Tax equalisation – four reasons for a new approach
Tax equalisation (TEQ) – the practice of holding international assignees to the tax rates applicable in their home country whilst working overseas – has long been a staple of companies with a globally mobile workforce. However, trends show that companies are limiting, or abandoning the practice.

KPMG Australia’s Tax Equalisation Policy Survey found that while 74 percent of companies have a TEQ policy, over 60 percent believe that TEQ policies are on their way out.

A key issue is that many organisations have a ‘set-and-forget’ approach to TEQ, leading to cost inefficiencies and impacting the success of international assignee programs. Drawing from the survey findings, here are four reasons why your organisation’s TEQ policy might be due for a rethink.

1. One size does not fit all

TEQ policies can be inflexible and hard to calibrate to the disparate tax environments of overseas jurisdictions. Of the employers who implemented a TEQ policy, 71 percent applied TEQ to all home and host country combinations. But for many, TEQ will not be the most cost-effective option for either the employer or the employee, especially when they’re moving from a higher to lower tax jurisdiction.

Australia is a high tax environment, and outbound assignees often face a hypothetical tax rate much higher than the rate paid by local colleagues in the host jurisdiction. This can dissuade employees from relocating, so companies are forced to incentivise assignees with generous allowances and benefits. The result can be increased taxes for the assignee (albeit hypothetically), and the higher costs of relocation packages for the company.

Another option for companies with many Australian outbound assignees may be ‘Local Plus’ remuneration packages. Local Plus policies set the total remuneration at a comparable level to host country employees performing similar roles. They provide outbound assignees with modest relocation assistance such as tax advice and short term temporary housing. Employees are personally responsible for their home and host country taxes so they can benefit from the lower income tax rate in their host country.

Flexibility is the key here – these options show that TEQ doesn’t need to be applied to all assignees to all destinations. Rather, decisions about TEQ should be driven by commercial reasoning.

2. Global policy, local application?

Only 18 percent of surveyed companies have a specific Australian TEQ Policy or addendum to their global policy. If your organisation falls in to the other 82 percent, now is the time to review this.

How does your organisation’s policy address changes to Australian tax rules for non-residents? For example, does it take into account the removal of the main residence Capital Gains Tax exemption, or the apportioned availability of the long term Capital Gains Tax discount? What about potential foregone losses on rental properties when assignees are ‘treaty exempt’ from Australian tax on employment income? Or double taxation on shares acquired as a non-resident under an employee share scheme (in certain market conditions)?

If you haven’t documented these positions upfront, they may leave your organisation open to disputes with assignees, and may impact your global mobility program. It can expose you, unwittingly, to significant Australian tax costs.
3. Is the benefit worth the burden?

Effective TEQ policies can be useful to promote overseas assignments. When structured well, they take tax out of the equation when employees are deciding whether to accept an international assignment. Who would be happy to move to Denmark where personal tax rates top around 60 percent? And what if they had a choice between Denmark and Dubai, with its zero percent income tax rate?

But while TEQ policies offer clarity, fairness and equity amongst assignees, survey respondents indicated there are significant administrative burdens. This can include the development and oversight of policies and their application, hypothetical tax calculations requiring updates for each tax change or pay rise, engaging a tax provider to prepare assignee income tax returns and year-end TEQ reconciliations, processing and tracking of TEQ settlements due to and from assignees, and the need to continually educate assignees and cross border payroll team members.

For companies with few expatriate employees, or where host destinations have similar tax environments to those in the home country, the TEQ administration can very quickly outweigh the benefits. Only 24 percent of companies use assignment management software to support their TEQ programs, with most preferring to use MS Office or existing accounts systems. However, with more assignment management software hitting the market, pricing is becoming more competitive, making it easier to access.

There are other policy options to TEQ, which may prove less burdensome and better suited to the needs of a globally mobile workforce. For example, tax protection is used less than TEQ, but the survey revealed that this policy is gaining ground in Australia, with over two thirds of organisations currently implementing some form of tax protection policy.

Under a tax protection policy, the assignee pays all actual tax liabilities. Employers provide assignees with tax assistance only if the total liability on all tax-protected income (usually employment-related income only) exceeds the tax they would have paid on that same income had they stayed at home. This is usually a reimbursement of the excess tax arising from the assignment. Assignees won’t pay more tax as a result of the assignment, but may pay less. And if they’re moving from a high tax jurisdiction to a low tax jurisdiction, and won’t be subject to actual home country tax while on assignment, there’s no need for year-end reconciliation or settlement, as their tax burden won’t increase. This reduces both administration and costs.

4. Long term assignees: time for a phase out?

How long has your organisation’s longest long-term assignee been on assignment? Two years? Five years? If you don’t know, or your answer is longer than anyone can remember, then it’s time for a TEQ re-visit.

The survey found that 92 percent of companies are using TEQ policies for long-term assignees, and with good reason. TEQ policies allow back-to-back assignments, and can ease the assignee’s way back in to the home country remuneration structure on their return. However, with very long-term assignments, companies should consider a cut-off point, after which an expatriate mobility policy (including TEQ) can be cut off, or phased out.

Tax equalising very-long term assignees can give an impression of inequity between host country employees and assignees performing similar roles. After a few years of living and working alongside locals, assignees and their families have often put down relatively solid roots. Phasing expats off full benefits after a period of time is fairer, as assignees are remunerated at a comparable level to local employees, and taxed in the same way for performing the same work.

What next?

The benefits of TEQ are well-known. It offers equity across all assignees and host country tax regimes, removes tax considerations from the decision of whether to accept an assignment, and ensures that employees are no better or worse off from a tax perspective by going on assignment.

However, with new drivers emerging for international assignments such as using them to develop high potential junior staff, rather than reserving overseas postings only for senior executives, and evolution in the types of assignments being undertaken, applying a TEQ policy to all scenarios is unlikely to result in the most cost effective outcome.
KPMG’s tax experts can help you explore what more your TEQ policy could be doing for cost effectiveness and the success of your international assignment program.

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