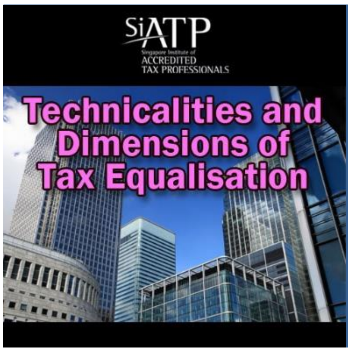

Tax Equalisation and Tax Protection

Managing International Mobility Through Tax Sharing Schemes

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Facilitated by:
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The global economy today is more interconnected than ever. To compete on the world stage, businesses are embracing global value chains and aggressively expanding their international footprints. Naturally, this creates a high demand for skilled talents to run their international operations. To address talent crunch in specific countries, businesses often turn to international assignments to bridge these talent gaps.

At a *Tax Excellence Decoded* (TED) session organised by the Singapore Institute of Accredited Tax Professionals (SIATP), Accredited Tax Advisor (Income Tax) Ooi Geok Eng, Director, and Candice Ee, Manager, Global Mobility Services, PwC Singapore, shared their expertise in dealing with international assignments, "Businesses can use a tax sharing scheme to alleviate the additional tax costs that employees may incur as a result of their overseas assignments; this can be modelled either as a tax protection plan or tax equalisation plan."

Tax Protection Plan

Under a tax protection plan, the employer would reimburse the employee for actual taxes paid in excess of the amount the individual would have paid in his home country if he had not been posted overseas. If the employee's total actual tax liabilities (in his home and host countries) are less than his hypothetical home country tax, the employee would only be liable to pay for the actual (lower) tax liabilities.

Essentially, tax protection ensures that the employee does not incur more tax than he would have if he had remained in his home country.

A tax protection plan can be implemented with relative ease as no action is required before and during the overseas assignment. At year-end, the employer prepares the final hypothetical tax and tax protection settlement calculation, and reimburses the employee for any actual tax liability in excess of his hypothetical tax.

Candice Ee, together with Accredited Tax Advisor (Income Tax) Ooi Geok Eng, talked about the practical side of tax equalisation.

Tax Equalisation Plan

In contrast, a tax equalisation plan ensures that the employee's tax burden remains the same (not better off or worse off) as if he had remained in the home country. Employees are responsible for their hypothetical tax, while employers are responsible for the actual tax liability. Consequently, if the actual tax is more than the hypothetical tax, the excess tax burden is borne by the employer. If the actual tax is less than the hypothetical tax, the employee does not enjoy any "windfall gain".

Administratively, it takes considerably more effort to implement a tax equalisation plan than a tax protection plan. In addition to preparing the final hypothetical tax calculation and tax settlement calculation at year-end, the employer is also required to prepare estimated hypothetical tax calculations, generally on an annual basis, to facilitate the withholding of estimated hypothetical taxes from the employee's monthly payroll.

A Quick Comparison: Tax Protection & Tax Equalisation

From the employee's perspective, tax protection allows the employee to enjoy "windfall gains" from lower foreign taxes while restricting the maximum tax obligation to his hypothetical tax. On the other hand, tax equalisation provides tax neutrality for the overseas assignment without the potential of "windfall gains" for the individual employee.

The above difference may encourage certain employee behaviour. For example, employees under tax protection schemes may be more motivated to be relocated to a low or no tax jurisdiction to reap the benefit of the lower tax costs. They may also seek ways to lower their actual tax liabilities and pose a non-compliance risk.

In contrast, employees under tax equalisation schemes will not factor in tax costs in choosing their preferred overseas location as they are tax neutral. Employees will, however, be less motivated to help lower the actual tax liability as it has no bearing on them.

Accredited Tax Advisor (Income Tax) Ooi Geok Eng (2nd from left) answered queries about tax equalisation.

Tax Sharing Policies in Practice

In practice, businesses may adopt different approaches in handling international assignments. Some organisations may adopt a *laissez faire* approach with no specific policy in place, that is, each international assignment is assessed on a case-by-case basis.

Other organisations may adopt a partial tax protection or tax equalisation scheme, where certain income items (such as personal income or equity compensation) are excluded from the scheme, or a full tax protection or tax equalisation scheme, where the employee is fully tax protected or tax equalised on all types of income. Organisations may also opt for a hybrid of tax protection and tax equalisation policies, depending on the type of income and assignment policy, to suit specific business needs.

Practical Issues and Considerations

There are numerous practical issues and considerations in managing international assignments through tax sharing policies.

LACK OF POLICY

Start-ups or small and medium-sized enterprises (SMEs) typically do not have comprehensive tax sharing policies and tend to handle international assignments on a case-by-case basis. This is understandable as the number of international assignees may not justify the costs of developing full-fledged policies.

Although the case-by-case approach may be practical in the beginning, it will become increasingly inefficient to negotiate with each international assignee as their number grows. In the absence of formal policies, there are also higher risks of inconsistencies in employee's overseas packages, which may lead to staff unhappiness. Start-ups and SMEs anticipating a rise in international assignments should consider putting in place a comprehensive tax sharing policy.

IMPLEMENTATION AND PROCESS

As multiple internal teams are involved to carry out tax sharing policies, it is important that each team is clear of its respective role. There should also be a monitoring mechanism in place to ensure compliance. In the case of tax equalisation, where multiple estimated hypothetical tax calculations are often performed throughout the assignment period, organisations should decide on the frequency of their hypothetical tax calculations based on their need for accurate estimate and the compliance cost involved.

POLICY GUIDANCE AND INTERPRETATION

To prevent misunderstanding and future disputes with employees, it is essential for businesses to ensure that their tax sharing policies have clear guidance and interpretation. For example, each tax sharing policy should clearly state the types of income covered under the policy, specifically excluded income items, and applicable personal reliefs for the purpose of calculating hypothetical tax. For further clarity, it is also good practice for the policy to address specific employment scenarios, such as mid-year resignation and localisation.

CASH FLOW

The ability to pay one's individual tax through GIRO instalment plans in Singapore may create a unique cash flow issue for outbound Singaporean assignees under a tax equalisation plan – in the year of transfer, the Singaporean assignees may still be paying the instalment for their prior year's tax liability, while simultaneously be subject to monthly hypothetical tax deductions.

As tax equalisation plans are internal policies, employers may consider whether monthly salary withholding is necessary. To the extent that the policies are consistent and fulfill the organisation's objectives, employers may decide to collect the hypothetical tax at a later date to ease employees' cash flow (for example, when the final hypothetical tax calculations are performed at year-end).

EMPLOYEE COMMUNICATION

Communication is a vital to the success of tax sharing schemes. If lengthy disputes are to be avoided, employers must ensure that employees understand the fundamental concepts of the tax sharing scheme from the very beginning to align expectations.

Other Areas

It is possible to extend tax sharing policies to other areas such as social security. Consider Singapore's Central Provident Fund Board (CPF) which mandates compulsory CPF contributions for locally employed Singaporeans and Singapore Permanent Residents. If a Singaporean is sent on an overseas assignment, then his CPF contributions become voluntary (for both employee and employer).

Employers can choose to compensate for this difference and compute the amount of CPF contributions for the employee had he remained in Singapore, and reconcile it with the amount of actual CPF contributions (as well as contributions to host country's social security, if applicable). The employee can then be equalised or protected from a social security perspective.

Ultimately, tax sharing schemes are internal policies and there is no "one-size-fits-all" way to do it. Organisations must think through their business objectives and limitations: Are there adequate resources and internal processes to implement a tax sharing scheme? Should the policy be kept simple and easy to understand, or be comprehensive and detailed? Should the organisation apply different policies for different types of assignment?

Only when organisations are able to answer these questions will they be able to arrive at an appropriate tax sharing scheme.

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