conducting semiannual compliance reviews of existing compensation plans in all countries where equity compensation is used. While the notion of committing scarce resources to these reviews might seem a tempting target for cost containment, forward-thinking corporations avoid this trap.

Many Asian governments increasingly perceive multinationals to be potential revenue streams as evidenced by both laws designed to discourage profit repatriation and heightened scrutiny and enforcement of existing tax laws concerning multinationals and their foreign employees. Accordingly, risks associated with noncompliance are likely to be greater than administration or compliance costs associated with semiannual reviews of well-crafted and well-run global equity-based compensation plans.

Tax law changes

As taxing authorities become more sophisticated, they increasingly view the taxation of equity compensation as a loophole that should be eliminated. Until recently, many Asian income tax laws simply did not address equity-based compensation. Consequently, taxing equity-based compensation was open to interpretation and, once established, didn't change from year to year.

Many Asian jurisdictions now realize that equity-based compensation may represent a sizable portion of the recipient's overall compensation package and therefore becomes a very attractive target. As a result, Asian legislatures and regulators frequently alter equity-based compensation laws in order to maximize their revenue potential.

In order to keep up with these swift changes, compensation departments in forward-thinking organizations must be aware of the changes in rules and regulations in each of the countries where they grant equity. Failure to stay current could have dire consequences for both organizations and their employees.

For example, India recently changed its tax law to impose a "fringe-benefit tax" on equity compensation. Unlike income tax, this tax is usually imposed at the employer level and is not deductible for corporate tax purposes. As a result, for equity compensation, such as exercised options, the employer is responsible for the tax rather than the employee. However, the government has provided the organization with an unusual provision that

allows it to collect this employer tax from the employee, so fringe-benefit tax recovered from the employee is considered paid by the employee and is not considered income to the organization.

For a global equity-based compensation plan where there are India-based participants, the cost to the employer increases dramatically unless proper planning and documentation are in place. If the organization does not include a provision in its equity compensation plan that ensures the India-based employees pay the employer's FBT liability, the organization will incur a large and unnecessary tax obligation.

Similarly, equity-based compensation plans in China face new rules in relation to stock option reporting that can have a substantial impact on an organization's employees. As is the case in India, proper planning can lead to substantial tax savings.

Generally, the Chinese tax regime requires monthly individual filings. The monthly filing determines the tax rate, which is a progressive rate up to 45 percent. Receipt of a stock award during a given month results in the inclusion of the entire amount in the determination of that month's tax rate.

Under the new rules, the exercise of qualified stock options can be leveled over 12 months, resulting in less income per month and the possibility of a lower tax rate on the exercised option amount. But in order to qualify for this potentially substantial benefit, the employee must be enrolled in a plan qualified under Chinese law. Organizations hoping to maximize their employees' benefit from the exercise of qualified stock options must register in advance with the appropriate authorities.

Additionally, China's new Stock Administration for Foreign Exchange (SAFE) rules allow stock-option plans to be administered more efficiently. Stock options encourage employee ownership, but this positive outcome was discouraged under previous Chinese tax policy because

China's foreign-exchange regime required employers to sell all of their shares upon exercise in order to pay the exercise price and pass along the net proceeds to employees through payroll.

Under SAFE rules, plan registration allows local employees to retain shares upon exercise because the rules allow employees to transfer foreign currency in and out of China for the exercise of the option. If an organization fails to take advantage of these new provisions, then the law defaults to the previous rules, which would result in the loss of all equity positions for a company's China-based employees.

Inconsistent rules across jurisdictions

In addition to becoming increasingly sophisticated in the theoretical frameworks they employ, tax authorities are becoming more creative in devising rules and regulations that they believe will meet their particular needs. As a consequence, the laws vary widely from jurisdiction to jurisdiction. This increases the complexity and could lead to double taxation.

These jurisdictional inconsistencies exist in a wide variety of areas. The most pertinent for this discussion, however, relates to sourcing of income, valuation and tax recognition points.

Regarding income sourcing, equity-based compensation plan administrators should be aware of jurisdictional conflict related to "grant to vest" sourcing (when the option becomes exercisable, as opposed to "grant to exercise" options, which is when the option is actually exercised) of stock awards. From a valuation standpoint, organizations also should be aware that even the taxation point is inconsistent across jurisdictions.

Although the income recognition point (the point where the income is considered taxable to the employee) may be the same, such as when an option is exercised, the sourcing of the income may be determined differently.

For example, if an employee has received a stock option while working in one country, but exercises it while residing in another, the compensation income may be taxable in both countries. However, one country may consider the income earned from the date the option is granted until the date the option is *exercisable*, while another may consider the income earned from the date the option is granted until the option is *exercised*. This could result in double taxation of income with no relief, along with varying reporting or withholding requirements imposed on the employer.

Further, suppose an employee receives a stock option while working in the United States and works in the United States for two years until the option is exercisable, but then moves to Japan. While living in Japan, the employee exercises the option after another two years. The taxation point is the same for both countries (the exercise date). However, the sourcing of income is considered “grant to vest” for US tax purposes and “grant to exercise” for Japan tax purposes. As a result, 100 percent of the income would be considered US-sourced and taxable in the United States for US purposes, while 50 percent of the income would be considered Japan-sourced and taxable in Japan for Japan purposes.

Of course, under this scenario, the income tax treaty between the two countries would equalize the situation, but no such treaty exists between other countries or jurisdictions such as Hong Kong or Singapore.

Along with income sourcing, the taxation point and taxable value may be different. The most notable Asian example is in Singapore. For foreign employees (noncitizens or permanent residents) transferring out of Singapore, the employer is required to report a “deemed gain” with respect to any options or awards granted when the employee resided in Singapore. The value of the deemed amount is calculated as if the taxable event occurred one month prior to the termination of Singapore employment. This creates several obvious problems for the employee. First, Singapore tax is due before the value has been transferred—or is even legally entitled—to the

employee. Second, the same income might be taxed later by another country, as cited in the earlier example. Finally, the tax could be due on an award decreasing in value or not ultimately delivered.

Unfortunately, the Singapore tax authority has only addressed the third point. If the eventual compensation income results in lower income than the deemed amount, the employee can apply to reopen and adjust the deemed gain for the relevant tax assessment. However, in order to receive this adjustment, the application must be made within six years of the relevant tax year and proof of the actual income received must be presented.

Employers in Singapore should track all grants made by any of its companies, not only to determine if the gain is reportable but also to determine if a deemed exercise should occur when a foreign employee leaves Singapore. An organization might be liable for the relevant taxes if these reporting procedures are not strictly followed.

Securing a corporate income tax deduction

In many situations, organizations provide parent company stock as part of a global equity plan for employees of its subsidiaries. However, a deduction for the subsidiary is only available if permitted under local law. Most jurisdictions require the incursion of an economic cost in order to secure a corporate deduction. To satisfy this requirement, a parent company could charge the subsidiary for the value of the equity delivered to its employees, a process known as “recharge.”

To implement a recharge process, a subsidiary cost-sharing agreement would first need to be in place for equity-based compensation awards. The agreement should cover all forms of equity (stock options, restricted stock, etc.) that might be delivered to the subsidiary’s employees. The agreement should create a legal liability for the subsidiary to pay the parent company for the economic value of the awards transferred to the employees (or “spread” value of options exercised). Consideration should be given to the foreign subsidiary’s capital level, as it could be important for regulated entities.

Technically, the agreement should be in place at the time the awards are granted, although agreements executed after the grant date can still be respected. The recharge transaction requires a cash settlement via intercompany accounts and proper accounting at the subsidiary level. For employees who relocate internationally between the grant and vesting dates (or during the sourcing period), the recharge should be allocated between the parent and the subsidiary or between subsidiaries.

The recharge process benefits the subsidiary by providing a reduction in cash tax expense when a corporate income tax deduction is claimed—in effect, reducing its tax expense. In addition, recharging lowers the upfront accounting expense for equity awards through the value of the future tax savings by establishing a deferred tax asset. Cash also can be repatriated to the parent and generally is not considered a taxable distribution of earnings and profits.

From an accounting perspective, a recharge allows a company to record an income statement benefit for the expected income tax deduction measured by reference to the accounting cost. Notably, journal entries that record the income statement benefit are not the same entries used to record actual recharge. The recharge journal entries reflect the payment that the subsidiary must make for the employee compensation without regard to the accounting cost. This eliminates the recharge impact during corporate consolidation for group entities, leaving only the statutory deduction effect in the consolidated income statement. As a result, a company that recharges has two sets of books to record equity income tax activity.

Nonetheless, there are potential drawbacks to the recharge process that organizations should consider. First, recharging can result in increased compliance requirements under the subsidiary country's tax laws, typically in relation to wage withholding and information reporting. The recharge process also can increase social security tax costs for employers in certain countries. A necessary aspect of recharging—the movement of cash from subsidiaries to the parent company—may reduce subsidiary capital levels. Also, local regulations in countries such as India may restrict cash movement.

The use of a parent company's stock as an award for its subsidiary's employees could create a "permanent establishment" risk for the parent in the subsidiary's country. Permanent establishment occurs when a parent company is considered to be doing business in the other country and must therefore allocate a portion of its income for taxation. This risk occurs because the employee could be interpreted to be earning compensation income directly from the parent company. However, many multinational organizations provide equity compensation in this manner, so this alone should not create material permanent establishment concerns. In addition, recharge agreements provide protection from permanent establishment risk because the subsidiary absorbs the full equity expense for compensating their employees.

In transferring shares associated with a recharge, use of treasury shares is recommended because this type of transfer indicates a real cost of shares versus newly issued parent company stock. In some countries, most notably Japan, treasury shares are required because a deduction is not allowed for the issuance of the company's own shares. Note that in Japan, a corporate deduction is available on the date of exercise/transfer of shares. For stock options, technically, the deduction should be the value of the option premium on the date of grant, though this value may be difficult to calculate.

As local governments become increasingly sophisticated with regard to equity compensation plans, noncompliance risks correspondingly increase. Consequently, the frequency of equity plan audits is increasing in Japan and Hong Kong, specifically, and these audits may result in significant exposure to penalties, interest and legal concerns.

Upon audit of the recharge, deductions generally are allowed only if documentation is in place. The use of treasury shares and the cost of those shares are usually questioned. In addition, auditors may request proof that employees recognized ordinary income at the stock transfer date and that the amount matches the deduction, though this is not frequently questioned. During the course of an audit, employers will need to show wage withholding and/or information reporting.

Recharging generally increases the nonresident tax filing exposure for employees because chargeback agreements create clear audit trails for documenting the compensation event. As a result, many countries require some form of wage reporting or withholding tax on the compensation element of stock awards.

The income tax withholding obligation usually rests with the employer of the employee (i.e., the subsidiary) and not the parent company transferring the shares. Lack of involvement with the shares transferred to the employee usually will not be a valid defense upon audit or examination. Most jurisdictions will seek to recover the tax withholding from the employer upon audit. Some countries, notably Japan, Hong Kong and Singapore, do not require withholding even with a recharge of equity compensation costs. In these countries, the employer should educate its employees on the tax-filing and reporting requirements to encourage compliance.

Conclusions and best practices

Even in today's cost-sensitive work environment, multinational corporations still aim to provide global equity-based compensation to their employees around the world. In doing so, they can bolster institutional memory through semiannual compliance reviews of existing compensation plans in countries where equity compensation is being granted. In addition to minimizing the loss of institutional knowledge or lack of experience, these reviews help the organization manage market risk from noncompliance.

A secondary benefit of the semiannual review process is an increased awareness of changes to tax laws and regulatory compliance requirements. Increased awareness, in turn, provides organizations the opportunity to engage in advance planning to examine changes in existing laws and the implications of changing country-specific regulations. By keeping abreast of regulatory trends and issues, organizations reduce unexpected future administration and noncompliance

levies. Further, in a situation where a parent company provides equity to a subsidiary's employees, a properly documented recharge process can result in significant tax cost savings as well as other related benefits.

Increased awareness is especially important today given the heightened audit scrutiny of equity compensation plans. Understanding that audit topics evolve over time will allow plan administrators to potentially build flexibility into existing plan designs to allow for country-specific compliance needs. This also increases the possibility of opportunities for beneficial tax rates and potentially lowers administrative burdens by leveraging local payroll reporting and withholding knowledge.

In summary, best practices include:

- Taking a complete inventory of tax rules in all locations
- Considering tax withholding rates and effective share delivery processes
- Updating employee profiles for each employee receiving equity grants
- Reviewing chargeback strategies and documentation with special emphasis on the impact to wage withholding, if any
- Establishing methods to withhold and deposit taxes in countries where required
- Preparing and distributing employee question and answer documents, annual tax information statements, etc.

By adopting these best practices, organizations will be well-positioned to effectively use equity-based compensation as an incentive solution and meet the challenge of retaining their high-performing employees while balancing the needs to contain costs and streamline their workforces.

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