Localisation - A Potential Lower Cost Alternative To Expatriate Assignments

The cost of an international assignee typically amounts to two to five times the cost of a local hire. This creates challenges for businesses trying to reduce costs and get a worthwhile return on investment from expatriate assignments.

As organisations implement cost saving initiatives in employing mobile workforces, categorisation of the various sub-sets of employees is becoming an integral part of international assignment planning. Organisations are re-defining assignments into long-term, short-term, commuter, rotational, developmental, local & local plus and short-term business travellers and, consequently, are developing variable policies.

When It Comes To Reducing Costs, Employers Frequently Think Of Localising The Individual. What Does This Mean?

Many recent global mobility surveys highlight localisation as a common low cost alternative to employing expatriate employees with many companies adopting localisation policies. 'Localisation' is the term used when an assignee is placed on the host country terms and conditions of employment and is provided with local pay elements. The other major trend being seen is much greater use of commuters and short-term business travellers, which will be the topic of a future article.

For employers, localisation typically refers to transferring the individual so that they are no longer an employee of the foreign (home) entity and they become an employee of the local entity in the host country.

In this article we will look briefly at localisation in general, before considering some of the tax and social security issues that can arise.

Why Would An Assignee Accept Localisation?

While localisation may help businesses to reduce costs, there may be little to incentivise the assignee to accept the offer to localise or move as a local. The significant challenge for the Human Resource department is directing localisation to the right group of assignees. Added challenges include making localisation equitable for the assignee and the organisation, and also clear as to its implications.

Straight forward localisation policies do not usually provide premiums related to cost of living adjustments (COLA), tax assistance, and provision of housing and education costs. However, a one size fits all approach is certainly not always advantageous when planning international assignments.

The comparison of income tax rates, wages, salaries, standard of living, benefits, cultural and living conditions between home and host locations, play a vital role when considering localisation as an alternative to employing expatriates. For instance, movement of an assignee from a moderate hardship location to a high hardship location, with dissimilar socio-economic and cultural diversity, may result in opposition to any attempt to localise.

When Is Localisation Optimised As A Strategy?

Localisation strategy may be optimised among a particular sub-set of assignees that may include early career expatriates or developmental employees, where the deal breaker is not so much remuneration, reward and benefits, when compared with the potential for career progression and development.

Additionally, movement from a low salary index ratio to a high salary index ratio may not require much intervention as a positive response to localisation is possible once the assignee grasps the concept of the earning potential and spending power in the host location. Attaching detailed salary build-up calculations with referenced notes in terms of variables used to calculate the assignee net take home pay, can be a valuable tool in creating localisation success stories.

How To Introduce Localisation

Designing a localisation policy framework requires research relating to host country norms and practices. Strategy and policies may vary from one location to another as certain remuneration or other related trends are directed at a subset of the assignee population, which may require country specific localisation policies.

Depending on affinity between home and host locations and to facilitate transfers, a Local Plus Package may be implemented. This method of pay includes local salary benchmarked in the host country plus for example, education, housing, tax return preparation and/or home leave travel assistance or other benefits.

An alternative to the local plus package is the Lump Sum Approach. Here the assignee is transferred directly to the host country payroll and a lump sum payout or cash buy out is provided to compensate for costs associated with COLA, housing and education costs. A disadvantage in adopting this approach is the organisation may lose the assignee to a competitor soon after paying the lump sum, which can be a common scenario. There may also be tax disadvantages.

Depending on the host location, an alternative to the Lump Sum Approach is perhaps the transitional Phase-Out Approach. This approach involves payment of the lump sum in tranches and pay elements and/or allowances are graduated and phased out over a period of time. Payment delivered in tranches may result in a smoother transition for the assignee with an increased return on investment for the organisation.

Timing Of Localisation

Once a decision has been made to localise, for most employers the main question remaining is one of timing. Does an individual go immediately to local status from the date of arrival or are they transferred at the end of a particular period or occasion? A challenge is worthwhile at this juncture - is localisation really the only option?

Assignment Then Localisation

The traditional route to localisation is to cap the length of time on expatriate status, with longer-term assignees making either a gradual or immediate change to local status at a fixed point in time as indicated above. This provides the assignee with the benefits of mobility and means that the majority of assignees will have these throughout the assignment. At a certain point in time the individual will transfer from the foreign (home) employment to local employment, terms and conditions.

Localisation From Outset

Increasingly however, employers are often seeking to localise from the immediate point of relocation. The position can be simpler if the employer puts the individual onto immediate local status and employs them in the host country, as one does not have to worry about the tail off of tax equalisation and tax credits. Nonetheless, it is worthwhile the employer taking time at the outset to review matters such as the availability of expatriate concessions and social security (see below). By looking at planning opportunities costs can be minimised to the benefit of both employee and employer.

Assignment As An Expatriate But On A Local Package

An alternative, which more companies are now exploring, is keeping the employee as an expatriate employed by their home country but paying them as a local in the host country. Essentially this means doing away with some or all those extra benefits and allowances such as housing and education, which in turn reduces the direct costs of employing expatriates. There may also be savings for the employer on items such as social security.

Tax And Social Security Issues

Localisation at any point in the transfer may not be as simple or as cost effective as it may at first appear. Tax and social security can influence the outcome, for example:

Expatriate Concessions

Expatriate concessions are usually time bound. Where they exist the rules vary from country to country. For example, in the Netherlands you can qualify for the 30% facility, which allows the employer to pay a tax-free allowance of up to 30% of present employment income and tax free reimbursement of international school fees for up to 10 years. In other countries concessions apply but conditions attach to these, for example, you actually have to be employed by resident employers or permanent establishments to qualify. Employers should consider the impact of putting the individual onto local status or onto a local payroll. What is the effect on any concessions that may be available? Employers may ask should they care if there is no tax equalisation. One reason for doing so, is that is the ability to utilise concessions and flex the individual's package possibly resulting in a lower cost to the employer but with higher net pay for the employee.

Social Security

Putting the individual onto local status generally means payment of social security into the local system. This may or may not be more expensive and you should check before you take action. A cheaper alternative may be to phase out or cut allowances without an immediate change to the employing entity.

Social security liabilities generally depend on a number of factors including employment status and available treaties. Social security treaties will also be for varying periods. For example, UK agreements with Canada, Japan and the US are for five-year periods, whereas the agreement with Jersey is for three years.

The social security position becomes much more complicated when you look at transfers within the European Union. The general rule is you pay where you work; however, the agreement can apply in certain circumstances such that contributions will be due where an individual is habitually resident or perhaps where the employer is located. The UK's impending Brexit is likely to add an additional layer of complexity, particularly for roles that involve working across a number of EU countries.

Again, as an employer you should consider social security implications before deciding to localise an individual. Social security can be an expensive burden particularly within Europe, and to some degree there may be an element of choice as to whether one wishes to utilise the benefits of the treaty.

Tax Equalisation

Tax equalisation and the transfer away from this also cause problems when localising. Choosing the appropriate time is made more difficult as tax years differ between countries. Whilst the tax year for most countries is a calendar year, several other countries apply a different year-end. For example, the UK has a year-end of 5 April, Australia's year-end is 30 June and Hong Kong's is 31 March. It needs to be decided when tax equalisation will cease and how income will be dealt with in the year of cessation. For example:

- How are allowances, deductions and rate bands split?
- Does localisation begin on the assignment anniversary, the start of the host tax year or, the start of the home tax year?
- What happens if the individual receives a bonus in a period after tax equalisation has ended but the bonus clearly relates in whole or part to a tax equalisation period?
- How is this tracked?
- How do you deal with spousal income?
- How do you deal with stock and stock options earned during a tax equalisation period?
- How do you deal with the astute individual who takes advantage of tax equalisation policies and accelerates or defers payments to their advantage and their employers' expense in the full knowledge of impending localisation?

Employers cannot simply say that the individual has been localised and then immediately walk away from the tax equalisation issue. The issue could exist for some time.

Some astute expatriates are instigating their own transfer to a local package, as they have calculated that lack of application of hypothetical taxes and tax equalisation, can mean more in their pocket if they utilise favourable local tax rules that are available. This is a valid point to consider as many companies who localised individuals in low tax rate jurisdictions several years ago are now struggling to move them to higher tax cost locations, with the individuals naturally wanting to maintain their net salaries, which leads to significant increases in the costs of the gross compensation package required.

Tax Credits

Tax credits and tax refunds generated are also additional matters that employers need to think about. An accumulation of, for example, foreign tax credits on the US return may have been attributable to payments made by the employer during the tax equalisation period. Are systems in place to track utilisation of this credit? What mechanism do you have to track employer tax payments in the year following localisation, or of refunds generated by such payments? Failing to monitor this can not only be costly, but can provide inequitable results.

Summary

Maintaining flexibility is the key to reducing costs for both the employee and the employer.

In all cases much depends on the reasons why an employee is required, the existing location of the best person for that job and the driving force behind the transfer. Once you know whom you want, keeping an open mind as to planning possibilities can make a significant difference to overall costs. Employing an expatriate does not have to be expensive and can actually be cheaper than employing a local.

Naturally there are a many other issues associated with localisation, such as company philosophy, headcount, employment law and immigration. Tax, social security and other fiscal effects are important but are not the only things to consider.

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