Cooperative compliance: The new frontier for global mobility programs

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Executive summary

Pursuing cooperative compliance for cross-border employee mobility tax obligations can yield cost savings, enhanced efficiency and risk reduction.

An expanding number of employees are crossing borders to work on short-term assignments or by engaging in frequent business travel. When they do, tax compliance obligations arise for both the employer and the employee that can trigger the need for payroll tax reporting and remittance as well an obligation to file individual tax returns in the host location.

But there is a growing trend for some tax authorities to eliminate these individual income tax filings as long as taxpayers pay the proper amount of tax owed through the employer's payroll withholding system. These cooperative compliance arrangements can achieve significant benefits for both parties.

Concept already in practice and growing

The general concept of cooperative compliance has been a growing area of discussion for many years. It was initially referred to as 'enhanced relationships,' but was rebranded as cooperative compliance in 2013 by the Organization of Economic Co-operation and Development (OECD). The concept is broadly viewed as an exchange of greater upfront transparency by the taxpayer in return for more certainty from the tax authorities. Reduced compliance costs and efficiencies often result due to the better utilization of resources by both parties.

Tax authorities in many countries have implemented, or are taking steps to implement, their own customized approach of cooperative compliance to streamline tax processes for cross-border employees. While it can be accomplished by expansion of domestic legislation, many countries formalize cooperative compliance arrangements in some kind of written agreement with taxpayers, such as a special ruling or dispensation from the tax authorities or a formal cooperative compliance agreement. A recent survey by PwC of 60 countries found that a significant portion of such jurisdictions had the potential to immediately negotiate an agreement to streamline mobile employee compliance in some way.

Taxpayers can reap significant benefits from these types of arrangements even beyond the cost savings from the elimination of certain tax return filings and greater certainty with respect to related tax obligations. Among other benefits, taxpayers may enhance their reputation as a 'transparent' taxpayer and leverage enhanced efficiencies to support the company's expanding number of mobile employees going forward.

Pre-requisites for taxpayers

Under a cooperative compliance agreement, companies must gain approval from their respective tax authorities on the completeness of their tax compliance framework in order to eliminate the requirement to file individual tax returns for certain mobile employees. This generally means that a company must employ a hyper-accurate and robust global compensation withholding and reporting system—a potentially high bar for employers depending upon their sophistication. Companies must also properly assess any potential negative risk with a cooperative compliance agreement before deciding to enter into one.

Factors that are fueling this new trend

Global talent shifts

Multinational companies are sourcing talent from around the world to find the right skills and capabilities to meet global business needs. This likely triggers a higher demand for employees and executives crossing borders, particularly on short-term assignments or by engaging in frequent business travel. The result is that companies will likely face a potential explosion of mobile employees triggering foreign tax compliance both on the individual and corporate level. This will require a significant increase in administration, tracking and expenses related to tax return compliance and expatriate management.

Targeted tax audits on global businesses

Global businesses are also managing an expanding number of tax audits concerning international tax issues for mobile employees. Most notably, employees on short-term assignment or those that engage in frequent business travel are being increasingly scrutinized because their activity and their physical presence can trigger unexpected personal and corporate level tax liabilities. Tax authorities on both the federal and local levels could be seeing this fast-growing population as a way to obtain greater tax revenue.

Those employees engaging in frequent business travel are difficult to track because they are often not part of a formal mobility program. Multinational companies are seeking technology to help automatically record employees' locations, for example, through their mobile devices. They are also looking for ways to gain greater certainty and less risk with respect to the resulting tax liabilities and obligations.

Rising administrative complexity

Depending on the country, filing individual income tax returns has generally become more difficult because the tax rules are more complex and time-consuming. For example, the length of the instructions to prepare the US Form 1040NR U.S. Nonresident Alien Income Tax Return (over 75 pages) is an indication of the form's complexity. According to the US Internal Revenue Service, average preparation time for this return is 12 hours. Moreover, many countries have added new reporting requirements such as the disclosure of the individual's ownership of foreign bank accounts or certain other foreign ownership interests.

Companies managing the cost of filing returns for mobile employees are aggressively seeking ways to manage this cost. For cross-border employees who perhaps only owe a small amount of tax in the host country jurisdiction (because they are present in the country for only a short period), the time and cost to file these returns can be particularly burdensome. In some cases, employees are not present in the country long enough to complete the income tax formalities required to file an income tax return, such as completing a tax registration process or obtaining a tax ID number.

Governments doing more with less

Fiscal deficits are casting a long shadow for many governments forcing tax authorities to seek greater revenue but with smaller administration budgets. Tax authorities are seeking creative ways to 'do more with less'—tackle the administration of increasingly complicated tax principles, increase revenue collection, and maximize efficiencies. They recognize the need to pursue opportunities such as increasing their cooperation with taxpayers, concentrating their resources on more high-risk taxpayers and issues, and becoming even more reliant on a self-assessment system.

Some country-specific examples

In the global mobility arena, many countries are currently embracing this cooperative compliance movement while still others are taking steps towards this goal. Roughly 40 countries are working towards approving legislation or processes in this regard. Others have moved in this direction in an informal manner.

The following are examples of countries that have already engaged in cooperative compliance agreements with multinational companies, producing efficiencies and certainty over tax liabilities for both tax authorities and taxpayers alike.

United Kingdom

The UK tax authorities and a multinational company may enter into a formal agreement under UK legislation to pursue 'real time information processes.' The arrangement typically covers short-term assignees (e.g., working in the UK for three to nine months) and who have UK and foreign source income below a certain threshold amount. These assignees need not file a UK individual tax return nor obtain UK tax identification numbers. Instead, the employer agrees to remit all of the proper UK income tax relating to their employment via a modified PAYE payroll agreement based upon the company's in-house payroll data. No 'true-up' is needed after payroll is closed for the year.

Netherlands

Employers can seek 'horizontal compliance' approval from Dutch tax authorities—a process that has been a foundational example of the OECD's cooperative compliance initiative. Once approval is obtained, the company's payroll withholding system is generally considered to yield the final Dutch liability relating to assignees working in the Netherlands. Tax returns for certain individuals need not be filed and assessments and notices from the Dutch tax authorities are also eliminated. In order to obtain approval, a company must demonstrate the quality of the payroll filings and the controls surrounding the payroll process.

Malaysia

Employers may seek 'bulk' waivers for annual tax filings as well as tax exemptions for short-term business travelers in certain circumstances. Companies will be expected to present their tax control frameworks that govern payroll and withholding compliance as well as the reasons why such arrangements would provide benefits to both the tax authorities and the taxpayer.

The examples noted above involve formal cooperative compliance agreements and special rulings or dispensations from the tax authorities to avoid income tax filings. But countries may also have special rules under existing domestic tax legislation for mobile employees meeting certain criteria to avoid having to file an income tax return without seeking approval from the tax authorities. While this latter action may not fall under the purview of cooperative compliance, these special rules could provide similar opportunities to eliminate tax return filings.

Weighing the benefits and the risks

Cost reduction benefits

The cost savings and increased efficiency resulting from the elimination of filing tax returns for a specific population of mobile employees under a cooperative compliance agreement can be significant. Companies can save in the hundreds of thousands of US dollars in one year in one jurisdiction, although savings will depend on the number of assignees covered by such an agreement and the specific country. Multi-million dollar savings could be possible for a company if agreements are negotiated with multiple countries. Looking ahead over the next five years, this trend could reduce the number of individual tax returns filed relating to short-term assignees and frequent business travelers by 30 to 45%.

Moreover, the savings relating to in-house administrative efficiencies could also be significant. For example, there should be time saved for not needing to correspond with assignees about specific tax return questions. Correcting employee wage statements may also be avoided. Note that these savings could be difficult to calculate in precise monetary terms.

Greater certainty relating to tax compliance

Achieving greater certainty regarding tax obligations and liabilities is another meaningful benefit for pursuing cooperative compliance agreements. This can include avoiding interest and penalties if amount of tax is not remitted and preventing resource-draining tax audits. The desire to pursue more certainty regarding taxes is quickly becoming a C-suite issue because the failure to properly manage tax-related risks can have damaging consequences to the company's reputation. Depending upon the company, the C-suite may view a cooperative compliance approach as an innovative and fresh approach to help mitigate this challenge.

A company pursuing a cooperative compliance approach can demonstrate that it is being transparent, accountable, and engaged with tax authorities—in other words, the company is a 'good corporate citizen'.

If the tax authority uses a tax risk rating system (such as Australia), this approach could influence the company's tax risk rating profile in a beneficial way, potentially lowering the incidence of exams, audits, and notices for that taxpayer.

Laying a foundation for the future

A strong tax control framework specific to global compensation data and withholding processes is an important pre-requisite to pursuing a cooperative compliance agreement. Implementing this framework now can serve as an excellent foundation as your company's business operations and need for employee mobility expands going forward. And it should further strengthen the company's overall corporate governance framework. If no action or new approaches are considered, the company may be faced with significant increase in administration and expense related to tax return compliance where an explosive growth of short-term assignees and frequent business travelers occurs.

Broader scrutiny could be triggered

Risks associated with cooperative compliance should also be carefully considered. While taxpayers may wish to pursue a mutually open and transparent relationship with tax authorities, it is paramount to consider that information provided to such authorities over and above baseline statutory and regulatory requirements could be used to its fullest by the tax authorities. Volunteering information under a cooperative compliance agreement specific to mobile employees could lead to a broader tax audit involving all of the company's activities in that country. Whether this occurs depends on the tax authority's current processes and the company's circumstances (e.g., their risk make-up as well as tax paying and audit history).

Avoiding mismanagement of expectations

Taxpayers should have a clear and upfront vision of what goals they want to accomplish from the cooperative compliance arrangement to avoid the risk of mismanaged expectations. The benefits described above can be formidable but it is important for a taxpayer to define detailed objectives as well as a clear working process to obtain them before pursuing an agreement. Each country will be different so this must occur on a country-by-country basis.

Is your organization ready?

Robust global payroll and withholding processes

A readiness assessment should be performed to determine if the company has a sufficient tax control framework in place relating to its global payroll and withholding processes. This includes a review of current risk areas through a maturity and risk evaluation which can involve, for example, PwC's global Tax Management Maturity Methodology (T3M)—a tool for determining the quality of the tax control framework. Tax authorities will want to know that proper controls are in place to ensure the accuracy and completeness of the tax-related information relating to the assignees. And companies should be prepared to communicate in detail how their tax controls framework is accurate.

Many elements should be considered during a readiness review, starting with an analysis of the current process and then identifying where the process may be breaking down. For example, are there automated systems controls? Are there workflow and validation models in use? Are processes and controls relating to payroll integrated with business operations? Is the company taking preventative measures or reacting after the fact to fix problems as they arise? Are there quality and assurance mechanisms to ensure that risks are being monitored on an on-going basis?

Technology as a core ingredient

Technology plays a critical role when standardizing and streamlining a company's global compensation reporting process. Tools such as PwC's Global Data Collect platform can automate the review of data using a configurable rules engine. Company-specific rules can be built in that monitor historical trends in real-time while predictive analytics can be used to identify potential inaccuracies in the data.

Other technology tools such as PwC's TravelWatch can track employees and their movements across borders. TravelWatch, for example, can allow employees to automatically or manually record their location around the world. Travel data can be more quickly gathered, helping employers compile information needed for withholding and reporting obligations on a timely basis. Scenario modeling can also occur.

Overall, technology-embedded processes can enable robust reporting capabilities that can provide valuable insight to mobility program costs and trends.

Prior year tax history a potential focus

Before agreeing to finalize a cooperative compliance agreement or ruling, the tax authorities may want to evaluate the company's general status as a taxpayer in the eyes of the tax authorities. For example, companies may face questions regarding the tax years prior to the start of the cooperative compliance agreement. Companies must be well prepared to provide details about business activity in the country and taxes paid to assure the tax authorities that they have made reasonable efforts historically to remit the proper amount of tax.

Synergy with overall tax strategy

An important question is whether the pursuit of cooperative compliance agreements in the mobility are in line with the organization's overall tax strategy supported by the Tax department and C-suite. An understanding of the company's corporate and indirect tax situation outside of the global mobility area in a particular jurisdiction is essential. This means that the mobility program management and/or the HR team should be in close communication with the Tax department to ensure coordination. Integrating the potential benefits of cooperative compliance to the mobility area could open the door to apply the concept to other parts of the organization's tax strategy and vice versa.

Contacts

For more information about this topic, please contact one of the following or any other member of the Global Mobility network or the Global Tax Policy network:

Peter Clarke
Global Mobility Services—Global Leader
+1 203 539 3826
peter.clarke@us.pwc.com

Stef van Weeghel
Global Tax Policy—Global Leader
+31 887926763
stef.van.weeghel@nl.pwc.com

Eelco van der Enden
Global Tax Policy
+31 88 792 51 38
eelco.van.der.enden@nl.pwc.com

Dave Reubzaet
Global Tax Policy
+ 31 88 792 1460
dave.reubzaet@nl.pwc.com

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