Tax Risks Within The Assignment Life Cycle

As businesses expand globally so comes the challenge of moving people. In our last article we raised a number of issues to get right with any international assignment. In this article, we explore the tax risks arising at various points in the assignment life cycle.

Pre-assignment

Who is going, where and what will it cost? Could you structure it differently?

In general, projects start with a potential business opportunity where it is necessary to move people to a different location.

Given that staffing is often the biggest expense, it is amazing how few businesses consider the tax cost of any assignment/ project. For example, many businesses express surprise, some 18 months after the assignment has ended, once the final tax bills come in, saying that if they had known that it would be that expensive then they never would have sent the individual/s on assignment. Some businesses resort solely to basic internet research that often throws up outdated figures and rules and omits practical, on the ground, local experience. A properly considered upfront analysis of the assignment, the applicable rules, and projected tax cost, can assist greatly with budgeting and managing cost expectations for all.

Planning can also help reduce the cost of an assignment. In many instances there are tax breaks for short-term assignees, e.g. UK, Netherlands, Sweden and Denmark all have such reliefs. These reliefs may have conditions attached for example, to the length of the assignment, the employer's location or the level of salary and allowances. Such tax breaks can be considerable, for example, the Dutch '30% facility'. Additionally, paying certain benefits through the employer or having the employer provide them directly (e.g. accommodation in Hong Kong), can result in reduced tax and social security liabilities. By considering available tax breaks in conjunction with the aims of the project, assignments can be planned and structured in the most tax efficient manner, potentially significantly reducing the costs of an assignment.

Work Permits/immigration

Clearly you do need to obtain the right work permits and visas to ensure that an individual can legally work in the country. The applicable rules may dictate whether an individual can/cannot be employed locally and has to be on an assignment. Do check such rules as they may restrict the ability of the business regarding employment structuring and tax planning.

Tax Policies

With few assignees arguably a tax policy is not needed, as this permits maximum flexibility to reduce tax costs. However, when the numbers accumulate, the advantage of a structured approach becomes more apparent. By setting out the approach of a business to international mobility, this provides a ready template as to how to deal with assignments, and sets out the tax and social security philosophy (e.g. tax equalisation, home social security, assisted tax returns etc.). A policy can help to reduce tax risks by addressing clearly the approach to be adopted for international assignments and localisations. The need for a tax policy has been the subject of many previous articles, and please do refer to these for additional guidance.

Do you know who your assignees are, and do you know where they are?

Surprisingly many businesses are unable to correctly identify all of their assignees and their locations. Apart from the obvious security and duty of care risks that arise, tax risks abound. The issue of short-term business visitors is becoming a major topic and revenue generator for tax authorities around the world, and leads to a potential high risk tax exposure for businesses. It is important that businesses can track where their assignees are, and can identify the potential tax trigger points and proactively manage these. Don't assume that tax treaty exemption will always apply, the conditions for such exemption all need to be met – not just the 183 day test – and remember that tax treaty exemption applies to the individual and does not necessarily remove the reporting and withholding obligation for the employer. Be aware that authorities are becoming increasingly sophisticated when it comes to tracking and sharing data between different government departments. For example, the Australian tax and immigration authorities have recently agreed to share data.

Departure meetings in home country and arrival meeting in host country

These meetings can be invaluable in assisting both the employee and employer understand what tax forms and procedures need to be completed and followed, and what records needs to be kept for the duration of the assignment. Failure to hold such meetings can result in assignees missing out on opportunities through ignorance such as failing to keep relocation receipts, workday and travel records, or registering for expatriate concessions (e.g. the 30% facility in the Netherlands has a 4 month window to register to get it backdated to the start of the assignment).

During The Assignment

Withholding taxes - Is the company paying withholding? Are they paying the right withholding?

Frequently the biggest tax risk that arises with assignees is the failure by the employer to deduct withholding taxes. Withholding taxes such as Pay As You Earn (UK), Pay As You Go (Australia) should often be deducted by the employer. Employees can be fickle, and with many moves resulting in early cessation of assignments and possible termination of employment on or shortly after completion, it can be difficult or impossible to recover taxes from former employees. Where there is a failure to deduct withholding, tax authorities will generally look to the employer to rectify the position and may insist on a grossing up of any resulting tax liabilities thus increasing the tax cost. Always deduct withholding taxes and do this on a timely basis: after all you can usually get this refunded if excess withholding is paid. Where variations to withholding are appropriate (e.g. UK's nil tax codes and reduced s690 overseas workday relief withholding directions or tax treaty exemption), do ensure you get the appropriate documentation from the tax authority evidencing their approval.

Are you picking up split payments and pre-assignment payments?

Assuming withholding taxes are being deducted, do ensure it is being operated on the correct basis. For example, are split payroll amounts being taken into account? It is very easy to overlook home country/third country payments that remain in existence. Additionally, payments that relate to the assignment but are paid before the assignment commences could be liable to withholding in the host country. All may need to be reflected in the payroll calculation and even if there is no actual payroll or entity in the host location, withholding taxes may need to be operated on a shadow or ghost payroll basis. Payments will of course also need to be reported, as appropriate, in the individual's tax returns.

Is the company picking up all the benefits – home and host paid or pre-assignment paid?

Another issue that is frequently overlooked for business or individual reporting is that of benefits. Again it is important that both home/third country benefit provision is considered when assessing host (and home) country tax liabilities. It is very easy to overlook their provision, for example continuing home country long-term storage or medical insurance costs. Additionally, where benefits such as relocation expenses are paid pre-assignment, these can often be forgotten when it comes to assessing host country liabilities. Host country rules will need to be examined to determine what needs to be reported and taxed.

Is social security being paid in the right location – on home and host payments?

Part of the initial assignment structuring should be to determine where social security will be paid. This may be in the home country, the host country, both or neither, or in a third country depending on the circumstances. Bear in mind that social security costs can sometimes outweigh the tax costs, with employer contributions in locations such as France and Italy being approximately 40% on an uncapped basis. Contributions in other countries such as Germany may appear high at face value, but capping limits the costs for high earners and employers. In other countries such as Hong Kong and Singapore, it may not be possible for foreigners to join the local social security system. Planning can help to reduce any social security liability, but the impact on future benefits does need to be considered. This is of course extremely difficult with ever changing rules.

Once the right location for payment has been determined and the individual is on assignment, it is important to ensure that social security liabilities are calculated on the correct amount. For example, are all cash payments being recorded? Payments through split payrolls are often overlooked, as are benefits provided in home or host countries. Do gather all details on a timely basis so that liabilities for both the employee and employer can be correctly calculated and paid. As with withholding tax, failure to deduct by the employer can result in additional liabilities for them if the employee becomes an ex-employee. Always deduct where you need to and do ensure you have the right, up to date, certificates of coverage in place to demonstrate why liabilities are being or are not being deducted as appropriate.

Are tax returns being filed by the individual – on what basis?

Completion of personal tax returns whilst an individual is on assignment can often be overlooked or dismissed as an easy compliance task. This is particularly risky when one considers there will be added complexities, interactions between differing tax systems, and the unfamiliarity of foreign implications and foreign tax regimes to deal with. Failing to provide tax assistance can lead to missing and incorrect tax returns – whether innocent or otherwise. This could affect the corporate reputation of the business entity and possibly even its ability to continue to undertake business in a location. Providing professional assistance with this task can help both the employee and the employer to ensure correct and timely filings and leave both parties to focus on the success of the assignment.

Have any tax reconciliations been undertaken?

Where there are tax equalisation commitments by the employer to meet certain or all elements of an assignee's foreign tax liability, it is important to ensure that not only is the correct liability paid, but that relevant steps are taken to recover hypothetical tax underpayments or real home country tax refunds from the employee. Tax leakage may occur for the employer where this does not take place promptly or at all.

Recharges and bearing the cost/transfer pricing

From a business perspective, cost and benefit typically go together and should be located in the same place. However, this relatively simple business rule can have far reaching consequences. Recharges can jeopardise potential treaty exemption for the individual. The failure to consider people issues and the resulting costs can create problems with tax authorities when transfer pricing rules are overlooked. The impending introduction of Base Erosion and Profit Shifting (BEPS) rules needs to be considered from an international mobility context. In certain circumstances recharges can also trigger a non-recoverable VAT liability.

Corporate residence and permanent establishments

Although your company is located in and is a resident of a certain country, sending people to another country may create a local presence to such an extent that the company will also be subject to local corporate taxation. Whether or not this is the case will depend on their purpose of being there, as well as their authority to act on behalf of the company, does it or does it not create a 'fixed place of business' is usually the criterion to analyse. This whole area is currently under particular scrutiny by the OECD and tax authorities, so do look out for future changes.

Post-assignment

Tax equalisation reconciliations and loans

On cessation of the assignment it will be necessary to unwind any tax loans and deal with final tax equalisation reconciliations. Do remember to undertake these tasks especially, as so many individuals leave their employer after an assignment and memories of tax arrangements agreed at the outset of an assignment quickly fade.

Trailing liabilities – stock and bonuses. Are you taking these into account?

Naturally you have been correctly reporting stock awards and bonuses during the assignment itself, but do you continue to track and map those relating to the assignment once the individuals cease their assignment? How long do you track for? Tax authorities around the world are increasing aware of the potential for tax to be overlooked and not paid in such circumstances. They will pursue such liabilities so do ensure you withhold and file as appropriate, and remember to collect any contribution towards tax and social security liabilities from the employee.

Use of carry forward foreign tax credits

In certain circumstances payment of taxes by the employer, whilst an individual is on assignment, may result in excess foreign tax credits which may be unusable during the course of the assignment but available thereafter. As the taxes giving rise to these credits were paid by the employer, arguably they belong to the employer not the employee. How long does your business track such foreign tax credits to ensure any tax refunds generated go to you?

Tax clearance certificates, tax payments and post-assignment individual tax returns

Relevant departure forms should be submitted to record the individual's tax departure from the host country and return to their home or next country. Do remember that certain countries, for example Singapore, require tax matters to be settled and liabilities paid before a departure clearance certificate can be obtained. Don't forget that final year tax returns may still need to be filed and the existence of post departure bonuses and stock may necessitate filings beyond the actual year of departure.

Forgotten bank accounts and host country investments

In the rush to move to the next location or return from assignment, it can be relatively easy to forget to shut foreign bank accounts or report their or other host country investments ongoing existence in future tax returns. Don't forget to do so, otherwise tax authority enquiries will probably ensue. The volume of information reported between tax authorities is seeing a massive surge and this can easily trap the forgetful. Do seek to get it right from the outset.

I have only briefly touched on the tax risks that can arise from international assignments during the assignment life cycle. Careful tax planning, a structured approach to tax and implementation of a tax process, can help both employers and employees alike to mitigate tax liabilities and minimise tax risks. All department teams (HR, Tax, Finance, etc.) should work together with the assignee and the tax adviser to achieve this goal.

Andrew Bailey is National Head of Human Capital at BDO LLP. He has over 30 years' experience in the field of expatriate taxation. BDO has offices in 154 countries and is able to provide global assistance for all your international assignments. If you would like to discuss any of the issues raised in this article or any other expatriate matters, please visit our website at; www.bdo.co.uk/services/tax/human-capital/expatriate-tax-advice or contact Andrew Bailey on +44 (0) 20 7893 2946 email Andrew.bailey@bdo.co.uk