Taxing Issues: Expatriate Terminology

Imagine you are busy working when your HR Director calls you late on a Thursday afternoon to tell you that you need to deal with expatriate issues relating to an employee who is to work in another country. The employee is due to start in just over two weeks and the HR Director is now off on their holiday. You are on your own but the HR Director has suggested you talk to the individual and then the tax adviser in order to take matters forward.

If you are new to dealing with expatriates, the terminology used may appear to be a totally different language to that with which you are familiar. This article looks at some of the terminology and aims to help to guide you through the meaning of some common expatriate words. Please note that whilst certain definitions may be used within your own business, tax authorities and advisers may use different wording.

What's An Expatriate?

The first place to start is with an "expatriate". The Oxford English Dictionary defines an expatriate as a person who lives outside their native country. The traditional, yesteryear, impression of an expatriate is someone sitting in the sun, in their white suit, sipping their gin and tonic, counting their profits whilst the locals do all the work. Some locals may say nothing has changed, but today businesses are far more attuned to the costs of international assignees and the potential for disparity both in terms of working conditions and pay with local hires. Today the word expatriate is much disliked and increasingly businesses use a different word, with most firms referring to their "international assignees". The dictionary definition of an expatriate does not appear to encompass those individuals working in other countries whilst not living there, a common situation in today's business world.

You may also come across the word "inpatriate". Whilst an expatriate generally refers to someone leaving a country, an individual entering a country may be referred to as an inpatriate. Business visitors and short-term assignments cover those who undertake either sporadic one-off visits and those anticipating spending a minimal period in the location. Whatever terminology is used, tax and social security issues multiply as soon as individuals start to work across borders or live outside their native country.

The Employment Package

You decide to start off by talking to the individual to ascertain what's been agreed. The individual tells you they are initially going to the location for a 6-12 month period, with a possible extension. They advise that the CEO and HR Director said something about an assignment, a foreign-service premium, housing allowance, cost of living allowance, mobility allowance and relocation allowance, together with tax equalisation. The individual mentions that other expatriates they have talked to also get a hardship allowance and home leave. They want these too. They would like to see the assignment letter. If only you had an expatriate specific dictionary.

Deciphering The Employment Package

The individual mentioned "assignment". What's the difference between an assignment and "employment"?

You need to be able to distinguish between the two. Employment refers to the underlying contract either verbal or more usually written. This sets out the basic terms of employment, job title, location of employment, reporting and control, remuneration package, and termination covenants and clauses. This usually remains in situ whilst an individual works overseas. If it doesn't, then a new employment contract may be issued either with the host country or another entity. This is the situation when the individual becomes employed as a local hire or through an employee leasing or international assignee company. For most non-permanent moves individuals tend to remain employed by the home country and an assignment or secondment letter is issued varying the terms of the original employment for the duration of the assignment. In most cases where there is an expectation, the individual will return to their home country, and their underlying employment typically continues in the home country. The tax and social security treatment will vary depending on who is the employer and this needs to be determined from the outset.

The suggested components of the package are as follows:

Foreign-Service Premium - this is an additional sum paid on top of base salary as a result of going to work in another country. It may be a fixed percentage or an agreed additional sum. Payment may be for a specified period only. It is not intended that the payment will continue on return to the home country, hence the reason why any additional payment is not merely added to base salary. It is fairly common to see uplifts in salary for the duration of an assignment, although some companies will not pay for inter-regional moves or developmental moves and a large number simply no longer pay foreign-service premiums. The payment is normally treated as taxable income.

Housing Allowance - is a payment towards housing costs at the host location. An allowance is paid in cash to the assignee. Such a payment is generally treated as taxable income, although usually there are greater tax advantages in situations where the employer rents the property directly and then makes it available to the individual. Certain companies apply a "housing norm", which is a contribution by the assignee to the employer for the cost of provision of housing at the host location. A payment generally assumes that the assignee does not have continuing costs in the home country whilst they are on assignment and it would be fair to expect that a contribution would be made. A housing norm is usually treated as negative income and is deducted from taxable remuneration. However, some companies don't want to get involved in property issues and do not wish to either rent a property or apply a housing norm, leaving the individual to make their own choices and decisions regarding home and host country housing.

Cost Of Living Allowance – as the name suggests this is a payment for the added costs of living at the host location. It may be referred to as a "goods and services differential" or some other variation. Service providers can provide indices on the relative cost of living differences between countries and cities. Such indices apply to "spendable income", that which the individual has available to spend after usual monthly deductions have been made and family size taken into account. The indices can be calculated in many different ways, for example, they may be based on a standard index, which assumes the assignee will seek out familiar brands or an efficient purchaser index, which assumes assignees seek out similar but local products. Negative cost of living allowances can arise where costs at the host location are cheaper than the home location, but few companies apply these. Payments are usually treated as taxable, but in certain countries and situations it may be possible to get tax and social security exemption.

Mobility Allowance – this is a one off payment for moving. Generally it amounts to a month's salary paid to an individual for being willing to move. It can be paid on a net of tax basis so the individual receives a guaranteed sum. Common many years ago, fewer companies now pay such allowances. Payments are normally treated as taxable income.

Relocation Allowance – is a one off payment for moving. It is usually aimed at meeting the costs of moving to another location and may be made either in addition or opposed to reimbursement of actual relocation costs. It is often an amount that does not need to be backed up with receipts and is intended to meet sundry payments. It may be based on a month's salary. Such a payment is generally treated as taxable income and there are often better tax advantages in situations where receipts are kept for genuine relocation costs.

Tax Equalisation – the principle behind tax equalisation is that the individual is neither advantaged nor disadvantaged from a tax perspective as a result of an international assignment. This takes tax out of the mobility question and should enable an assignment to proceed from the individual's perspective without having to consider whether the move is to a high or low tax cost country and whether the move should be brought forward or deferred. The employer being responsible for actual taxes in the home and host locations achieves this. In return the individual pays to the employer a "hypothetical tax", which is what they would have paid in tax in their home country ignoring assignment related elements of remuneration. For the employee, tax equalisation makes an assignment tax neutral. Tax protection as the name suggests, protects the assignee from an increase in the tax liability as a result of an assignment. If the tax liability increases the employer picks up this additional liability, whereas if the tax liability decreases the assignee is better off. In situations where an employer pays the tax liability for an assignee this is usually regarded as a taxable benefit, so you have a tax on tax or a gross up. Hypothetical tax is normally treated as negative income and is deducted from taxable remuneration.

Hardship Allowance – as the name suggests this is a payment for moving to a country with comparable hardship. Such payments are often associated with assignments to areas of extreme discomfort or danger. One should not always assume your standards apply as, for example, miserable weather in Northern Europe may make for an uncomfortable assignment for those more used to sunnier climes. Hardship allowances do vary with location, conditions and timing. Again any payment is usually treated as taxable income.

Home Leave – payments are frequently made by an employer to enable an employee to return to their home country. Payments may be limited to a set number of trips per annum and restricted to a certain class of travel. Payments can be extended to family members and could also work in reverse to enable family members to visit the assignee at the host location. Home leave payments are often not taxable but conditions may need to be met for such exemption. As an alternative or in addition to home leave, rest and recreation (R & R) payments/leave may be available to assignees in hardship locations.

You now know what you want to see in the assignment letter.

The Tax Adviser

You then call the tax adviser. They ask about the employee's package and request a copy of the draft assignment letter. They ask you what you know about the individual and when you advise that the period involved is initially 6-12 months they start to mention domicile and residence, together with tax and social security treaties. They also ask about the work permit situation. Your head is spinning. Going on your own holiday sounds ever more enticing!

Translating tax adviser's talk will be the subject of our next article.

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