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International assignment perspectives

Critical issues facing the globally mobile workforce

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Cross-border assignments are showing no signs of a slowdown. In fact, 59% of CEOs surveyed plan to send more staff on international assignments.

And while achieving cost-effective assignments has always been a strategic priority, the economic downturn has placed a renewed and enduring emphasis on cost control.

Considering that even a well-planned assignment can cost three to five times an assignee's salary, effective and strategic planning—from tax considerations to how an assignment is structured—is more important than ever. In this edition of International Assignment Perspectives, we'll take a look at some of the key economic and strategic issues companies should consider for the long-term success of their mobility programs.

For instance, some countries have enacted changes that make assignments more expensive to employees and the companies they work for, while other regions, eager to attract talent, have made assignments more economical. Keeping on top of these ever-changing rules and laws could have a financial impact on your program.

We're also seeing an increase in the use of short-term assignments and commuter arrangements. While long-term assignments continue to be used widely, these alternative arrangements are often more cost effective and provide a greater degree of flexibility to the employee and the organization. For many organizations, it's a good time to consider whether supplementing long-term assignments with alternative options will meet your business' strategic needs.

And whether your employees work abroad for a few months or several years, you'll want to keep tabs on your assignee retention rate to make sure you realize full return on your investment. Companies often invest heavily in their mobile workers, only to see many resign shortly after the assignment ends. When the employee leaves, companies lose big—both in terms of intellectual capital and ROI. That's why it's so important to incorporate retention and talent management programs into your overall mobility strategy.

International Assignment Perspectives—Volume 5 is a collection of thought leadership articles exploring these and other issues. We hope this fifth edition in the series is insightful and thought provoking, and provides you with a strategic framework for addressing the current and future challenges of international assignments.

Sincerely,

William F. Owens, Jr.
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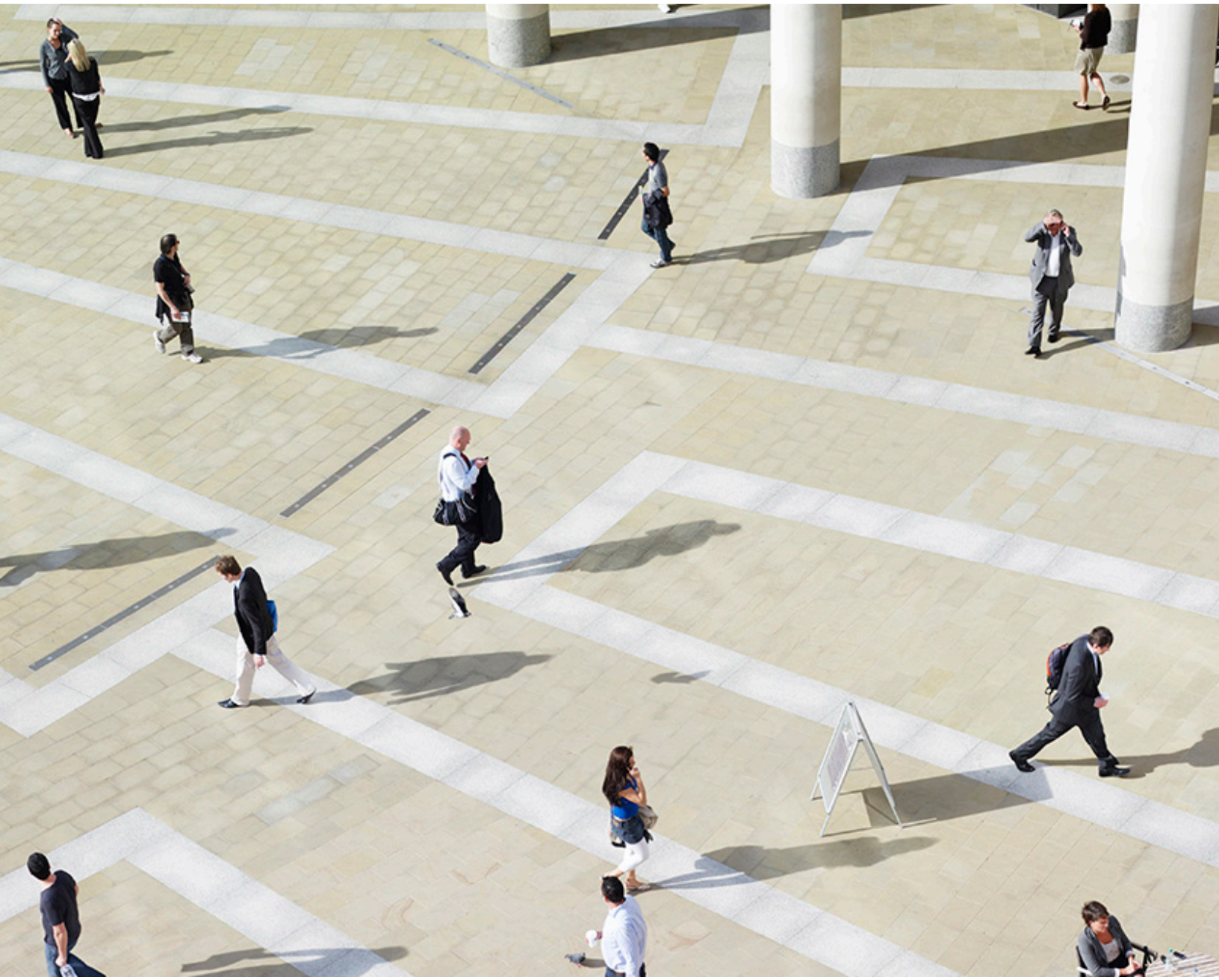
International Assignment Services

The missing piece:

Why mobility programs need a talent management strategy



The rapid pace of globalization continues to make expanding a company's global footprint into new and emerging markets a necessary business response. And expansion hinges on how effectively key individuals are deployed to international locations to support overall business goals and objectives. To retain these key individuals, companies must recognize the importance of both global mobility and talent management programs and take steps to link the two.

By Eileen Mullaney

Principal and Leader of PwC's
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Create a culture of mobility:

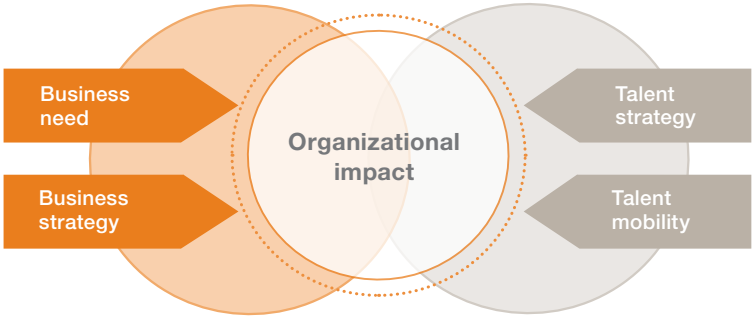
How do organizations successfully embed a talent strategy into their mobility strategy to develop talent mobility and then operationalize it?

The rapid pace of globalization continues to make expanding a company's global footprint into new and emerging markets a necessary business response. And expansion hinges on how effectively key individuals are deployed to international locations to support overall business goals and objectives. To retain these key individuals, companies must recognize the importance of both global mobility and talent management programs and take steps to link the two.

Because the investment required for global assignments are tremendous—from a cost, time, and planning perspective—companies need to get it right. Obviously, companies dedicate a great deal of thought to the assignee selection process—getting the right individuals on assignment at the right time—and to improving their retention and promotion rates among those returning from global assignments. Companies appear to be more aware of how important it is to define the purpose of an assignment, set objectives, and then measure success against those objectives. We are seeing increased focus on maintaining ties to the home organization, career mentor programs, and anticipating what might happen after the assignment as part of a career plan.

Absent a true and articulated talent mobility strategy, there is generally a feeling across organizations that a global assignment may be an unspoken prerequisite to promotion or advancement, or at the very least, a personal resume enhancer. In the past, assignments were used to set up operations or transfer

Figure 1: Combining a talent strategy with a mobility strategy



corporate culture, rather than as a critical component of an individual's overall career plan. In today's environment, the organization needs to revisit the basic questions of its mobility strategy (i.e., Why do we need a mobility program? What is the purpose of assignments? How are we growing our leaders for tomorrow?).

The answers to these questions can serve as the foundation of a culture of mobility, with movement as much a part of the organizational culture as training programs. As an organization looks to global sourcing of talent, there is less focus on nationality and geographies. This is really the critical component of the talent mobility shift—the talent pool is no longer a headquarters or even a local talent pool, but a global talent pool. Organizations will source the best talent wherever they can, sometimes from locations where they may not even have operations. Today, mobility encompasses much more than just traditional long-term and short-term assignments—it embraces all types of movement, from temporary to permanent, across geographies and even functions.

Design sustainable and cost-effective talent mobility policies

How can companies design mobility policies to support a talent sustainability (mobility) strategy?

Before a company can form its global mobility policies, it must first understand the business objectives of mobility. In today's environment, program cost continues to be an overriding consideration and requires the organization to revisit the basics of its mobility strategy.

Traditional programs tended to be executive heavy with a large concentration of assignees from the headquarters and regional headquarters locations. As organizations look to a global talent pool, the program demographics shift dramatically from 80% to 85% of assignees from the headquarters location to less than 50%. We see an even more dramatic shift in the assignee profile as well, from 80% of assignees at the executive level to less than 20%, with an increasing percentage of the assignee population on developmental assignments and the remainder of the population in technical and subject matter expert roles.

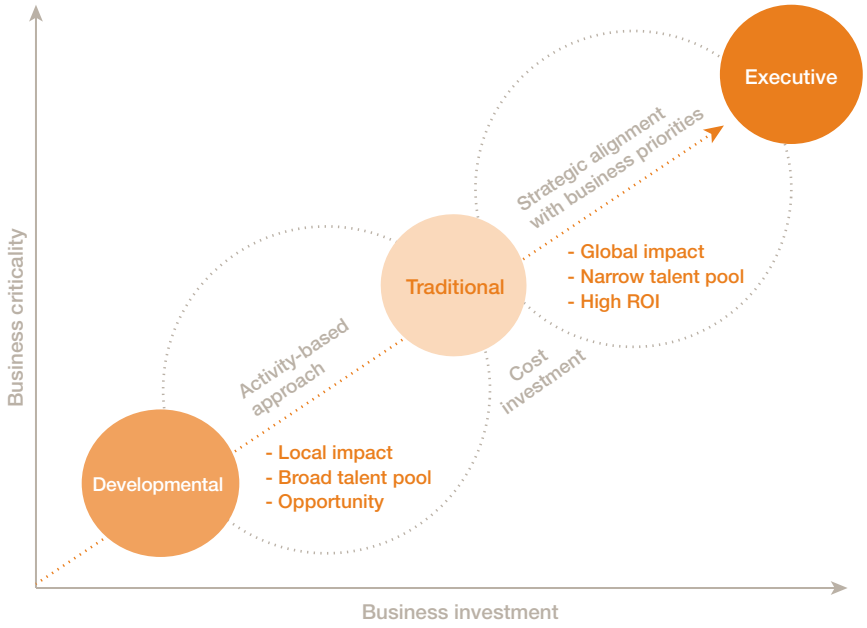
Once a company identifies its various types of assignee talent, it can look to policy design to see if its policies support the strategic objectives of the program and the rationale of the assignment.

For example:

- Will the program be used for talent management and development?
- Will the program be used for leadership development?
- How are we using our mobility program to reflect the shift in expected revenue streams?
- Will the organization continue to send high-potential employees onto specific international projects or placements, or will the focus be only on business-critical locations?
- Is there any opportunity to use resources from developing markets to train and transfer knowledge back if these economies are still showing growth potential?
- How does our program look today and how can we expect it to look in the future?

Some companies recognize that, regardless of their geographical location, certain obstacles to mobility—like retention—exist and may not always be resolved with cash. More thoughtful planning is needed to overcome these barriers. In the 1990s, the need for global talent to fill skill gaps and spread the corporate culture led to a rapid expansion of the expatriate population of many companies. During the past 10 years, global organizations started paying closer attention to the costs incurred by their global workforce as they continued to expand their footprint overseas. Today, organizations require a mobile workforce aligned with the company's business strategy, even as they focus as never before on curbing costs. Companies have always wanted the right people, in the right places, at the right time, but now we can add "at the right cost" to that statement.

Figure 2: Designing a mobility policy framework



A framework helps balance business and assignee needs

Through a mobility policy framework, companies can provide a range of assignment packages that balance the business needs quantified by the level of investment with personal developmental opportunities for all types of assignees. As assignments become a critical component of the career plan and assignee populations grow, organizations focus more on how to invest in assignments and how to define the types of assignments needed for the business.

After determining the policy types, organizations can design a global policy framework to address all policy types (long-term, short-term, permanent transfer, intra-regional, commuters, etc.). The framework may include variations or "tiers" within the long-term assignment policy to address different assignee demographics, such as leadership or developmental opportunities and employee-initiated assignment. Some organizations may take a more flexible approach to address the varied assignee demographics using optional policy elements (based on company discretion) and lump-sum payments.

A four-step guide to building a talent mobility process

After designing talent mobility policies that follow a defined framework, organizations need a consistent and comprehensive talent mobility process to track assignee data, evaluate assignees for assignment selection, coach assignees throughout the assignment, and repatriate them after an assignment ends.

1

Step 1: Assignee inventory

Most organizations track and report on their potential assignee population on a regular basis. The assignee inventory takes reporting on demographics a step further—focusing not just on assignee name, location, and assignment duration, but also on assignee-specific data such as performance record, capabilities assessment, and next likely position. The assignee inventory helps the organization determine the success of each assignee, his/her fit for the purpose of an assignment, the return on investment in the individual's assignment, and even the next appropriate position for the individual (if any).

2

Step 2: Assignee selection

The order of the following steps is critical: identify the criteria required for the position based on technical/functional match with job responsibilities and then select potential assignees. This is likely to be a collaborative process with the business and HR units, led by talent management. Once a candidate is identified; identify and document assignment and performance objectives along with a detailed job description.

3

Step 3: Mentor programs

As the talent process becomes more defined, create an established meeting schedule so the home manager, host manager, and the assignee can have an open dialogue regarding performance objectives, developmental opportunities, and feedback. Mentor and in-country support programs may supplement this meeting schedule.

4

Step 4: Repatriation planning

Determine role and timing for the repatriation—discussions should begin well in advance. Once the role is identified, similar discussions should take place around the new role and performance objectives. Also, maintain continued dialogue with the repatriated assignee on the outcomes of the assignment from a development perspective, use of their skills going forward, and their participation as a mentor to new assignees.

Assignees have high expectations—about how an assignment will affect their personal and career development, about the assignment incentive package itself, and about what will happen upon their return. Although they do expect a "cash out" from the assignment, according to a recent voice-of-the-customer study, assignees no longer see the short-term financial gain as the primary incentive, but rather see assignments as a means of achieving a longer-term, broader role in the organization.

Manage the process to achieve competitive advantage and ROI

Competitive advantage awaits organizations that are able to create an integrated talent management life cycle to recruit and retain the right people, develop and deploy top talent rapidly based on changes in business needs, and create a learning and collaboration culture.

"Best-in-class" programs exist when performance management opportunities are embedded into the day-to-day activities and processes of the talent mobility process. Familiarity with the process demographics and deliverables is essential to measuring process effectiveness. Various performance statistics can help organizations identify, track, and report this data, including:

- Success measures (satisfaction levels of all stakeholders, including business managers, HR and the assignees, effective cost structure, exception management, efficient program administration, and competitive policies)
- Return on investment (connected to specific business or HR requirements such as retention, promotion, and diversity statistics; localization and replacement with local national statistics, performance on assignment and impact on business (incremental assignment cost to a meaningful business measurement)

Given the financial investment organizations make in each assignment, retention of assignees is a paramount concern. Many companies use retention rates as well as performance analysis and promotion statistics to measure the success of their programs. Retention of returning expatriates is many times driven by how successful the employee is in re-integrating into the home organization. Historically, these statistics were measured at one point only, at repatriation. Companies have since realized that this may not present the full story and have started to measure retention, performance, and retention rates not just at repatriation, but also 12 months and 24 months after repatriation.

Harness the power of mobility

Talent mobility is a topic that challenges every level of an organization's structure and business strategy. This is an opportune time to begin assessing how significant an international assignment is to the life cycle of experience for individual employees and, as such, begin to move toward a mobility strategy that focuses on and harnesses this talent.

Spotlight on Mexico:

What to know about residency and tax remittance implications

When sending employees to work in Mexico, companies often consider alternatives to a standard long-term assignment. The discussion might revolve more around short-term assignments, cross-border assignments, or frequent travelers. With any of these scenarios, residency and tax remittance implications arise. Evaluating each scenario, understanding the tax remittance process, and adopting the appropriate tax policy can be challenging during the planning stages. Companies may need to gain a better understanding of the implications of each of these scenarios, especially in circumstances where compensation continues to be paid outside Mexico, there is no local employer in Mexico, or they will charge back the compensation to Mexico.

By Dominique J. Wadhwa, Claudia Campos and Yessika Aranda

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Residency consideration

As a first step, a company will need to understand whether the employee who will be working in Mexico will be treated as a tax resident or nonresident. A foreign national in Mexico may be taxed as a resident or nonresident. While a resident individual is subject to Mexican income tax on his worldwide income, a nonresident is taxed only on the Mexican source income.

Residency in Mexico

For tax purposes, an individual is considered a resident when he establishes a home in Mexico. If the individual also has a home in another country, the individual is considered a resident in the country where he has his center of vital interests. Under Mexican tax law, a person has his center of vital interests in Mexico if (a) more than 50% of his income for the calendar year comes from Mexican sources or (b) Mexico is the primary place of the person's professional activities.

When an individual qualifies as a resident of both Mexico, under the above definition, and another country during the same period, and Mexico has an income tax treaty in place with the other country, the "tie-breaker" provisions of the tax treaty may be applied to determine the tax residency of the individual.

A resident individual is generally required to file an annual individual tax return and must include his worldwide investment and compensation income. A resident individual is subject to tax on a graduated scale with a 30% maximum rate if income exceeds Ps$392,843 (about US$33,000) for 2010.

When no annual tax filing is required

- If a resident of Mexico permanently leaves Mexico prior to the end of the year (i.e., December), he would be considered a nonresident at year end. As such, his income tax withholdings or provisional tax payments would be considered final and the employee would not be allowed to file an annual tax return.
- If a resident individual's only source of income is from a Mexican employer and the compensation received in the year is less than Ps$400,000 (about US$33,000), the employer is responsible for making an annual withholding tax adjustment for the employee so that the annual withholding tax would be in line with what the income tax would have been on the individual's annual return if an annual return would have been required to be filed. When such situation takes place, the employee does not have to file an annual tax return.

Nonresidency in Mexico

If an individual is considered a nonresident, he would be subject to tax on his compensation for services rendered in Mexico on a graduated scale with a maximum rate of 30%. These graduated rates differ from the graduated scale in place for Mexican residents and provide that up to Ps$125,900 (about US$10,500) is not subject to taxes; from Ps$125,900 to Ps$1,000,000 (about US$83,000) of Mexico source income is taxable at 15%; and above that at a 30% rate.

The Mexican nonresident income tax would generally be paid on a monthly basis, and no annual tax return would be filed.

Figure 3: Quick Reference Guide

Tax treatment	Individual resident in Mexico	Nonresident	Employee ending residency before year end	Mexican resident receiving only compensation income of Ps$400,000 or less
Taxed on worldwide income	✓	N/A		
Taxed on Mexican source income	N/A	✓		
30% maximum income tax rate	✓	✓		
Annual tax filing deadline (April 30 - no extension)	✓	N/A	N/A	N/A
Tax paid through withholdings (requires shadow payroll or Mexican payroll set-up)	✓	✓*		
Tax paid through estimated electronic tax payments (17th of following month)	✓**	✓		
Social taxes	Yes, if Mexican employer	Yes, if Mexican employer		

* If compensation is paid by the Mexican entity or salary is cross-charged to the Mexican entity. Option also available if the employee who qualifies as nonresident elects to have the Mexican entity on the premises where he works to remit taxes on his behalf.

** If compensation is not paid by the Mexican entity and salary is not cross-charged to the Mexican entity.

As a first step, a company will need to understand whether the employee who will be working in Mexico will be treated as a tax resident or nonresident.

Compensation paid by a non-Mexican entity—implications

With compensation chargeback

- When an employee is paid by a non-Mexican company and the compensation is charged to a Mexican resident entity, the Mexican resident entity is treated as sponsoring and employing the expatriate for immigration and tax purposes. As a result, the Mexican entity will be responsible to withhold and remit the Mexican income tax including social taxes. In this case, a shadow payroll in Mexico would need to be implemented because the Mexican entity would be required to report the compensation and remit the taxes to the Mexican tax authorities.

Without compensation chargeback

- When an expatriate's salary is paid directly by a non-Mexican company sponsoring the individual on assignment in Mexico and the employer is not considered a tax resident of Mexico or the cost of the compensation is not charged back to Mexico, the expatriate employee bears the responsibility for making monthly provisional tax payments. No social security contributions would be remitted, since no social taxes can be submitted through a non-Mexican employer. A shadow payroll cannot be implemented in such cases.

Monthly provisional tax remittance—considerations for nonresidents of Mexico

As discussed earlier, if a nonresident employee is paid by a non-Mexican employer and the Mexican source compensation is not cross-charged to Mexico, the expatriate employee is responsible for making monthly provisional tax payments. The nonresident employees who do not have a local employer (e.g., cross-border commuters) have two options available to meet their monthly tax obligations, including having their taxes remitted by the company on whose premises they are working.

- One option is to make the employees responsible for filing their Mexican monthly income tax returns and remitting taxes. The individuals would be required to open a personal Mexican bank account to remit any estimated tax payments. The employees must pay the corresponding income tax by filing a monthly tax return electronically through the Mexican bank with payment due by the 17th day of the following month.
- An alternative and recommended approach is for the individuals who are nonresidents of Mexico for local tax purposes to elect to have the Mexican entity where they provide services remit Mexican taxes on their behalf. This process is recognized by Mexican law and can take place even though the entity remitting the Mexican taxes is not the individuals' employer or a party related to the non-Mexican employer. This process is easier to manage because the employees are not required to open an individual bank account in Mexico to remit their taxes and do not need to be contacted to file their Mexican monthly income tax throughout their stay in Mexico.

Cross-border employees and tax reimbursement policies—options

A number of US assignees are sent to work for companies that are based in Mexico, but established close to the US border (e.g., Maquiladora). Because of the proximity of the US border, these US employees live within the United States, close to the Mexican border (e.g., El Paso, Texas) so they can commute to Mexico to work.

The compensation package for a cross-border individual may generally no longer need to approximate a standard assignment package as a result of the employee maintaining his standard of living (since the individual lives in the United States). Instead, a limited relocation package can be considered (e.g., per diem). Also notable is that cross-border employees who would be considered nonresidents of Mexico would continue to remain on their home compensation package while an employee residing in Mexico would be entitled to other benefits (e.g., profit sharing, Christmas bonus) required under Mexican local laws.

US employees residing in the United States and crossing the border to work in Mexico would be subject to a non-resident income tax on the compensation attributable to their Mexican source income (i.e., their workdays in Mexico).

US employees residing in the United States and crossing the border to work in Mexico would be subject to a nonresident income tax in Mexico on the compensation attributable to their Mexican source income (i.e., their workdays in Mexico). As discussed earlier, the graduated tax bracket for a Mexico nonresident can permit certain US employees, depending on their level of compensation, to be subject to a lower effective rate in Mexico as compared to the United States. This lower effective rate can be possible because of the minimal amount of assignment-related wages needed to be grossed up by the employer.

However, since the Mexico tax rates are applied on gross income (versus income net of personal exemptions and deductions from a US perspective), employers may still need to review the tax impact on their population of cross-border commuters to make sure an appropriate and fair process is in place to reimburse their international commuters for any excess taxes, if applicable.

The following two options can be considered:

- **Tax equalization—**The US employee is tax equalized, and US estimated hypothetical taxes approximating what the employee's home tax liability would have been, if the individual had continued to work in the United States, is withheld from the employee's US paychecks. The company funds the actual US and Mexico taxes. After year end, a final hypothetical tax calculation is prepared using information from the final US tax return. If the actual taxes paid by the employer to both the US and Mexico exceed the hypothetical tax liability that represents the employee's ultimate tax responsibility, the employer funds the difference, which is reported as additional compensation to the employee. The taxes on such compensation, if any, after taking into consideration any foreign tax credit, would need to be funded by the employer.
- **Analysis of US foreign tax credit versus Mexico taxes**—Another option consists of having the employer remit the Mexican taxes on behalf of the employee every month (through the Mexican entity) and deduct such amount after tax from the individual's US paycheck the following month. In such circumstances, the US tax withholdings would be reduced in relation to the expected foreign tax credit on the US tax return. Once the US tax return is prepared, the US foreign tax credit claimed on the return is compared to the actual Mexican taxes paid. If the amount of actual Mexican income taxes paid exceeds the US foreign tax credit, the employer reimburses the employee for the difference. The reimbursement is treated as taxable compensation. The taxes on such compensation, if any, after taking into consideration any foreign tax credit would need to be funded by the employer.

The US employer may need to consider running a cost projection of the expected worldwide tax liability in order to determine the preferred tax reimbursement methodology described above prior to sending the employee on a cross border employment to Mexico.

Achieving financial discipline:

Inviting Finance to the table helps to manage assignment costs

We have all heard and used the phrase "Too many cooks spoil the broth," but we seldom think about whether there are enough cooks. When we consider international assignments, we tend to think of two cooks as the master chefs, Human Resources and Tax. International mobility has historically been the responsibility of HR or Tax, with good reason. Clearly with relocating employees, HR needs to play a direct and important role in international assignments, and with cross-border tax implications, so does Tax. It makes perfect sense for one of these functions to own the mobility program, working closely with the other to achieve business objectives.

By Pankaj Gupta and Rob Freedlander

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A function that is not necessarily in the forefront when it comes to mobility is Finance. In many organizations, Finance's role can be passive. It may only taste the broth that HR or Tax has prepared but not be "in the kitchen." In these cases, HR or Tax performs its own financial analysis and costing for international assignments and reports the results to the appropriate Finance executive, or ultimately to the CFO. In other organizations, the finance team is a third cook in the kitchen, an integral part of planning and administrating the international assignment program.

In this article, we examine some of the issues that organizations should think about and address to achieve optimal financial discipline around international assignments. This may mean interacting more closely with Finance departments or inviting Finance to have a permanent place as part of the larger team for a successful international mobility program.

We focus in this article on Engineering and Construction (E&C) companies. E&C companies invoice clients using various commercial cost-plus and lump sum models, and thus financial discipline is not only key but also essential to cost estimation, accuracy of client invoicing, and ultimately cost recovery from clients. However, the related issues and principles apply not only to the E&C industry and other project driven business environments but also across many, or most, industries.

Financial planning and modeling

In any industry, financial planning is the cornerstone for a project to be profitable. Sound financial planning for international assignments is as important. Industries where expat costs are reimbursable by budget-conscious clients may have a somewhat higher bar than companies mobilizing executives under only their own internal overhead scrutiny and value proposition.

In the E&C industry, widely practiced commercial terms require that all assignment-related costs are directly reimbursable by the client, as per actual costs incurred on a line-by-line basis.

Alternatively, these costs may be recovered in the form of one of two basic "all-in rate" structures. First is a multiplier style, where the client is charged a certain multiple of the assignees' base hourly rate, which would cover a number of salary-based cost components. A second form is a flat rate dollar amount per hour for the assignees that sufficiently exceeds base pay to cover the various other assignee-related costs. In some instances, instead of a cost plus model, the terms of the contract entail a lump sum fee where the client will pay a set sum for the whole project.

Financial planning is the cornerstone of a profitable project. Sound financial planning for international assignments is equally as important.

Whether the company is looking at an all in rate, a cost reimbursable contract, or a lump sum fee, financial planning becomes critical at the very beginning for the E&C contractor to submit a competitive bid. There comes a point where after an initial evaluation to bid, the contractor identifies project staffing requirements, including local employees and hires, along with expatriates to be sent to the project site. A comprehensive staffing plan takes into account various factors, such as level of experience needed, skill sets, countries of origin, and length of assignment. This begins the financial modeling process to estimate expatriate costs.

Finance will ask either HR or Tax to provide "cost projections" based on the different scenarios, varying compensation, assignment benefits, and length of assignment. These projections can be undertaken at an individual by individual assignee level if only a handful of expatriates are part of the staffing plan for the project. Where the expatriate numbers are larger, such estimates may be performed for groups of similar expatriates. Companies historically have used their expatriate tax service providers to assist with these calculations or have purchased programs from the providers that they can run in-house. Finance typically uses the projections to extrapolate and build a wider model to estimate overall costs of staffing the project with expatriates and local workers.

Thus, long before a company mobilizes a particular assignee, a cost estimate has already been established. Inaccuracies or significant variations in such costs will directly affect the profitability of the project, especially if client billing is based on an all-in rate or a lump sum fee. If the cost is recoverable from the client, such variations could lead either to disputes when it comes to settling the costs or a damaged client relationship.

In other industries, the projection process may take place at a later stage, but the significance and importance of analyzing assignment costs and working with finance teams at the start are key. Too often, this becomes an exercise post assignment where business units and HR do not understand the costs of the assignments until it is too late.

Mobilizing employees

We have discussed the crucial role of Finance in the initial planning stages of international assignments. But that is just the beginning, and the role of the finance team in the implementation process is as vital and beneficial.

In the E&C industry, oftentimes the jurisdiction where a project is based will be new to the company. It may be the first time expatriates are being sent to the area, and it may not be just a few expatriates but rather tens or even hundreds. The company may have no entity structure in place for the location. Although the scenario is not unique to the E&C industry, sometimes because of the remote location of the project site, whether it's a mining field or an oil refinery, E&C companies expanding internationally seem to face such a situation more often than not.

For a new location, whether sending one expatriate or a hundred, the company needs to take various actions. One of the functions that falls under the purview of Finance is payroll. How an expatriate is going to be paid and where need to be determined. Pay delivery may be affected by or may affect various areas, such as corporate tax withholding on reimbursing costs to the parent entity, permanent establishment issues, labor laws, and exchange control regulations.

A local payroll may be beneficial in a particular country to mitigate the home parent's creation of a permanent establishment or to eliminate withholding on cross-charge payments to the parent entity. At the same time, a local payroll may have negative implications for home country benefits, exchange control limitations, and currency fluctuation issues. There could also be certain overriding factors, such as requirements to deliver at least a certain portion of pay locally to meet work permit application requirements. The company needs to make many determinations to achieve the least financial burden for itself and the employees.

As employees are identified for assignment, the company should establish internal procedures, if not already in place, through which the terms of the assignment can be communicated to Finance—both the payroll team and the team responsible for billing the expatriate costs to the client in a cost reimbursable contract. It is ultimately the responsibility of the finance team to ensure that what is paid to the employee is as per the terms of the assignment and that in turn it is invoiced to the client as per the terms of the commercial agreement.

Simultaneous to this mobilization process, a number of financial activities related to project cost accounting and client invoicing need attention. The foundation on which all of these activities rest is the creation of project cost structures, required for timesheet submittal. Ultimately, these structures are used as cost objects to collect all project transactions so that the client invoicing can be done easily and accurately.

Without an integrated effort that includes the finance team, when mobilizing employees to new locations as well as old ones, a company runs a high risk that the initial setup may not be optimal and may lead to undesirable financial complications down the road.

Internal controls and accounting

When an employee is on assignment, clearly like any other transaction, appropriate accounting for the company's profit and loss statement and balance sheet needs to be accurately performed. It no longer is as simple as recording compensation costs in the company's books. With international assignments, recording and bookkeeping take on a whole new meaning. In addition to regular salary and benefits paid, which would be the main components in relation to a local employee, the employing entity faces several variables. These include accounting for cross-charging among home and host country entities, additional components of in-kind benefits such as housing payments to third parties, hypothetical tax reduction, accrual for outstanding home and host tax costs, and reconciling tax settlement receivables from employees.

Furthermore, in a cost reimbursable contract in the E&C industry, accounting entries need to ensure appropriate costs are being pushed through the system to create billings. These costs need to be properly accounted for as "to be billed." In such circumstances, a careful ongoing review of the work in process will help to identify costs that have been incurred but not yet billed. Where the ability to recover costs from the clients tends to decline as costs age, it is imperative that billings go out on a timely basis. Once costs have been billed, they need to be carefully tracked as receivables. While the billing of these costs generates the revenue on the income statement that everyone wants to see, the collection is imperative to the company's ongoing profitability.

It is also important to track the costs of a particular employee at the appropriate project level. A system of internal controls should be put in place such that each employee's costs are recorded and billed to the appropriate project. In many cases, employees go on back-to-back assignments, but costs related to the prior project may not materialize until later during a new assignment. The company should identify such costs and track them back to the prior project so that the appropriate client is invoiced. This could be a complicated exercise, for example, in the case of tax equalization costs, which are determined only after the year end; an appropriate allocation of the equalization costs would be needed for the multiple assignments in the year.

Even though clients may directly reimburse assignment-related costs, certain components may not be calculated as per actual costs but in the form of overhead allocated based on a fixed multiplier to projects. For example, statutory benefits may be picked up in overhead when accounting for internally but offset against a fixed-rate multiplier charged to the project. The intent would be that this cost has sufficient visibility to cause the project personnel to recover it from the client. The central financial services would need to regularly review these costs to make sure they do not begin to exceed the recovery rates that are being pushed to the projects or do not over-recover in a manner where clients may question the appropriateness of such allocations.

A well-controlled expat accounting and billing process should include internal controls and audit. Finance has the primary responsibility and owns the accounting function in the organization. A well-designed system with established processes and controls will ensure accurate reflection of international assignments in the books of the company and help recover costs and fees from clients in an organized and timely fashion.

Finance often adds value by providing assurance that expats will create a favorable effect on corporate profitability.

Demobilizing assignees

Demobilizing an assignee and bringing him or her back to the home location has challenges of its own similar to those faced on initial mobilization. It is also important to consider that assignment-related costs may continue to be incurred, even post-return for several months to years. A common challenge companies face is trailing home and host country tax costs. Often, taxes are not due until much later, after the end of the tax year. Further, there may be items of deferred compensation or equity-type compensation that could generate tax liabilities in the host jurisdiction years later.

A complication for E&C companies employing cost-reimbursable models is the recovery of such trailing costs from clients. Basic accounting theory teaches us how to accrue costs when one or more future costs will relate to current revenues or activities. While it is possible to do an estimate of future tax obligations and generate an accounting accrual, it can be a challenge to generate an estimate of future tax costs and hand the client an invoice with a "best guess" tax calculation. On the other hand, it's extremely difficult to collect the reimbursement for such costs from a client several years after the project team has demobilized and key personnel are no longer available to attest to the validity of the obligation.

A practice that PwC has seen as becoming more common is to develop an estimate on trailing tax cost. This can be compared to an exercise of cost projection when an assignment is first being considered, as discussed earlier. Instead, however, the estimate is prepared for a year or two post-assignment to mirror what the actual tax return and tax equalization calculation is expected to be. Clients will generally rely on such closing estimates and agree to remit payment with the understanding that actual cost will be within a reasonable tolerance.

Timing is one challenge companies often face with these estimation exercises. Generally, taxes are not high on the list of project closeout priorities. As such, by the time anyone realizes the need to address taxes, a final closeout deadline looms in just a few weeks.

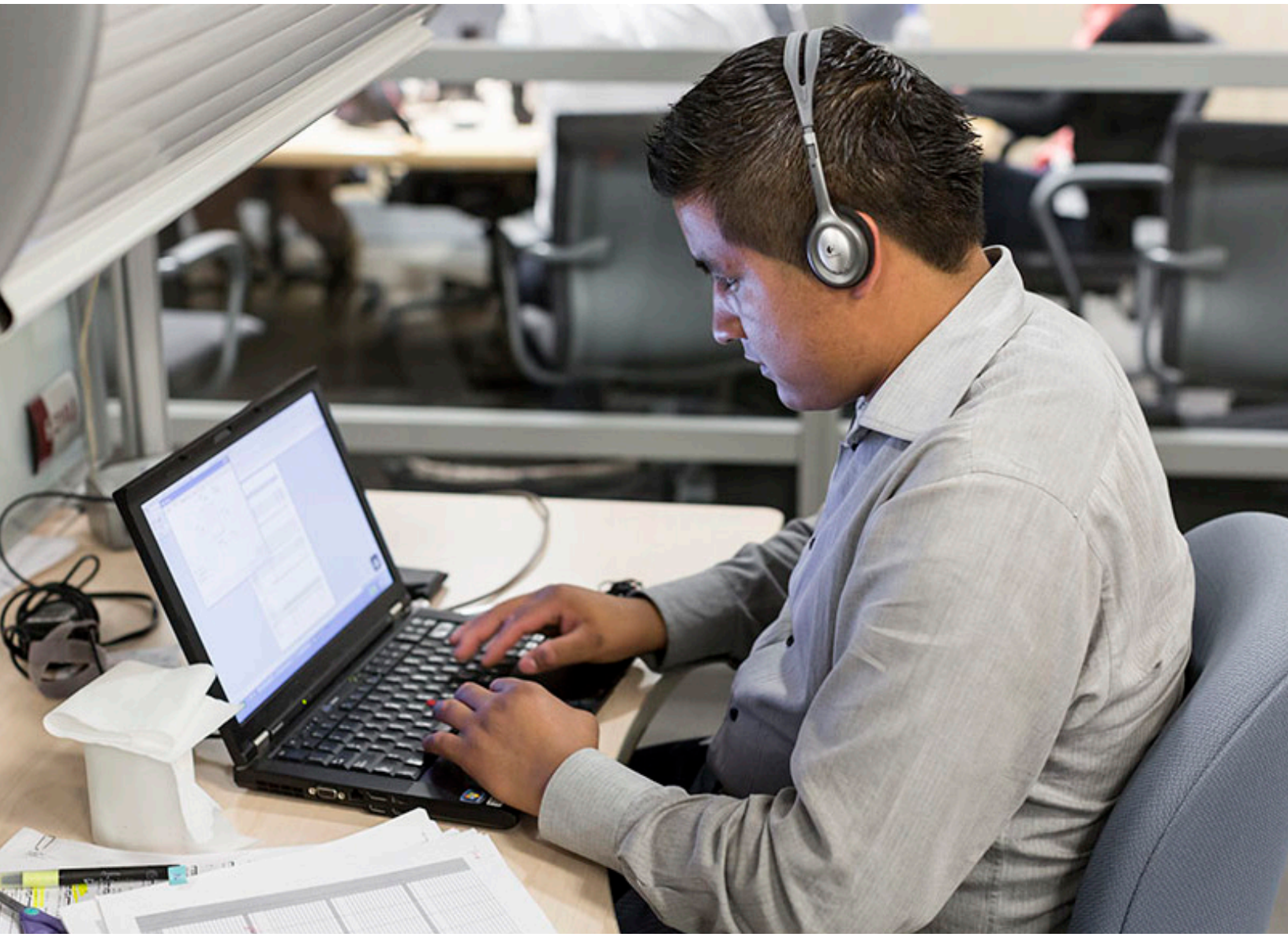
Regardless of whether the company needs to perform a detailed estimate for a cost-reimbursable contract, it is fundamental to achieve some form of financial closure when the assignment ends. The finance team can help.

Summary

In summary, international assignments, as much as they benefit an organization, can represent big costs and big risks. It is important to manage the costs and financial risks. HR, Tax, and business units have a heavy and direct role in international mobility. But the finance team's role in achieving financial discipline should not be underestimated. Finance will also often add value in providing assurance that expats will create a favorable effect on corporate profitability. Opportunities to add internal controls deserve full exploration. In a cost-reimbursable model, Finance needs to be the head chef to oversee that the correct costs are passed to clients in a timely and organized fashion.

Data at your fingertips:

Using technology to track and manage employee travel



On a recent visit to a large client (ABC Co.), Jane Smythe was required to register as a "visitor." While this is commonplace for all organizations, ABC Co. had a new, high-tech electronic registration system. Instead of using a typical paper sign-in sheet collected in a three-ring binder, Jane picked up a stylus to sign in electronically. The system advised her that it would "recognize" her the next time she visited. The system also distinguished her from employees visiting from another work location. As Jane left, she wondered if her clients in ABC Co.'s corporate tax department were aware that the security team was collecting this data. With check-in details readily available electronically, does that enhance the ability of ABC Co. to address cross-border tax matters related to "business travelers"?

By Alex Rubin

Alex is a Technology Director in PwC's IAS practice.

Thanks to constant, fast-paced evolution, new technology tools are being utilized in organizations to address business needs that are not directly related to tax matters. In fact, the implementation of such tools may have never been envisioned to affect tax requirements in any way. For various reasons, technology has advanced at tremendous speed—from handling security and streamlining processes to centralizing vendors, such as travel managers, and matching travel expense claims with where employees are working. Organizations are using technology tools in areas that did not exist just a few years ago. It is important for those responsible for tax matters to be aware of how technology impacts access to information.

Modern communication marvels help employees to collaborate, participate in meetings, and attend events virtually without leaving their office. Yet the global business travel trends show a steady increase in the number of travelers. They are responding to growing business needs, outsourcing, and a general increase in international business.

The governance and compliance concerns arising from business travelers have existed for decades. With these "stealth assignees," project teams, regional employees, and other traveling workers, the reality is that when employees cross geographic borders (intra-nationally or internationally), tax exposures may arise as well as immigration and other legal requirements.

Organizations are aware of these issues in various degrees and within various departments or functions. However, the "ownership" of these issues within an organization is often not clear. And regardless of who owns an issue, assessing risk exposure and managing the compliance requirements require ready access to quality data as well as understanding of the legal regulations. Historically, lack of access to data has often resulted in organizations reaching pragmatic decisions on whether they are able to address the compliance requirements.

Many companies are tackling the cross-border business traveler arena. Their interest in finding a reliable process is expanding, whether as a result of increases in travel volume, more global team projects, an employee detained at the border for a work permit issue, or a significant tax penalty. Data (demographics, legal requirements, etc.) is crucial and time consuming to gather and to understand.

With more employees crossing the country and regional borders, companies are facing an increasingly difficult task of ensuring compliance with the tax, immigration, and other legal requirements. Incorrect filing and failure to meet obligations on the personal or corporate level can lead to penalties imposed by the authorities and loss of business opportunities. To prevent these undesirable situations, it is important to monitor traveling employees and match the statistics for each traveler with the laws of the country and region. Depending on the travel volume, this task if done manually can quickly become extremely burdensome since most organizations do not have excess resources to address this area.

With up-to-date information at their fingertips, companies can effectively manage work requirements, predict taxable events, and take appropriate action to address a specific problem, thereby minimizing financial consequences.

Organizations have various means to gather data. Some leverage their travel management provider, some use their time and expense systems, and some collect travel calendars from employees.

Naturally, easy access to data would reduce the human resources costs and the organization's needs in this area. With up-to-date information at their fingertips, corporate staffs can effectively manage work requirements, predict taxable events, and take appropriate action to address a specific problem, thereby minimizing the financial consequences to the company.

Technology solutions that support tax compliance can facilitate the process of obtaining data needed to address the requirements. Tools such as an automated calendar may aid in the decision-making process. Technology tools automate the routine tasks of tracking compliance requirements and the not-so-routine task of assessing the requirements, such as permanent establishment, considering the data gathered.

Work location tracking and tax compliance analysis

Tax compliance management for companies with frequent business travelers starts with understanding where the travelers are spending work time. Using a calendar tool, the employees enter their location and the activity type. From a tax point of view, the location can be represented as a country or a region, such as a state, canton, or province. Work, travel, vacation, and sick leave are typical examples of activity types. Some calendar tools allow for online use with a computer connected to the Internet or a smart phone.

The company needs to aggregate and review the calendar input from multiple employees to assess its tax requirements. In some jurisdictions, the tax exposure may arise from a group of individuals rather than from a single employee.

Software helps the company to compile data for review. As an example, PwC offers two software solutions for frequent business traveler tracking and tax requirements analysis:

- TravelWatch
- BusinessTravelWatch

The TravelWatch provides complete calendar data synchronization support and reporting. BusinessTravelWatch takes the tracking technology a step further by introducing a link to the tax rules library, wherein travel data is compared against the tax rules and regulations of the employee's home and host locations.

Such software tools present a number of new options to the organization. Employee travel data can be automatically analyzed for taxable events, such as reaching an income threshold. A number of predefined reports are available with advanced features including drill-down. This information facilitates decision making on the tax compliance at the individual (e.g., personal tax returns) or corporate level to address a potential permanent establishment situation.

Various team members within an organization can subscribe to the alerts they are interested in. For example, a weekly summary provides information on employees approaching a change in residency status or on aggregated time spent on a project that raises a permanent establishment concern. Alerts will progressively escalate following a hierarchy defined by the customer.

It is the tax law library link that makes the BusinessTravelWatch unique. The tool comes with a set of standard rules for each supported country. The organization can customize the rules to address its specific corporate situations.

Mobile technology is so widely used, data collected from it can further enhance and extend the tax compliance platform.

Integration with the corporate systems

Other than using a calendar tool, organizations can obtain employee travel data in different ways: security systems, vendors, expense tracking, and project management systems. Each company can choose a unique way of integrating the travel data sources. For example, Company A uses a combination of a travel company interface and employees' manual entry of travel details into the calendar. Company B prefers to override the employee manual calendar entry with the interface from the expense tracking system.

Technology in the marketplace also can help organizations track and analyze business travel data, including PwC's MyTaxes portal. The portal interfaces with the TravelWatch and BusinessTravelWatch tools to gather and analyze business travel data for tax preparation purposes.

Compliance tracking for frequent business travelers is not necessarily bundled with the preparation of personal tax returns. Rather, its main purpose is to provide the information and the instruments for the organization to effectively manage its employer obligations in various jurisdictions. For a broader solution, personal tax return compliance can be supported by the calendar data collected by such technology through the corporate Web portal. Employees fill in their calendars only once. The information is then exchanged by the tax systems and used for business reporting and tax return preparation.

Modern mobile technologies

Today business travelers have little time and patience for routine tasks. Completing the calendar needs to be simple, fast, intuitive, and…yes, fun. The success rate of collecting the calendar data increases if a software solution meets these criteria. A large number of modern corporate business travelers carry a smart phone device or a tablet. Typically, it is one of these four: iPhone, iPad, BlackBerry, or Android.

A calendar entry on the phone can be made while on the road, waiting for a flight, on a train, or during lunch. It can be accomplished in a few seconds and is intuitive. Mobile technology is so widely used, data collected from it can further enhance and extend the tax compliance platform.

The mobile calendar could have:

- a list of favorite travel destinations
- fast travel entry
- at-a-glance view of the entire year
- synchronization with the vendor
- a secure data transmission.

Most smart phones on the market support the Global Positioning System (GPS) feature. The mobile calendar application could have an option to enable GPS to automatically track the user's location. It is important to note that locations are tracked at the tax jurisdiction level, such as a country or a region; software vendors will not store the exact location of each employee.

By pressing the synchronize button, an employee transfers his or her calendar data to the vendor. The data is analyzed and presented to the tax and human resources teams and optionally shared with the tax preparation portal.

The future of tax compliance technology

Today organizations face many challenges in the compliance domain. Technology can be a powerful instrument in answering such questions as:

- Are employees meeting their tax obligations in all countries in which they are working?
- Are employee movements triggering any corporate responsibility for income tax reporting and withholding?
- How do you know when you are at risk of creating a permanent establishment?

Solutions that tightly integrate into a work flow, delivering data to the customer, vendors, and the tax preparer, provide efficient and cost-effective ways for an organization to address tax compliance. Frequent business traveler and assignee data will be collected, processed, and presented based on the rules defined by the company and its tax advisors.

Companies like ABC. Co., where Jane Smythe visited, can use their electronic registration as one type of tool enabling them to track movements.

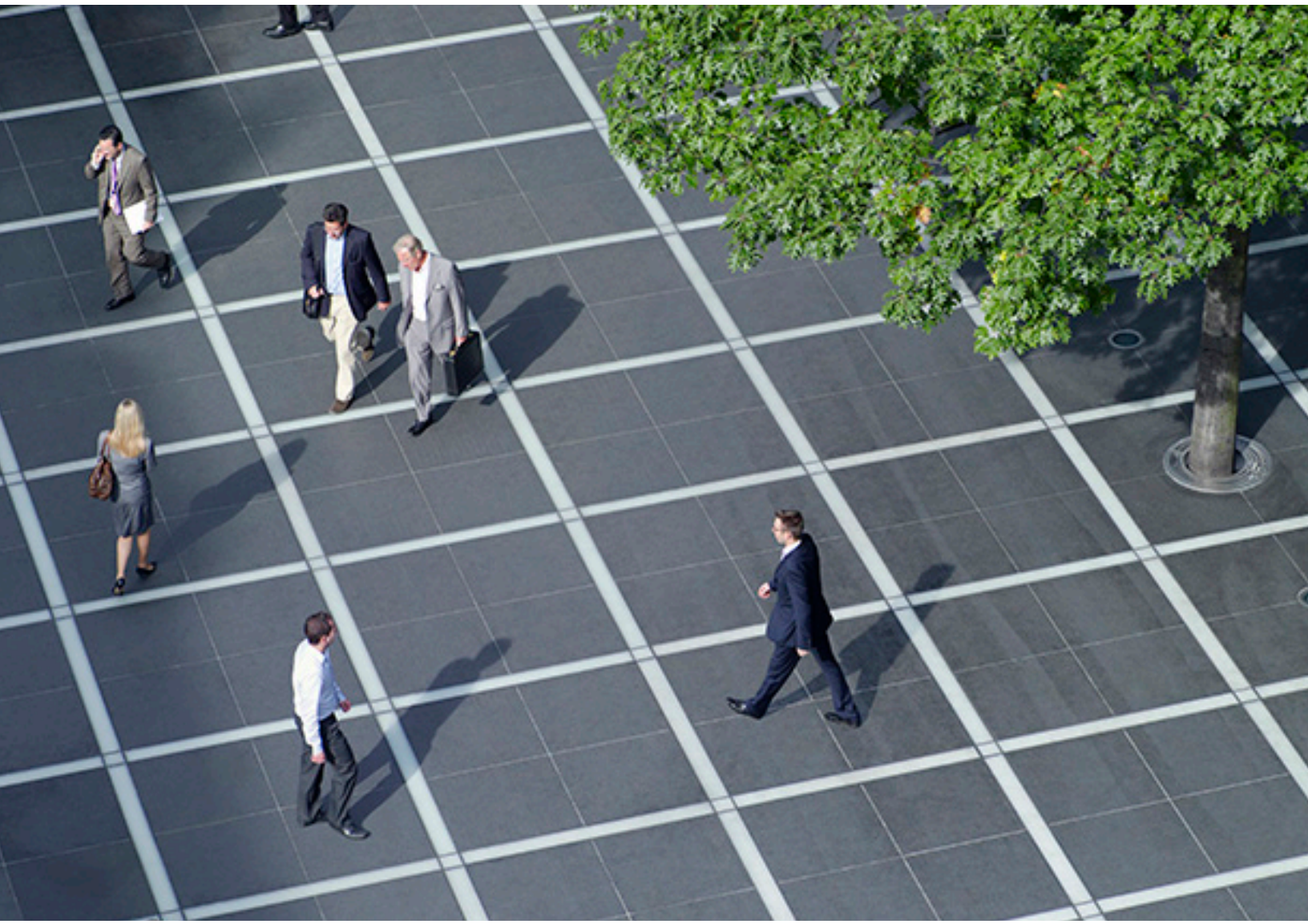
Future technologies will provide even more value, with their ability to predict a company's mobility trends and deliver early warnings on potential tax compliance issues. While cost containment remains in the focus, companies now look for ways to make strategic decisions in this complex area. Technology provides the powerful tools and data required to support organizations' process goals.

Figure 4: Tracking compliance through the cutting edge mobile technology

Blackberry, iPhone, Android

Short-term international assignments:

Maximizing effectiveness, minimizing cost and risk



Despite the precarious state of the global economy, multinational corporations continue to use international assignments as a means to expand into new territories and to maintain competitiveness in existing markets. However, the cost of these assignments continues to be an issue. Long-term postings abroad are increasingly used only in addressing strategic needs, with employers looking to short-term assignments for training, providing specialized skills on project teams, and addressing specific customer needs.

By Philip Miller, Richard A Murray and Girish Shankaran

Philip is a Partner, Richard is a Managing Director, and Girish is a Director within PwC's IAS practice.

There are a myriad of tax laws, as well as Articles in income tax treaties, that present opportunities for employers to minimize the costs of short-term assignments, both in the home and host locations. The tax landscape is continuously changing as countries enact legislation and re-interpret existing tax treaties as a means to increase revenue. This requires constant vigilance on the part of employers to keep abreast of the rules, or risk facing unexpected costs.

This article will address primarily the US income tax rules applicable to short-term assignments, as well as the application of income tax treaties, in particular the concept of "economic employer", which several countries have begun to use in applying the 'Dependent Personal Services' or 'Income from Employment' articles (often found at Article 15 of tax treaties). In addition to tax issues, we will examine policy and process matters as well as planning that employers should consider in managing cost-effective short-term international assignment programs.

Overview of US Tax Rules

The opportunities for tax savings for short-term assignments center primarily on the application of Sections 162 and 132 of the Tax Code. Section 162(a)(2) allows a deduction of "all ordinary and necessary business expenses paid or incurred during the taxable year in carrying on any trade or business", including traveling expenses, and meals and lodging, while away from home in the pursuit of a trade or business. For purposes of the preceding sentence, a taxpayer can typically be treated as being temporarily away from home on business, and thereby avail themselves of deductions for travel expenses allowed under Section 162, if the expected duration of employment away from home in a single location does not exceed one year. The expenses deductible under the rules of Section 162(a)(2) are commonly referred to by tax practitioners as "away from home" expenses.

Away from home expenses

Employers will generally reimburse travel, meals and lodging expenses of employees while they are away from home on business. Travel expenses are normally considered to meet the "away from home" requirement if they are incurred in connection with a temporary business assignment away from an individual's "tax home." Accordingly, determining one's "tax home" is critical in applying Section 162(a)(2). Generally, a taxpayer's "tax home" for purposes of section 162(a)(2) is considered to be located at (1) the taxpayer's regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business, then at the taxpayer's regular place of abode in a real and substantial sense. If a taxpayer comes within neither category (1) nor category (2), he is considered to be an itinerant who has his "tax home" wherever he happens to work, and thus is not "away from home".

Employer-reimbursed expenses meeting the tests under Section 162 are treated as business expenses and are not required to be reported as wages in an employee's Form W-2 under Section 132(a)(3) (as a working condition fringe benefit), if paid under an "accountable plan" (explained later in the article). This treatment avoids the imposition of federal, state and social security taxes on the expenses, prevents application of the 2% miscellaneous itemized deduction limitation that would apply had the employees deducted the expenses on Schedule A of their individual income tax returns, and prevents the related tax gross up costs which would typically be borne by the employer.

The standard for determining whether an individual is temporarily away from home is the taxpayer's realistic expectation regarding the duration of the period of employment, both at its commencement and upon the occurrence of a change in circumstances, as well as throughout the actual duration of such period of employment.

Revenue Ruling 93-86 clarifies "temporary employment" as employment in a single location away from home which is expected to and does, in fact, last one year or less. Employment expected to last more than one year will be treated as indefinite, regardless of whether the employment exceeds one year. If employment away from home is initially expected to last for one year or less, but later, due to a change in circumstances, is expected to exceed one year, then that employment will be treated as temporary until the date of the change in expectation. Conversely, an assignment to a single location that is initially expected to exceed one year cannot be transformed into a temporary assignment if the intent later changes to less than one year, or the assignment in fact lasts for less than one year.

If the assignment to a single location is expected to exceed one year, the location of the assignment becomes the individual's new "tax home", and the employer must report any reimbursed meals, lodging or non qualifying travel expenses for such location (i.e., expenses other than travel from the prior to new work location and transportation of goods and personal effects) as taxable compensation to the employee.

As noted, an employer's payroll obligations for business expense reimbursements or expense allowance arrangements are based on whether the arrangement falls under the 'accountable plan rules'. If these provisions are not met, traveling expense reimbursements or payments are taxable compensation to the employee but may be deductible as itemized deductions on the employees' individual income tax returns.

Example:

To illustrate, assume an individual is on a short-term assignment initially expected to last for eight months. At the beginning of the seventh month, circumstances now require that the employee spend another eight months before completing the assignment. In this scenario, employer reimbursements or per diems for travel, meals and lodging, qualifying under Section 162 and paid under an accountable plan, may be treated as excludable expenses only for the first six months of the assignment. Taxable compensation to the employee will result for any reimbursements for expenses incurred from month seven. Conversely, if a temporary assignment expected to last more than one year is terminated at the end of the seventh month, any reimbursed expenses in or to the host location must be recorded as compensation, as the original intention was that the assignment would exceed one year.

More than one 'regular' place of business

As mentioned, excludable 'traveling' expenses typically apply only while an individual is 'temporarily' away from their tax home. The question arises, however, where an individual regularly has more than one place of business and the arrangement is expected to exceed one year. For example, assume a taxpayer's regular job requires that he work in Boston three weeks per month and in Montreal the remainder, and that such arrangement is expected to last for several years. In such a case, is the taxpayer permitted to deduct travel expenses to Montreal? As mentioned, though the definition of 'temporary' for these purposes had historically been unclear, a one-year standard for the maximum period away from home was implemented by Revenue Ruling 93-86, 1993-2 CB 71. Prior to this ruling, several cases and rulings generally concluded that a taxpayer with more than one regular place of business may deduct the expenses of traveling to the minor post of duty.

Since then, we are not aware of any authority which has directly examined the deductibility of expenses for an individual with a principal place of business and a second regular place of business except for that provided in Revenue Ruling 99-7, IRB 1999-5. This ruling addressed, in part, the issue of transportation expenses of going between a taxpayer's residence and another work location where the residence was the taxpayer's principal place of business within the meaning of Section 280A(c)(1)(A).

Particularly important is the conclusion that such expenses were considered deductible, "regardless of whether the other work location is regular or temporary". Therefore, the ruling did provide that the 'temporary' requirement ordinarily required for Section 162 traveling expense deductions was not necessary for a taxpayer who had a principal place of business but who also regularly traveled to a second location for business purposes. However, the ruling did only examine the issue in relation to an individual whose primary place of business was his home.

Though the general rules do provide that the 'temporary' (i.e., maximum one-year time length) requirement be met for expenses to be deductible to a location away from the individual's tax home, Rev. Rul. 99-7 did provide an exception to this rule where a taxpayer has a major and minor post of duty. Given the acceptance in the ruling for a taxpayer's deductible travel expenses to a regular (i.e., not temporary) work location away from the individual's tax home, the one-year rule appears to be intended to provide a specific limit whereby the taxpayer's 'tax home' shifts if the taxpayer works a majority of time in a new location. In this example, the employee's minor work location is Montreal, so based on Rev. Rul. 99-7 it may be argued that the one-year limitation was not intended to apply. However, since no specific guidance appears to be available, the deduction of expenses for the employees' travel to and from Montreal may be subject to challenge.

Accountable plans

As indicated on the previous page, payments made to an employee as reimbursement for travel, meals and lodging while temporarily away from home on business within the meaning of Section 162(a)(2) may be excluded from the employee's compensation under Section 132(a)(3) provided that they meet the requirements of an "accountable plan", as defined in Treasury Regulation 1.62-2.

Amounts paid under an arrangement that meets the following requirements would be treated as paid under an accountable plan:

- Expenses must have a business connection. That is, the expenses must have been paid or incurred while performing services as an employee for your employer.
- The employee must adequately account to the employer for expenses within a reasonable period of time (i.e., substantiation).
- The employee must return any excess reimbursements or allowance within a reasonable period of time.

The definition of reasonable period of time depends on the facts and circumstances of each situation. However, the IRS has provided "safe harbor" guidelines as to what actions support a treatment as occurring within a reasonable period of time as follows:

- An employee receives an advance within 30 days of the time an expense was incurred.
- An employee adequately accounts for the expenses within 60 days after they were paid or incurred.
- An employee returns any excess reimbursements within 120 days after the expense was paid or incurred.
- An employee is provided a periodic statement (at least quarterly) by the employer, requesting that the employee either return or adequately account for outstanding advances, and the employee complies within 120 days of the statement.

The requirement that an employee substantiate by adequate records the amounts excluded from income under IRC Section 132 and the accountable plan rules is codified in IRC Section 274(d). Such substantiation must include the amount of the expense, the time and place of travel, entertainment or other expense, the business purpose of the expense and the business relationship of the taxpayer to the persons entertained.

Per-diem allowance

The regulations under Section 274 allow the Commissioner to establish a method allowing a taxpayer to treat a specific amount as paid or incurred for meals and incidental expenses while travelling away from home instead of substantiating the actual cost.

The IRS has established a per diem allowance that may be used by a taxpayer as substantiating the amount of lodging, meals and incidental expenses while away from home on business. The benefit of **per diem allowances** is that the 'amount' substantiation requirement is deemed met, however, it does not allow for avoidance of other substantiation requirements (e.g., date, location, business purpose). Under Rev Proc 2010-39, the term per diem allowance is a payment or reimbursement or other expense allowance arrangement that is:

- Paid for ordinary and necessary business expenses incurred, or are reasonably anticipated to be incurred, by an employee for lodging, meals and incidental expenses, or for meals and incidental expenses, for business travel away from home,
- Reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and
- Paid at or below the applicable federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

Tax planning is increasingly becoming a significant component for multinational companies using short-term international assignments.

Note that a per diem arrangement meets the requirements of Section 274, only if the employee is required to return to the employer within a reasonable period of time, any portion of a per diem allowance that relates to unsubstantiated travel days. That is, although a detailed accounting of expenses is not required, the taxpayer must nevertheless provide adequate documentation to the employer, as required under Section 274, substantiating that the employee was in fact on business travel during the period for which a per diem allowance was received. Failure to do so would require that the employer record as compensation the per diem paid for any days on which the employee has not substantiated their business travel.

Income tax planning

Tax planning is increasingly becoming a significant component for multinational companies using short-term international assignments. Although business needs tend to be addressed before tax issues are considered, current trends indicate that tax and/or financial consequences are given equal consideration by many businesses. Often, tax advisors are brought into the discussion after the individual has already spent some time in the host location, which minimizes the potential tax planning opportunities due to lack of timely action. This section will cover various facets of tax planning for these assignments and the resultant benefits.

Structuring the assignment letter

As referenced in the earlier sections of this article, certain expense reimbursements and federal approved per diem allowances can often be provided tax free to the individual provided the assignment in a single location is expected to last, and in fact lasts, for up to a year. Such intent should be corroborated through appropriate language in the assignment letter indicating the expected length of the assignment. In structuring the tenure of the assignment, assuming it is in alignment with the overall business objectives, employers may want to consider initiating a short-term assignment to reduce tax costs. This could translate into savings of Federal, State and other payroll taxes on traveling expenses, including employer and employee portions. These savings on a grossed up basis can be in the range of 45–50% of the allowances/reimbursements.

Note that if the assignment is intended to be long-term (in excess of a year), the taxable expenses may be offset by foreign tax credits, or may possibly even be eligible for Section 911 exclusion which could yield a more beneficial result than a short-term assignment. These situations need to be analyzed on a case to case basis.

The implications on the host country side should be weighed and one should investigate whether the foreign country has a similar concept of short-term assignment rules. For example, the United Kingdom has somewhat similar rules known as "detached duty relief" for assignments that are intended to last for up to two years. In such a situation, the allowances/reimbursements derive a global tax-free benefit, thus, generally worth the planning for most assignments. However, if the host country taxes these payments, and assuming the host country effective tax rate is equal to or higher than the US rate, assignment planning may not yield the desired tax benefits.

Maximizing use of per diems

As noted in this article, employers can effectively use per diems to treat housing, meals and incidental costs of their short-term assignees as substantiated in terms of amount. Foreign per diem rates involving most countries and major cities are published by the US Department of State, which is also the maximum amount that can be treated as automatically substantiated in terms of amount to an individual under the accountable plan rules. The published per diem rates are often generously determined, and can generally sufficiently accommodate the assignee's costs for subsistence in the host location. There are several advantages of paying per diems versus other accountable plan alternatives:

- It alleviates the administrative need to substantiate the amount reimbursement claims.
- Does not block resources to perform the above tasks, especially when a company has a high volume of short-term assignees.

- As per diems are part of the accountable plan rules prescribed by the IRS, they can be provided tax free.
- Employers can also provide housing by paying the lease directly to the landlord (for example, or reimburse the employee for housing costs incurred even if in excess of published per diem rates), and a per diem for meals and incidentals. Per diems are broken into two components so this split is possible.
- Employee reimbursements versus costs for family members

In the current environment, it is common for companies to shift their strategy from the traditional 3–5 year international assignment to shorter durations (e.g., anywhere from 3–6 months to up to a year). Given the duration of these assignments, in rare situations family members will accompany the employee. However, employers will often reimburse the employee for expenses associated with trips made by family members.

As stated above, the general advantage of an individual being "away from home" on a short-term assignment is that certain payments or reimbursements are deductible or excludable for US purposes. Note, however, that the family members are not typically considered to be temporarily away from home in pursuit of a trade or business. So, any expenses reimbursed in relation to the family members are typically taxable as personal expenses of the employee. Quite often this is missed by employers and the tax costs related to employee travel and living costs are not appropriately accounted for up-front.

Host country planning

In planning for tax savings, it is important to consider both the home and host tax jurisdictions. In doing so, in many countries, the nature of the compensation element determines the taxability. For example, predominantly in Asian countries, housing is taxed at a preferential rate if the lease is entered into by the company, and the rent is paid directly by the company to the landlord. So, if there is no similar short-term assignment concept in the host location, the structuring of the compensation may be key in reducing the tax exposure. Although a per diem allowance may appear beneficial from a US point of view, this could generate a host country liability, as such the whole purpose of a per diem delivery may be defeated. These factors should be given due consideration in devising the individual's compensation package.

Application of Income Tax Treaties for Short-term Assignments

Background

The Organization for Economic Co-Operation and Development (OECD) consists of 33 member countries, including the United States, most European countries, and various other developed countries such as Australia, Japan, Korea, Mexico, New Zealand, Israel and Chile. The OECD's goals are to promote economic stability and democracy in its member countries and in developing countries. Consistent with these goals, the OECD published a Model Tax Treaty in 1963. This Model Treaty was substantially revised in 1977 and has since been updated to a lesser degree several times over the years. This OECD Model is an important reference for tax practitioners and governments, as the OECD updates and commentary have significant influence on countries entering into discussions to amend existing Treaties.

Article 15 of The OECD Model, the "Income from Employment" Article, contains rules governing the taxation of short-term business travellers. Similar articles, often titled 'Dependent Personal Services' have been adopted, with slight variations, by most, if not all, countries entering into bi-lateral tax treaties. For purposes of this article we refer to these as 'DPS'. The United States also has a Model Treaty that serves as the basis for the Treaties it negotiates and which should be used as the primary reference source for interpretation of US Treaties.

The DPS Articles of the OECD and US Model Treaties set forth an exception to the general rule that employment income may be taxed in the State (i.e., country) where the employment is exercised. Under paragraph 2, the State where the employment is exercised may not tax the income from the employment if three conditions are met as follows:

- the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the taxable/ fiscal year concerned;
- the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
- the remuneration is not borne by a permanent establishment which the employer has in the other State.

The United States has adopted the language above in some Treaties. With respect to paragraph (a), some older treaties may contain "in any fiscal or calendar year" rather than "in any 12-month period commencing or ending in the fiscal year concerned". More recent treaties have typically adopted the "rolling 12-month period" as the relevant test. In addition, it is important to check the specific language in Treaties as some older Treaties may contain a different days threshold than "183 days" referenced in (a) above. Throughout this Article, "183 days" will be cited as representing the relevant period.

In applying the DPS Article, it is important to keep in mind the general requirement that in order to apply a Treaty, an individual must continue to be a tax resident of the "home" country. For example, an individual holding himself out as a nonresident of Germany could not apply the DPS Article under the US/ Germany Treaty to avoid US tax.

Application of DPS Articles

Over the years, it was commonly interpreted that if a resident of a Treaty country spent less than 183 days in another Contracting State, and conditions (b) and (c) above were met, that the individual concerned would be exempt from tax in the other Contracting State under the DPS Article of the Treaty. In these situations, it was often reasoned that if the "formal" or contractual employment relationship remained in the home location, so long as the compensation expenses were not charged to the host location, and the employee did not exceed the 183 day threshold, the employee would not be subjected to tax in the host location. In applying paragraph 2(b), it was commonly accepted that the formal or contractual employment relationship was the relevant employment test in satisfying the condition that "the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State". For short-term business travellers, the operating rules to avoid tax became (a) keep presence under 183 days, (b) keep the employment contract with the home country, and (c) don't charge costs to the entity receiving services.

The intent of the DPS Article was to allow for a reduced host country tax burden for an employee undertaking business travel on behalf of his home country employer. It was not intended to provide tax relief for short-term assignees working for the benefit of a host country employer. The misapplication of the DPS Article in Treaties led to issuance of commentary by the OECD on the application of Article 15 of their Model Treaty referred to on the next page.

The changing landscape—economic employer

In recent years, treaty countries have taken a fresh look at the DPS Article, particularly paragraph 2, in ensuring that the Article is being applied as intended. Interpretations contrary to the intent of DPS articles have often occurred due to the perceived definition of the 'employer'. Several countries have advanced an argument that the formal, or contractual employer, is not always the relevant employer for purposes of applying DPS. Rather, that if an employee provides services which are "an integral part of the business activities" of an enterprise, that such enterprise was the "economic employer" and that this is the relevant employer in determining application of paragraph 2(b) of DPS. Under this approach, a tax exemption under DPS would not be granted in the county in which the economic employer exists, since this would fail the test under paragraph 2(b) of Article 15.

This activity led, on March 12, 2007, to the OECD issuing a revised draft of changes to the commentary on Paragraph 2 of Article 15 of the Model Treaty. These changes were subsequently incorporated into an update to the OECD Model Treaty in July 2010.

The most significant revisions are as follows:

- Commentary suggesting a direct relationship between paragraph 2 of Article 15 to Article 7, relating to permanent establishment. Article 7 is based on the principle that an enterprise of one contracting state should not be taxed in the other state unless their business activity rises to the level of permanent establishment. The exception of paragraph 2 in Article 15 (i.e., exemption from host country tax) extends this principle to the taxation of employees who carry out business activities for a relatively short period of time. Subparagraphs 2 and 3 of Article 15 make it clear that the exception is not intended to apply where the employment services are rendered to a resident company or to a permanent establishment in country.

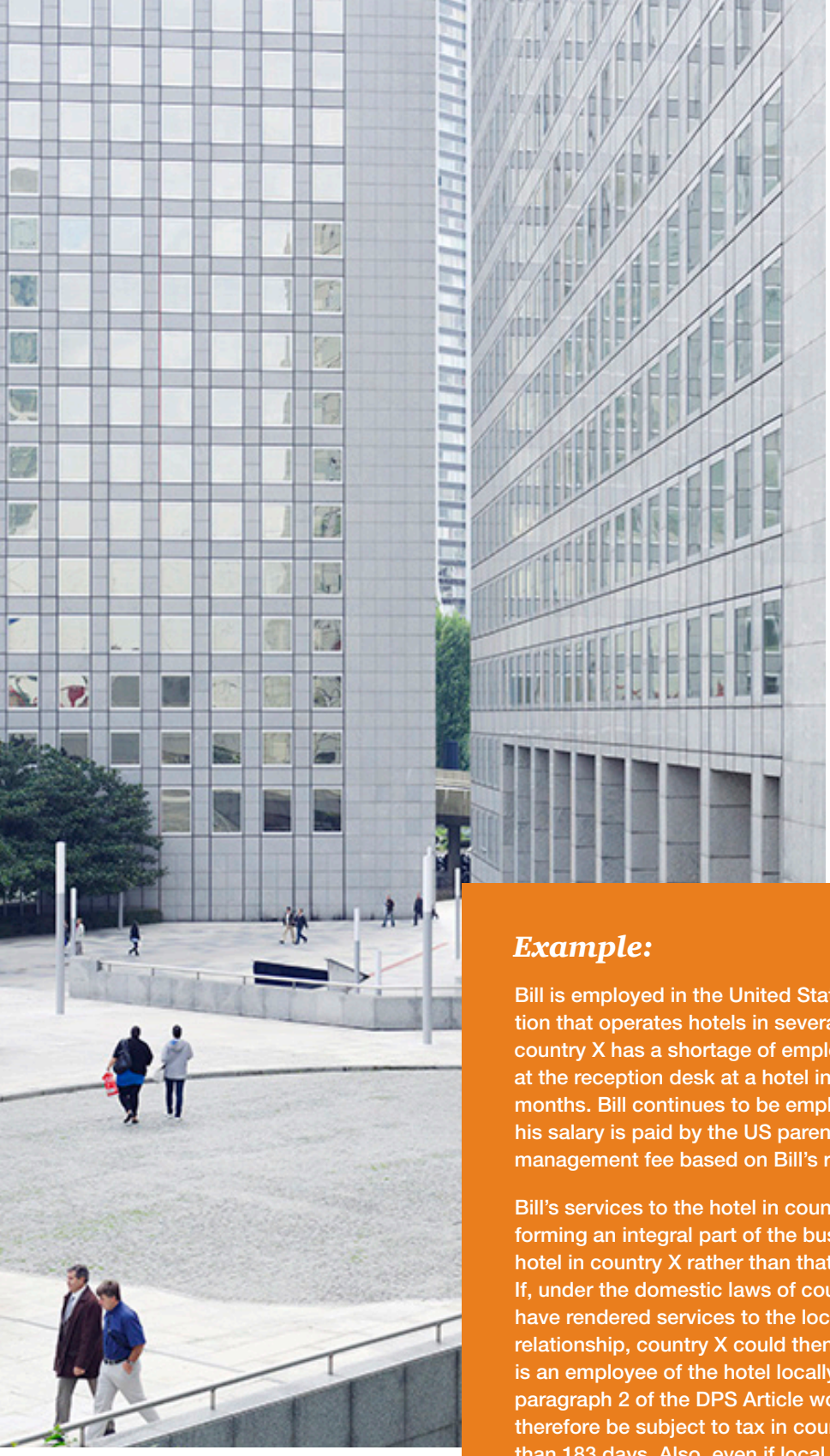
- Unless the context of the particular Treaty requires otherwise, it is a matter of domestic law of the country in which services are rendered to determine whether services are provided in an employment relationship. *That determination will govern how that country applies the Treaty.* This is subject to the limit that a country could not argue that an employment relationship exists where, under the relevant facts and circumstances, it clearly appears that the services are rendered under a contract for services concluded between two separate enterprises. Similarly, a country could not deny employment status in cases where an enterprise formally employs an individual.

- An individual's formal or contractual employer is not always the relevant employer under par. 2 of Article 15. Employment may be deemed to exist with en entity even if services are provided under a formal employment contract with another entity.

- Even absent a determination of employment under domestic law of the country applying the Treaty, paragraph 2 of Article 15 must be interpreted according to the object and purpose of paragraph 2. Some countries note that it would be contrary to that object and purpose to provide a tax exemption for what is in substance the ordinary work force of an enterprise within a country.

- In determining whether services are rendered in an employment relationship rather than under a contract for services, the nature of services rendered is important. It is logical to assume that an employee provides services which are an integral part of the business activities of an employer. For this purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work.

- Where an examination of the facts indicates an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:
  - Who has authority to instruct the individual regarding the manner in which the work must be performed;
  - Who controls and has responsibility for the place at which the work is performed;
  - The remuneration of the individual is directly charged by the formal employer to the enterprise to which the service are provided;
  - Who puts the tolls and materials necessary for the work at the individual's disposal;
  - Who determine the number and qualifications of the individuals performing the work.



Where a formal employee of one enterprise provides services to another enterprise, the financial arrangements between the two enterprises will be relevant, although not necessarily conclusive. A charge of actual salary and benefits with no profit element would suggest a direct charge by the formal employer. However, if the fee charged bears no relevance to actual expenses and is at arm's length, this would suggest a contract for services and imply that the employment relationship remains with the contractual or formal employer. It should be noted that a direct charge of expenses from the formal employer is only one of the *subsidiary factors* in determining the employment relationship.

Example:

Bill is employed in the United States for a multinational corporation that operates hotels in several countries. A subsidiary in country X has a shortage of employees so Bill is sent to work at the reception desk at a hotel in country X for a period of five months. Bill continues to be employed by the US parent, and his salary is paid by the US parent. The parent charges X a management fee based on Bill's remuneration.

Bill's services to the hotel in country X may be viewed as forming an integral part of the business activities of operating a hotel in country X rather than that of the US parent's business. If, under the domestic laws of country X, Bill is considered to have rendered services to the local hotel in an employment relationship, country X could then logically conclude that Bill is an employee of the hotel locally, and the exception under paragraph 2 of the DPS Article would not apply. Bill would therefore be subject to tax in country X, even if present for less than 183 days. Also, even if local law did not consider Bill to be an employee of the local hotel, he could nevertheless fail the test under par. 2 since he is part of the ordinary work force of the hotel and it is contrary to the object and purpose of the DPS Article to provide a tax exemption in such cases.

Arms length pricing and permanent establishment issues

Generally, the approach being taken by Treaty countries in adopting an "economic employer" test in applying DPS is that business travellers whose services are integral to the business activities in their home country will benefit from a tax exemption under DPS. Examples would include an executive attending management meetings, or exercising management oversight functions requiring business travel. Conversely, an employee sent on a four-month assignment as part of a project team to service a customer of a foreign subsidiary would likely fail the necessary test under DPS and be subjected to tax in the host location, as their activity would likely be considered as being integral to the business activity of the host enterprise.

The OECD commentary contains several examples that illustrate that services may be rendered pursuant to a service agreement in which arms length pricing is used, and meet the requirement for tax exemption under DPS. In one example, Aco concludes a contract with Bco to provide computer software training to employees of Bco. Aco is specialized in the provision of computer software training. Employees of Aco sent to provide such training are exempt from tax under Article 15 provided they spend less than 183 days in the host country in any 12 month period, as their services are provided pursuant to Aco's contract with Bco, and such services are an integral part of the business activities of Aco. Also, for the tax exemption to apply, Aco cannot be deemed to have a permanent establishment in Bco which bears the cost of the employee's remuneration. If a permanent establishment existed, the employees of Aco would fail the test under paragraph 2(c) of Article 15.

The adoption of an economic employer test makes it more difficult for an employee to gain tax exemption under DPS. If the employee provides services "which are an integral part of the business activities" in the host location, it is likely that countries following an economic employer approach will deny Treaty exemption under DPS. If, on the other hand, the activities undertaken are also integral to the business activities of the transferring enterprise, and a contract for services with arms length pricing is put in place, the tests under DPS may be met. However, the transferring enterprise may increase the risk that its business activities may rise to the level of permanent establishment in the receiving location. If a permanent establishment is deemed to exist, the employee would be subject to tax as they would fail the test under paragraph 3(c) of the DPS Article.

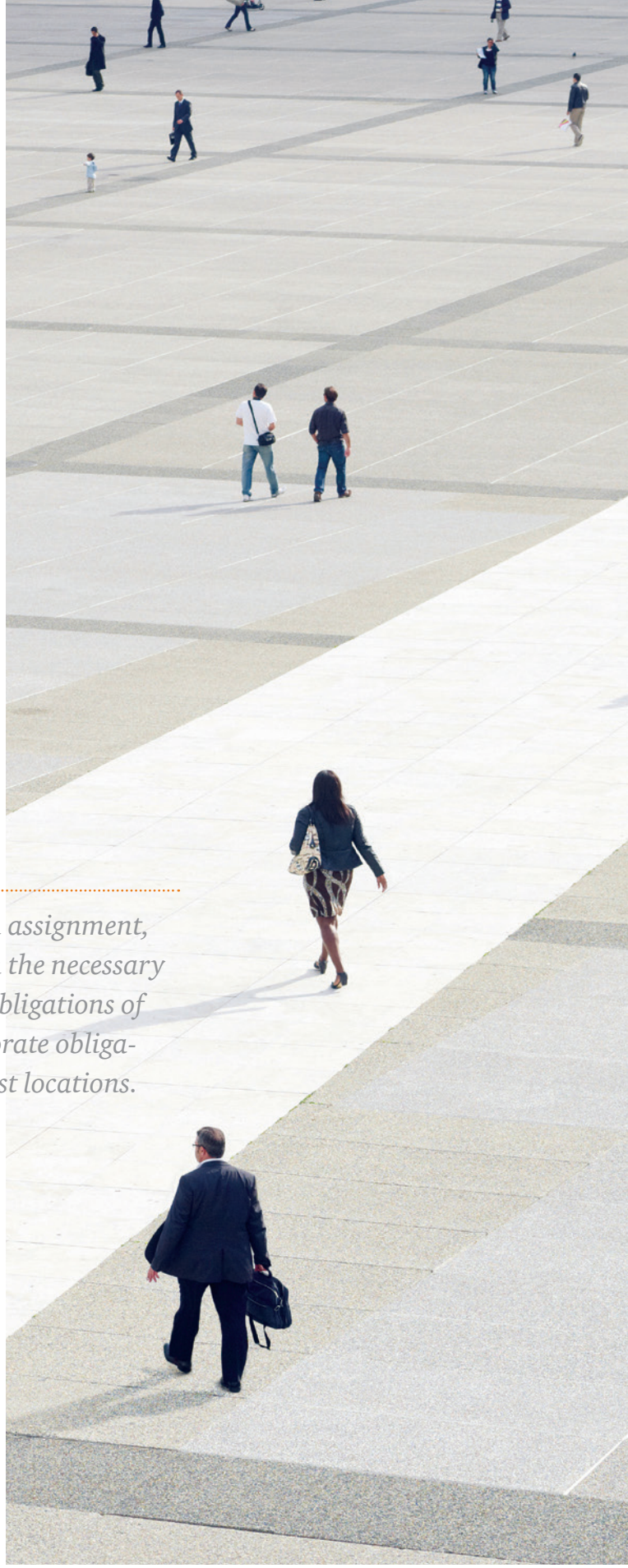
Chargeback of salaries

As discussed above, although not intended under the Treaty, the commonly held belief prior to the advent of "economic employer" was that DPS would apply to eliminate tax for short-term business travellers so long as an employee did not exceed the 183 day threshold and there was no chargeback of salary expenses to the host location.

Given the changing landscape, employers must be more aware of the relevant factors in determining which entity is considered to be the employer under the DPS Article. Even in countries that do not apply the "economic employer" concept, such as the United States, the result should be the same—that the entity benefiting from services performed is entitled to a tax deduction for the related compensation and is considered to be the employer under the DPS Article. In such circumstance, the employee would be subject to host country tax.

The issue of salary chargebacks must be carefully considered, as it is possible that an employee may be denied the tax exemption under DPS *even if their salary charges remain on the books in their home country.* The OECD commentary cites the salary charge as only a *subsidiary factor* in determining whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services between two enterprises.

If an employment relationship is deemed to exist in the host location and the services are *not rendered under a contract for services*, it is in the interest of the sending location to pass the salary charge to the enterprise receiving (benefiting from) the services. Otherwise, there is risk that the home country tax authorities may deny a corporate tax deduction for the salary expense, since the revenue being generated from the employee's services is not being subjected to tax in the home country.



The way forward

The heightened awareness created by the OECD draft commentary in March 2007 on the DPS Article and subsequent application in the 2010 update to the Model Treaty creates a new area of risk for employers. In addition to the potential tax liability that may be incurred by its short-term business travellers, employers may face increased tax compliance, including host country reporting and withholding on salary payments. Caution must be exercised in attempting to structure around the problem through the use of service contracts, as this may not always solve the "employer" question, and may lead to the creation of a permanent establishment with corporate tax implications.

Prior to sending an employee on a short-term assignment, it is incumbent upon the employer to perform the necessary due diligence to determine the potential tax obligations of their employees, as well are any related corporate obligations for reporting and withholding in the host locations.

It should be noted that if the employee incurs a host country tax liability, this may not necessarily represent an increased tax cost for the employer. This is because a foreign tax credit would likely be allowed in the employee's home country tax return, thereby eliminating double taxation. The employer should have policies in place to recover the benefit of this credit if they are funding the employee's foreign tax obligation.

Prior to sending an employee on a short-term assignment, it is incumbent upon the employer to perform the necessary due diligence to determine the potential tax obligations of their employees, as well are any related corporate obligations for reporting and withholding in the host locations.

Policy and Process Considerations

Armed with an understanding of the items above, short-term assignments often fail, or at least are not as tax effective as planned, if the following are not built into an employer's standard process for administering these assignments.

Despite the existence of a robust network of tax treaties, employees on short-term assignments will often be subject to a host country tax liability.

Formal, written policy document

Having a written, formal short-term assignment policy document goes a long way in ensuring there is consistency between, and clear communications with, employees and also increases the likelihood of successful implementation of up-front home and host country tax planning. Topics typically addressed in written policies include:

- Assignment allowances provided, including per-diems, location premiums, host country housing and transportation, etc.
- Relocation support, including shipment of personal effects
- Accompaniment of family members
- Number of home leaves and class of airfare
- Home and host country tax matters (e.g., who will fund any host country tax liabilities, tax equalization, etc.)
- Business conduct and compliance
- Repatriation matters

In addition to a broader policy document, there should be a formal assignment letter between the employee and the company including items such as:

- His or her specific duties while on assignment (think of the economic employer principles discussed above)
- Compensation details
- Employing entity while on assignment
- To whom this individual reports while on assignment
- Expected duration of the assignment
- Specific repatriation location and duties upon returning, etc.

Coordination with Payroll personnel

It is essential that the appropriate home and host country payroll personnel are involved in planning for short-term assignments.

Assignment allowances, such as per-diem reimbursements, are often paid through the **home** country payroll. As most short-term assignees remain on the home country payroll during their assignment, the home country payroll group must be informed of the nature of the assignment and payments to effect the proper payroll reporting for these. For instance, for a given assignment, Payroll will need to understand whether the per-diems will or will not be considered taxable to the employee.

Similarly, many host countries will require withholding of income taxes through a local payroll. This will not only require that the host country payroll personnel are informed of the assignment and the payroll particulars, but they will also need to understand the other reimbursements the employee is receiving (e.g.,housing, meals, home leave, etc.), as these may well be considered taxable in the host country, even **if they are not taxable in the home country.**

Host country tax liabilities

Despite the existence of a robust network of tax treaties, employees on short-term assignments will often be subject to a host country tax liability. As the employee typically does not break residence in their home country, they will generally continue to have actual home country tax withholdings taken from their payroll. As such, and to further ensure compliance with host country tax laws, generally the employer will fund any necessary personal host country tax liability related to the assignment. Two important things happen next.

First, this host country tax reimbursement will be considered taxable compensation to the employee in both the home and host country. This, again, requires coordination with both payrolls, as the income not only needs to be reported, but also "grossed-up" so that the employer is not only funding the host country tax payment, but the tax on that reimbursement, as well.

Second, as the employee will generally not break residence in his/her home country, there will often be taxation in both countries on the same income.

The individual will generally be allowed a foreign tax credit for the host country taxes paid on the home country return—resulting in a reduced home country tax liability due to the employer-paid host country tax. Therefore, in order to avoid unintended employee windfalls, it is important to address, and communicate clearly, whether the expectation is that the foreign tax credit benefit will be returned to the employer. If so, a process must be put in place to record, track and collect this employee receivable.

Alternatively, the employer can generally modify the withholding on home country payroll items by accounting for the expected foreign tax credits through appropriate payroll documentation, thereby minimizing excess withholding and consequently avoiding unnecessary windfalls.

To ensure compliance with home and host country tax laws and filing obligations, as well as to assist with the implementation of the employer's policy around collecting tax refunds (or tax equalization in general), employers will usually engage an international tax firm to assist with these processes.

Immigration matters

It goes without saying that companies should seek qualified legal immigration counsel with respect to any short-term business traveller or short-term or long-term international assignment. In addition to the reputational and personal risks of an incorrect visa, there are often tax planning strategies available for individuals on certain types of visas, such as for F and J visa holders on assignment in the US, which may reduce assignment costs for the employer.

Stealth assignees—business travellers

As companies seek to increase overall corporate compliance, an almost universal focus over the past several years has been establishing a process to comply with individual and corporate tax laws associated with business travellers—both international and interstate. The problem is that a solution involves many layers, and most are difficult to achieve.

In attacking the problem, first, a company MUST have a mandate from the highest levels within the organization that compliance with tax obligations associated with business travel is mandatory, and that non-compliance will not be tolerated.

Second, employees will need to be advised to keep a contemporaneous log of their business travel. This travel data needs to be provided or linked to an individual or a system that understands the rules and can apply the necessary withholdings and/or reporting. For interstate business travel, many companies use a time reporting system linked to their payroll to capture employees' travel and effect the necessary withholdings. International business travel is often more difficult, given the various host country withholding and reporting requirements, the number of payrolls and payroll personnel involved, etc. Given these challenges, some companies will summarize and evaluate employee travel data on a regular basis (monthly, quarterly) in order to reasonably comply with applicable withholding and reporting requirements.

There are a few firms pursuing a high-tech solution for capturing and applying the data—and this will continue to evolve. For now, most companies apply a rigorous, and somewhat manual, process around the steps above to meet the compliance obligations of their business travellers.

Finally

Planning for, and administering, effective and efficient short-term international assignments is challenging. Some of the keys to success are to:

- Understand the home and host country tax rules, some of which are discussed on the previous page.
- Establish a formal short-term assignment policy to minimize exceptions and foster consistency and clear communications.
- Establish communications between the business units, Tax, HR, legal, Payroll, etc. early in the assignment planning process, as well as when any assignment extension is contemplated.
- Establish a process owner for these assignments—someone with responsibility and authority.
- Periodically evaluate the existing processes for adherence and improvement.

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