

International assignment perspectives*

Critical issues facing the globally mobile workforce

Volume 2



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Foreword

The world around us is changing at an unrelenting pace—in everything from the economy to the environment—which only reinforces the importance of maintaining a competitive edge. In light of this uncertain business environment, it is the people in your organization that can make the difference between a business that fails and one that thrives.

Today we must look past our own borders for business leaders with the skills and knowledge to efficiently and effectively manage talent. In fact, PricewaterhouseCoopers' 11th Annual CEO Survey revealed that talent management is top of mind among CEOs across the globe. As a result, we are seeing many companies use their international mobility programs as part of an overall talent management scheme, both as a means to attract and retain top performers, as well as a way to provide specific experiences for people groomed for leadership positions.

But, maintaining an effective international mobility function that moves teams around the world fluidly while sustaining alignment between broader HR strategies and global business objectives is no easy feat. Increased compliance, economic volatility, continued expansion into new territories and ever-changing, complex tax rules create a mountain of challenges facing HR leaders working to address the needs of today's international assignees. How effective an organization is at addressing these issues will determine how successful it is in managing mobility.

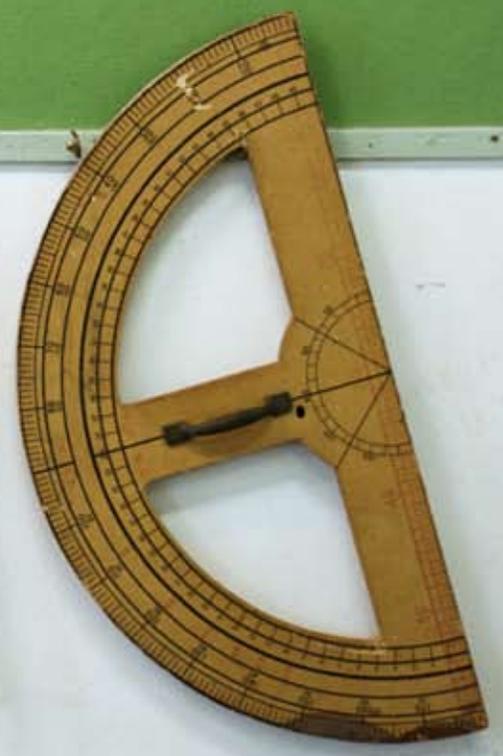
International Assignment Perspectives is a collection of thought leadership articles that explore current issues requiring the attention of today's HR leaders and tax directors who manage a globally mobile workforce. This publication from PricewaterhouseCoopers' International Assignment Services practice shares insights on a number of topics affecting multinational companies, including tax equalization, multi-state reporting requirements, international equity compensation and compliance, the devaluation of the American dollar and expansion into new territories with specific focus on navigating the uncharted waters of Africa.

Organizations need to stay on top of the fiercely competitive market for global talent by retaining the knowledge and ability to address the various challenges that await their globally mobile workforce. We hope you find the second edition of *International Assignment Perspectives* an insightful and innovative read that presents answers to your key questions and provides a strategic framework for addressing today's challenges in international assignments.

A handwritten signature in black ink that reads "Billy". The signature is written in a cursive, slightly stylized font.

William F. Owens, Jr.
US Practice Leader
International Assignment Services

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Eliminating the surprise

A practical and accurate approach
to tax equalization costs

Jim Muth and JoAnne Davidson

One of the more challenging aspects for finance departments of global organizations is to accurately budget and accrue for the tax costs of equalized international assignees (IAs)—a necessary process that, when done correctly, allows business leaders to anticipate the full cost of their international assignment program at the beginning of the fiscal year. Unfortunately, it is also a process that can result in unanticipated expenses at the end of the year if original budgets and accruals end up being inaccurate.

While several compensation costs related to international assignments can be reasonably estimated (i.e., salary, bonuses, living expenses and housing costs), tax equalization costs for IAs, historically, remain the one component that accounts for significant budget variances and underaccruals. The increasing complexities of ever-changing tax laws and rates around the world, myriad of company compensation structures and diverse accounting methods complicate the accurate tracking of these tax equalization costs. The result is often an unexpected—and potentially substantial—charge to a business unit, sometimes well after the assignment has ended. As these expenses can impact business results and performance metrics, it is clear why global companies, particularly companies with substantial tax equalized IA populations, require a structured process that helps mitigate surprises.

Tax equalization costs

For purposes of this article, tax equalization costs is defined as the cost the company will incur to keep the assignee whole under the company's tax equalization policy. The cost to the company will be the actual home and host income taxes funded by the company less any hypothetical tax liability funded by the employee.

To address these accounting and budgeting challenges, this article offers a responsible approach for companies to use based on their IA populations. In our experience, this approach has proved successful at minimizing expense surprises and provides a self-correcting method of accurately budgeting and accounting for tax equalization expenses. We have separated the approach into four components that require attention, and provided alternative sources/approaches for companies based on specific IA populations and demographics, level of necessary accuracy and expected amount of experienced internal support. The overall methodology, however, is the same for all companies. Following are the four main areas of focus:

- Methodology and implementation
- Tax cost estimates
- Accounting
- Maintenance

Methodology and implementation

It is critical to first focus on determining the method to use for estimating IA expenses, identifying the key internal players and securing their approval of the methodology. A strong methodology may include the following steps:

1. Ensure tax accruals are maintained at corporate headquarters for centralized management.
2. Calculate tax cost projections for each assignee, including appropriate gross-ups.
3. Spread total tax cost evenly over assignment length (i.e., three years) to determine monthly chargeout to host location entity. Charge to host location and credit business unit–specific tax cost accrual account at corporate.
4. Once annual tax returns and tax equalization calculations are complete, charge actual amount against corporate accrual and advise host of actual amount for statutory local books (tax purposes).

5. Revisit tax cost projection and input actual amounts; recalculate and determine new total tax cost; spread over the remainder of assignment and adjust monthly chargeout to host as applicable.

This approach charges the host location the expected tax costs in the assignment period. It also addresses the three main problems inherent to accounting and budgeting for IA tax costs that we have seen in our experience:

- No established accruals for assignments
- Premature clearing of accruals (generally due to timing of tax returns)
- Open balance sheet accruals—never appropriately cleared

Of course, companies may use different variations of this approach. For example, some may permit the accruals to reside within the host locations for local maintenance and management. However, delegating this responsibility locally results in the increased risk of the three items above due to lack of centralization and control. Companies may want to consider the use of technology solutions to mitigate those risks by providing a central location for storing and updating data, and placing controls around what each stakeholder can access or modify.

In order to appropriately prepare for the implementation of this approach, the corporate and local entities must officially buy into the approach. Applying a strategic approach to the tax accrual calculation—including the use of a cost projection calculator to arrive at the accrual amounts—provides another notable benefit: the ability to minimize the overall cost of the assignment. By providing the agreeing parties with assignment planning alternatives, such as when to deliver compensation (beginning, during or end of an assignment); assignment duration to gain maximum tax benefit; applying special concessions—the receiving entity can affirm due

diligence and that the incurred costs associated with the assignment have been well thought out and well planned to minimize the tax burden.

Agreement between the corporate and local entity on the approach and roles can be accomplished via effective communication. An effective communication package distributed to all stakeholders can include details of the issue/concerns, the proposed solution and approach, the role each stakeholder will play, what actions are required by whom and when and the estimates of the accrued amounts. Typically, corporate controllers are the best facilitators of such communication because they will already be aware of such budget/accrual issues.

Let's look at the components required for this approach and the alternative variations that may be more feasible for your company.

Tax cost estimates

Once the process and methodology have been established, the next step is to project what the expected tax costs of the assignment will be in order to determine accrual amounts and chargeouts to the host locations. Typically, even if accruals are managed and maintained locally, tax cost estimates are centralized under a consistent approach.

In estimating tax costs, several alternatives are available based on the acceptable margin of error. By level of accuracy, options may include:

- Individual tax cost projections are prepared by an international tax service provider. These calculations will generally be the most accurate projections because (1) they may take into account known personal income/deduction items, (2) applicable tax planning is in place and (3) actual tax data for returns is already completed.

- Individual tax cost projections are prepared internally by the company. These may be prepared by someone with international tax experience. Often, a global projection tool will be used (such as one available from an international tax service provider). Output will depend on appropriate input, chosen tax positions and the level of experience of the employee preparing the projection.
- Marginal or average rates, adjusted for applicable gross-ups, can be used for individual assignees based on compensation packages. These calculations generally do not take into account tax planning, applicable deductions or graduated tax rate schemes.
- Average rates or historical factors (e.g., 1.75 of total compensation) can be applied to groups of assignees in specific countries, or all global assignees. Clearly this is the most unscientific method, but it is the least labor and time intensive to calculate. This method is generally used where there is a high margin of error tolerance on an individual basis (which may be offset by a large IA population).

Once the calculations are complete, they should be provided to the appropriate accounting or finance person within the company, who will be responsible for charging out the amounts of estimated tax costs to the host location.

These calculations should be reviewed annually to take into account any discrepancies and to reflect final tax amounts. The major sources of differences are usually unforeseen compensation amounts (equity income, deferrals, etc.) and tax law / rate changes. Utilizing technology solutions that accumulate compensation data and estimate the cost of an international assignment enables a company to proactively manage changes in tax law or compensation. The need to have in-depth knowledge about each applicable country's tax rules is supplemented by the technology solution, which frees up the company to focus its efforts on planning strategies. By revisiting these factors annually and adjusting the monthly amounts, differences will be minimized.

Accounting

Once cost projections have been completed by the appropriate source, the person responsible for charging out the tax costs to the host locations will review the calculations and spread out the amounts over the remaining length of the assignments as indicated on the projections, smoothing the charges over the lives of the assignments. We generally see these amounts set once during the year and revisited annually after tax returns are completed and cost projections revised. A global cost projection calculator provides an easy mechanism to perform the annual review and revision. Previous calculation results are stored and can be referenced for the purpose of comparison. In addition, an update to the existing calculation reduces the time necessary to perform the annual review process.

Once the current year's tax returns and tax equalization settlements are completed, the following should take place:

- Corporate (assuming this is where the accruals are centralized) should apply actual taxes against the accrual and reduce the intercompany receivable from the host country. If applicable, tax equalization expenses and employee leasing fees should be reported as well. This will clear the accruals in a timely manner as the actual amounts are received.
- Host location (assuming the accruals are centralized at corporate) should reduce accounting book expenses (i.e., US GAAP) and intercompany payable accounts by the amount of the actual expenses incurred, then record those actual expenses on the host location's statutory tax function books.

A company's tax service provider may be able to provide guidance with sample entries based on the final amounts.

Maintenance

For this approach to be successful, the key lies in the careful maintenance and management of the accruals. Therefore, selection of the appropriate department, personnel and technology tools is important. Typically, the person selected to fill this type of role is someone in the accounting or finance department. This point person(s) will be responsible for the following:

- Overseeing the appropriate transfer of the accruals
- Annually recalculating the tax cost projections (or ensuring recalculations are completed) based on actual final numbers to arrive at new amounts to be charged out: this essentially trues up any discrepancies and spreads the difference.
- Ensuring that actual amounts are accurately recorded in a timely manner and that accruals are relieved as appropriate.
- Managing accruals by business unit on a centralized basis.

The person responsible for maintaining and monitoring the accruals can rely on data gathering and calculation tools to manage the IA population over the lifespan of the assignment. Actual budget results can be easily compared and analyzed to determine why discrepancies exist. An increase in accrual may be explained by an increase in compensation or a tax law change that was not in effect at the time the accrual was set. In addition, trend analysis using technology solutions can be performed to determine if there is a need to revise the compensation package offered to employees. It can also help determine if modifying the candidate selection process—including the consideration of short-term or local hires within a country—may help minimize the tax impact of the assignment to the fullest extent allowable.

Adopting a new approach

We have found that the structured, practical approach to tax equalization costs outlined in this article tends to minimize surprises. Our clients use variations of the approach to create customized versions of the methodology, yet adherence to the following core principles is crucial to their success:

- Oversight—Central control or oversight must be provided. Who will own the process?
- Discipline—The key to successful implementation of our approach is annual review of the projections and adjustment of the accruals as necessary. Regardless of who is responsible for the calculations, they should be revisited at least annually to smooth any “spikes” that generally occur at the end of an assignment (or later).
- Communication—Good communication ensures that all stakeholders understand the process and why outstanding accruals are not credited back after the assignee returns home (since the final liability is still outstanding).
- Tax knowledge—Combined with technology solutions, provide the stakeholders with the tools to effectively manage the dynamic nature of tax laws that impact the international assignee.

With the appropriate guidance and support, it is possible to virtually eliminate many of the time-consuming and potentially costly surprises associated with tax equalization costs. Companies should evaluate their acceptable margins of error and internal skill sets to determine the best approach and the resources necessary to implement a more efficient methodology for budgeting and accounting for IAs.



International assignees

The difficulties of multistate reporting in the US

David Austin and Cristina Schrob

Multinational companies may have two types of international assignees whose activities trigger US payroll reporting and individual taxation: non-US employees working in various locations within the United States and US employees assigned abroad who may travel to the United States for business trips during their foreign assignment period. In each case, there are US tax compliance requirements for both the individual (federal and state individual income tax returns and perhaps estimated payments) and the employer (income tax withholding).

However, even employers who comply with *federal* payroll requirements often are not aware of the *state* tax compliance issues for international assignees, particularly when an employee performs activities in more than one state. In today's increased regulatory environment, higher levels of awareness and compliance are necessary to mitigate a companies' and employees' heightened risks for audits, interest and penalties.

This article explores the state tax compliance issues that companies face with respect to international assignees, including (1) the difficulties of determining the individual tax filing requirements for assignees in their nonresident state locations, (2) tracking multistate workdays for assignees and (3) employer payroll withholding and reporting requirements.

Complex rules, complex situations

Each state has its own rules for determining whether an employee is subject to tax in that state, as either a resident or nonresident. The rules are just as varied with respect to the treatment of US citizens who work abroad and non-US employees working in the United States. These multiple layers of complexity can create difficulties in determining state income tax reporting and withholding requirements.

Foreign employees on expatriate assignments in the United States are generally subject to the same state tax requirements as US citizens: those who live and work in only one state and meet state residency requirements file resident individual income tax returns and are subject to withholding on all income earned in that state. However, since foreign employees may work in the United States for limited periods, it is important to look at each state's definition of a residency period, as some states allow these employees to file as nonresidents.

Generally, it may not be difficult to track the requirements for employees who work and live in one place for the entire year, such as a foreign employee who arrives in the United States and works and lives for an extended period within a single state. Likewise, when a US employee goes abroad and stays abroad for an extended period without traveling back to the United States, tracking for these assignees can be manageable.

But reality is often less straightforward. For example, a foreign employee working in the United States may actually work in multiple states during his or her stay. Also, US employees working abroad often return to the United States for vacations during their foreign assignment period, and they may return temporarily for business meetings or other necessary work before returning abroad. While in the United States, these assignees may also spend time working in several states.

This reality often leads to noncompliance on the part of both the employee and the employer. One area that can be problematic is income tax reporting: Does the employee who works in multiple states file nonresident returns as required in those states? These filing requirements often are identified, but typically, the identification is done after year-end by the tax preparer of the individual's tax returns. Even if proper nonresident state returns are filed, the individual's tax return may still be assessed with penalties and interest if there have not been adequate withholding and/or estimated payments made throughout the year. Generally, tax equalization agreements for international assignees direct companies to reimburse such interest and penalties.

Many states permit a US expatriate to be classified as a nonresident during an overseas assignment. In these cases, generally only the amounts earned for work performed within that state are subject to state

withholding. For example, in Illinois, residency generally ceases during the overseas assignment of an individual who was an Illinois resident immediately preceding the assignment, provided the individual stays outside the state for more than 12 months.

Conversely, for Colorado purposes, residency generally continues during the overseas assignment of an individual who was a Colorado resident immediately preceding the assignment, and amounts in excess of the foreign earned income exclusion (i.e., Internal Revenue Code Section 911) are subject to withholding.

A further level of complexity arises from the fact that states have diverse threshold rules for determining how many workdays an employee must conduct in the state before becoming subject to nonresident taxation and withholding. As a result, adequate compliance requires that an employer accurately track the workdays of these international assignees on a state-by-state basis in order to determine which states require:

- The employee to file a nonresident individual tax return
- The company to withhold state income taxes from the employee's wages
- The company to file payroll, unemployment tax and other returns

Easier said than done

For companies that have a payroll system capable of tracking each employee's state of work activity on a daily basis, identifying multistate workdays can be manageable. However, many, if not most, payroll systems either do not or cannot capture that information. In such instances, the information would need to be tracked and updated manually by the payroll department, which is an extremely tedious process. When internal or outsourced systems do not identify the time an employee spends in multiple states, they generally also do not capture the time a US expatriate works during a temporary return to the United States.

Take the case of a US employee who formerly lived and worked in Illinois, then moved, along with his family, to Italy for a three-year overseas assignment. Near the end of the first year, the employee and his family came back for an extended vacation. While the family remained in Illinois on vacation, the employee worked in Michigan for a few weeks and then in New York for a few weeks before they all returned to Italy. It is likely the payroll department never learned that the employee was working in any of those states, much less in the United States at all. As a result, even if the employee was subject to state tax in any of those states, there is all too frequently no withholding or payroll reporting, which leads to penalties and interest if and when the employee later files state individual income tax returns for this work activity. In addition, the employer may be assessed up to 100% of the tax that should have been withheld, as well as

penalties and interest for failure to withhold and remit the appropriate state income taxes.

The same problem occurs for inbound foreign assignees. To the extent the employee remains in his or her resident state, withholding and reporting will generally be done correctly as long as the individual is set up correctly on US payroll. The compliance problem arises in the same situations as the US expatriate, commonly when the foreign assignee travels to other states to work and the company does not have the ability or the proper process in place to track the workdays and state payroll requirements.

Paths toward compliance

Many companies do not have a system for tracking employee time (e.g., daily timesheets) in terms of workdays by state. In today's environment, a wait-and-see noncompliance strategy is far riskier than in the past because states have become increasingly aggressive about targeting temporary workers, increasing the likelihood of audits and resulting penalties and interest.

Consider a case in which a US employee working abroad returns temporarily to the United States and works during his or her stay. One might erroneously conclude that a state has no way of knowing about those US workdays. For example, some states—New York, for one—are combating noncompliance by reviewing employee expense reports. Auditors may request expense reports for the top 100 highly paid employees that are

nonresidents of New York (and not assigned to a New York work location). This review can identify which non-New York employees worked in New York and for exactly how long. The auditor can then extrapolate the result for those 100 employees to a larger employee population to arrive at an estimate of total under withholding. The employer can be assessed up to 100% of the tax that should have been withheld, plus penalties and interest. Since there is a dual responsibility for state income tax—to the extent the employee has filed his or her individual income tax return and paid the correct tax to the state—the employer may not be assessed the withholding tax. However, the penalties and interest for failure to withhold would still likely be imposed.

If a company wishes to move toward compliance but is neither able nor ready to take on a comprehensive time reporting system that can track multistate workdays, are there solutions? We can offer some ideas that companies have successfully used as they begin to work toward multistate compliance for their international employees. A working approach includes three elements:

- Knowledge of the thresholds for reporting and withholding in each state
- Development of a practical tracking system for target groups of employees
- A team approach involving a company's HR, tax and payroll departments

Know the rules

Many states have a de minimis threshold that determines when an employee working within a state becomes subject to reporting and withholding requirements; however, each state's rules are a bit different. The chart in the appendix at the end of this article summarizes the de minimis withholding requirements for nonresidents in several states in order to provide an idea of the wide variety of state rules. For example, New York has a 14-day rule stating that no withholding is required if a nonresident is assigned to a work location outside the state and works in New York 14 days or less during the year. Both Georgia and Hawaii maintain several thresholds used in determining whether nonresident withholding is required, as shown in the chart. On the other hand, the de minimis withholding thresholds are so low in other states—such as California and Ohio—that an employee can be subject to withholding from the first day services are performed within the state.

It is important to note that some states maintain reciprocal agreements with their neighboring states, which can also affect nonresident withholding. A reciprocal agreement generally provides that if an employee lives in one state and works in another, withholding is permitted in the employee's resident state rather than in the employee's work state, which is normally required. For example, an employee who lives in Pennsylvania and works in Ohio would be subject to Pennsylvania withholding rather than Ohio, as indicated by the appendix chart.

Develop a practical tracking system

Knowledge of the rules must go hand in hand with tracking employee time to identify withholding and reporting requirements for specific employees. Companies that cannot or are not ready to implement a daily state-by-state reporting system for all employees can consider moving toward compliance by identifying specific target groups of employees representing the most significant exposure (e.g., highly paid employees, those employees who travel frequently or the expatriate population). A company could then develop an alternate system for tracking multistate working days for those employees.

A company might utilize a variety of tracking mechanisms. Here are two possibilities:

Expense report-based system. One way to identify multistate workdays and withholding/reporting requirements is by utilizing employee travel and expense reports. This method requires communication between the payroll department and those responsible for reviewing, approving and reimbursing employee travel and expense reports. One approach is to conduct quarterly or semiannual expense report reviews whereby the payroll department would perform a “day count” to determine how many days an employee has performed services in other states and whether they meet the de minimis threshold in the state for withholding. The review could be conducted for a specific group of employees or a random sample of employees.

Calendar system. International assignees meeting certain thresholds (e.g., based on pay levels) could be required to report their whereabouts on a regular basis to the payroll department. An electronic reporting system that tracks state workdays on a real-time basis can be utilized for certain employees. A simplified system could ask employees to estimate their planned workdays by state at the beginning of the year, and payroll could develop percentages by state and deduct those percentages from each paycheck throughout the year. The limitation with this approach is that in January, an employee may not know that he or she will need to go to a particular state later in the year, or for how long, but it may work for those employees whose work tends to follow a pattern.

A team approach

We often see a disconnect between HR, payroll and tax departments when it comes to reporting for international assignees, and no specific group assumes responsibility for compliance in this area. For example, the HR department may consider its responsibilities fulfilled for an employee going abroad when HR has arranged the move, housing allowance and other aspects of the relocation. The tax department may consider its role complete when the employee’s tax returns have been finished, while the payroll department may not be aware of an employee’s multistate travels or aware of the reporting rules for international assignees.

Add to the mix the fact that many companies use third-party payroll providers, and so the opportunity for noncompliance increases yet again because everyone may assume that the third-party provider has attended to all withholding and reporting requirements. Companies need a coordinated effort that looks at what is actually happening and asks where employees are, where they are traveling and whether they are being taxed in the proper jurisdictions.

In order to work toward compliance, HR, payroll and tax departments will most likely need to work together within an organization to find a workable solution that accounts for the unique characteristics of its systems and its employees.

Prepare for a bumpier road ahead

Always in search of revenue, states are beginning to more aggressively audit in this area, compelling companies to take a second look at their practices. New York is already auditing aggressively, and there are rumblings that Connecticut and California are considering audit programs similar to New York's.

In addition, in an effort to adopt a uniform approach to nonresident withholding and tax filing requirements among the states, The Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 (H.R. 3359) was introduced into the US House of Representatives in August 2007. Under the proposed legislation, states and localities would be prohibited from imposing

personal income tax on an employee's wages unless that employee is a resident of the state or locality or is physically present and performing duties within the state for more than 60 days during the year. Although the current proposal calls for a 60-day de minimis threshold, states that currently have a shorter threshold are trying to push for a threshold based on a lower number of days. At first glance, companies may think such a uniform 60-day rule would reduce compliance burdens, but it may in fact create a higher level of compliance because a nationwide standard would force companies to comply with every state. Further, many companies are currently in compliance only with New York, due to its increase in employer withholding audits. However, once a uniform rule is implemented, other states are likely to be more motivated to implement New York-type audit programs.

In light of this increased regulatory environment, companies with international assignees working in the United States—even on a temporary basis—are well-advised to revisit their process for identifying reporting and withholding requirements across state lines: both in terms of identifying the need for employees to file nonresident returns and in terms of the company's obligation for withholding and payroll tax reporting. Even for companies whose payroll systems cannot track multistate workdays, a higher level of compliance is possible when the HR, payroll and tax departments collaborate to create customized and practical solutions.

Appendix 1

Chart of sample state withholding rules

The table on the right summarizes the withholding rules in several states in order to illustrate the wide variety of approaches to this issue.

Note: This information is based on state rules as of March 31, 2008, and it is subject to change.

State	Nonresident withholding required	Minimum withholding threshold for employer	Current withholding reciprocity agreements
California	Yes	Wages in excess of “Low Income Exemption Table” amounts—see Method A, Table 1, of the California withholding tables (i.e., a semimonthly wage amount of \$485 or less for a single individual is exempt from California withholding).	None
Georgia	Yes	Withholding is not required if services performed are casual or intermittent and for no more than 23 days in a calendar quarter, or if no more than 5% of their total income is attributable to Georgia, or if no more than \$5,000 of their wages are attributable to Georgia.	None
Hawaii	Yes	Withholding is not required on wages if <u>all</u> of the following conditions are met: <ol style="list-style-type: none"> 1. The employee can show that he or she is a nonresident. 2. The employee is temporarily performing services in the state. 3. The employer can reasonably expect the employee to be in the state, in the aggregate, for less than 60 days during the calendar year. 4. The employee is paid for his or her services in the state from an office outside the state. 5. The employee does not have his or her regular place of employment for services for the employer in the state. 	None
New York	Yes	Wages paid in excess of the employee’s personal exemption; wages paid for services performed in the state for more than 14 days per year.	None
Ohio	Yes	Wages paid in excess of \$300 in any calendar quarter.	Ohio maintains reciprocal agreements with Indiana, Kentucky, Michigan, Pennsylvania and West Virginia. Residents of these states should have their resident state tax withheld rather than Ohio tax. Employees must complete Form IT-4NR and submit to employer.



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The dollar dive

How US expatriate programs are addressing issues relating to the falling dollar

Clarissa Cole, Eileen Mullaney and Merrilou Samson

As a result of the falling value of the US dollar, the costs of international assignments into and outside the US are rising for many employees and employers alike. These cost increases occur even if no fundamental changes are made to the assignment compensation packages of international assignees. Additionally, US employees working on assignment in foreign countries are looking to maintain their purchasing power in their host locations. As a result, more companies are reviewing payroll delivery approaches, with a portion of pay delivered in local currencies. Where companies (particularly US companies) typically value the overall cost of programs in US dollars, they often incur expenses in foreign currency—expenses that continue to rise above original expectations as the dollar continues to decline. Efforts to anticipate and control expenses while maintaining the integrity of their programs are prompting many US companies to reexamine some of their practices related to foreign assignments.

The first signs of a problem emerged just over a year ago. Many US employees on foreign assignments in Europe, particularly those in high-priced locations such as London, began to complain to their employers that the allowances they received in US dollars were not going as far as they used to because of the unfavorable exchange rates. The assignees weren't the only ones getting caught off-guard by such unexpected increases. Many companies are finding their assignment programs to be well beyond budget due to unanticipated rate increases—an issue that doesn't appear to be going away anytime soon.

The impact on human resources

There has been a broad impact on US-based companies who are using a headquarters-based package (USD); and all US-based packages. As a result, we are seeing three main HR issues emerge.

First, companies that shifted to 100% home-country pay delivery (no splits) in order to reduce administration in the year-end process are now reconsidering split payroll delivery options and/or third-party banking options. They are looking to deliver a portion of pay in local currency whereby the company bears the exchange risk on delivery of a portion of the compensation (i.e., host-country spendables).

Secondly, more employers are considering direct payment of some of the host-country allowances, such as host housing and school fees. Rather than converting such expenses to US dollars for the reimbursement to be made through US payroll (thus leaving it up to the assignee to manage the conversion of funds in order to make payments), companies are considering direct payment of these expenses locally on behalf of the assignee. Again, the company bears the exchange risk in this situation.

Lastly, companies that previously moved to annual or semiannual allowance updates in an effort to reduce administration are now reviewing allowance amounts more often—quarterly and in some cases, monthly.

For those assignees who are not on “traditional” (home-based) assignment packages but who may be on host-based packages, exchange rate issues need to be addressed and documented during the assignment planning process and communicated to the assignee. For example:

- Will funds need to be converted for home-country benefit obligations? What exchange rate will be used?
- Will there be an exchange guarantee?
- What income will be protected? How often? When will the rate be reconciled?

Refining program designs

The strategic importance of an international assignment program to a company’s global success should not be underestimated. This coincides with the reasons why companies, which have become very concerned about keeping their assignees happy and focused on work, are revisiting how they pay assignees. When assignees’ purchasing power drastically drops because of exchange-rate fluctuations, it can’t help but shift their focus from work to personal finance issues.

In the last year, PricewaterhouseCoopers has worked with more and more companies that want to proactively seek ways of addressing these delivery issues. We have helped these companies implement creative new policies and programs for the present, as well as helped frame their long-term strategies for assignee compensation.

Examples of some measures to consider include:

- Paying host-country expenses, such as housing or school fees directly to third parties or vendors
- Renegotiating or placing new clauses in assignee contracts to account for exchange-rate fluctuations (for nontraditional assignees only)
- Reviewing cost-of-living allowances more frequently (for example, reviewing and adjusting allowances whenever there is a 5% to 10% change in the exchange rate, rather than on a set review schedule)
- Including a buffer for exchange rate differentials in the assignment budget and accrual process

Tax liabilities

Program administration is just one side of the falling dollar issue. The other side involves the increased tax responsibilities that companies may incur. Higher liabilities present a tremendous burden for companies with a large number of equalized employees on foreign assignment, but there are measures companies can take to prepare for the jump in tax liabilities. Some may not realize that when it comes time to pay 2007 taxes in connection with tax reimbursement policies (such as tax equalization or protection); their tax liabilities will be far greater than anticipated.

When estimating expenses for the cost of assignees, accruals—in relation to the projected tax hit—tend to be vastly understated. It is best for companies to reevaluate and adjust accruals so they will not be surprised by the amount of tax owed for the year on behalf of their assignees. Foreign tax credits (FTCs) may provide some US tax relief, but not always complete tax relief.

Furthermore, income reported for US purposes must be converted into US dollars at the exchange rate in effect on the date paid. This often results in a higher than expected amount of US dollar income being subject to US income tax.

The following table illustrates the jump in tax liabilities from 2006 to 2007 for one hypothetical employer:

Foreign national assignee in the US	2006	2007
Foreign currency to US dollar	1:1	1:1.5
Salary and bonus (FC 200k)	\$200,000	\$300,000
Host country (US) expense reimbursements	\$50,000	\$50,000
Taxes (US only)	\$75,000	\$105,000
Total cost in US dollars	\$325,000	\$455,000

Why do higher tax liabilities occur?

High-tax foreign jurisdictions: US assignees in high-tax jurisdictions, with income paid from foreign-sources, may find that their foreign taxes will go up in US dollar terms. If all foreign-source income is subject to the higher foreign tax rate, the individual's US tax liability will often remain at zero, since it would continue to be offset by foreign tax credits. If the employer that funds the foreign taxes does business in US dollars, its costs will increase as the US dollars needed to fund the foreign tax liability will increase.

Foreign jurisdictions with low effective tax rates: If an assignee lives or works in a low-tax foreign jurisdiction, this often translates into insufficient foreign tax credit to fully offset the individual's US tax liability. This can also occur when a higher tax foreign jurisdiction does not tax all of the income that would be considered gross income for US tax purposes. In such cases, the effective rate of foreign tax could fall below the effective US tax rate, creating excess US taxes. If items of income are paid in foreign currency, the US dollar equivalent—and therefore the excess US tax costs—will increase.

US sourced income of US expatriates: If the assignee has some US-source income created by having US workdays during an expatriate assignment, the US tax on that income cannot typically be offset by foreign tax credits, since foreign tax credits can offset US tax only

on foreign-source income. In this case, if the assignee has US-source income from US workdays that is paid in foreign currency, the assignee's US tax bill will increase because the assignee's compensation will be translated to US dollars at a higher exchange rate.

Accrual-basis of claiming foreign tax credits-exchange rate impact: Foreign taxes paid on behalf of an employee under a tax equalization or tax protection policy, or any other compensation paid to an employee in foreign currency should be converted into US dollars on the date paid for purposes of determining the US dollar compensation amounts to be reported on a US tax return. For US tax purposes, foreign tax credits can be claimed using either the "paid" method or the "accrued" method. Each of these methods has rules for determining the exchange rate to be used when converting foreign taxes to US dollars. It is possible, therefore, for foreign taxes to be converted into US dollars by using one rate for income purposes and one for foreign tax credit purposes. This can lead to interesting results.

Example:

Employee A worked in country Z during all of 2007 and is on the "accrued" method of claiming foreign tax credits. On July 10, 2008, A's employer made a FC 100,000 income tax payment to country Z on his behalf. The average exchange rate for country Z currency to US dollars is 1:1. The exchange rate on July 10, 2008,

however, is 1:2. When this individual's employer converts the FC 100,000 tax reimbursement payment to US dollars for purposes of US tax reporting, the company would report \$200,000 of compensation for US income tax purposes (using the 1:2 exchange rate). However, for foreign tax credit purposes, the payment is worth only \$100,000 of creditable foreign tax (using the 1:1 exchange rate). Perhaps more importantly, other income items paid on the individual's behalf in foreign currency during the year, such as housing, may translate into a higher income inclusion, with a lower corresponding creditable foreign tax. Where foreign tax credits may have been sufficient to offset US tax on foreign-sourced income in previous years, they may no longer be as a result of the falling dollar. The unexpected US residual tax due may catch many employees and employers by surprise.

Foreign assignees working in the US: When non-US employees are sent to work temporarily in the US, their pay is often denominated in foreign currency (e.g., base, bonus, cost-of-living and other cash allowances). If equalized, the US host company often covers the US tax costs related to such workers for the period of the assignment. An individual's £100,000 base pay from the United Kingdom may have resulted in \$140,000 in reportable compensation for US tax purposes in previous years, but now may result in \$200,000 of reportable compensation. The US tax on \$200,000 of US-sourced compensation is obviously much higher than that on \$140,000, and that is before considering potential gross-up and payroll tax requirements. A very unexpected hit for an individual whose pay remains constant at £100,000!

A look forward

Assignee package design and delivery issues will continue to be a topic of discussion as more and more employees are sent on assignments—both as a regular part of doing business and as a popular component of employee development in a dynamic global marketplace.

As companies prepare workarounds to deal with the devalued dollar—on both the program administration and tax policy fronts—they should consider incorporating processes into their programs so that exchange rate concerns do not impact the employees' foreign work experiences or company budgets.

Structured, yet flexible, programs keep assignees focused on their work and employers competitive on the global front.



Equity compensation compliance and the globally mobile workforce

Simon Davies and Pamela Weems

The challenges corporate executives face today are enormous: managing the bottom line, cultivating cross-disciplinary coordination without diluting the unique skills and experience levels of each contributor, and driving employee empowerment to set and implement priorities aligned with the corporate mission, vision and strategy across a myriad of locations. In addition, as companies continue to expand their breadth across multiple territories, the workforce becomes more and more mobile, resulting in a multitude of compliance challenges. In the midst of such challenges, companies continue to rely on equity compensation as a critical element of total rewards.

A company seeking to recruit executives and employees who can harness the company's potential must understand current trends in equity compensation practices and their implications across the various markets in which they operate. To this end, PricewaterhouseCoopers launched its fifth annual Global Equity Incentives Survey.

The Global Equity Incentives Survey is one of the most comprehensive studies available on the design and administration of equity incentive compensation plans for multinational companies. The 2007 Survey was conducted during June and July 2007 and comprises data related to a variety of types of equity compensation. One hundred fifty-two multinational companies based in 15 countries worldwide participated in the Survey, with 64% of participants based in the Americas, 28% based in Europe and Africa and 8% based in Asia-Pacific.

This article reviews some of the current perspectives on and practices in equity compensation that were recognized in the Survey, and it reflects on how some of the key findings demonstrate the increasing challenge around global compliance when managing international assignees.

Stability in equity compensation

In the wake of new rules mandating an expense for all forms of equity compensation, increased workforce mobility across the globe and a seemingly constant change in tax regulations, equity compensation programs have become more complex to manage and more expensive to administer. However, employers remain overwhelmingly positive about the value of equity compensation. In fact, Survey participants almost unanimously (97%) reported that the benefits of equity compensation outweigh the costs, up from 75 to 80% during the period 2003–2006. This goes to show that when people at all organizational levels are responsible for bringing the company to life, it makes sense that stock in the company becomes a potent tool for binding together the interests of shareholders, executives and employees alike.

Moreover, the increased administrative and compliance burdens resulting from international expansion of equity plans is not dissuading companies from such expansion. On balance companies are more likely to be considering expanding the global reach of their equity plans than contracting, and 84% of companies recognize the value of a cohesive global equity compensation philosophy, citing this as the key driver of the international reach of their stock plans.

Companies are generally positive about the value of their stock plans and about the increase in benefits to their mobile and internationally based employees, but are they engaged in managing the compliance challenges that this creates?

The global compliance challenge

The headline indicators seem encouraging: Companies are certainly not blind to the challenge that compliance poses; in fact, 74% of respondents said it was the single most challenging aspect of offering a global equity compensation plan (up from 68% in 2006). At the same time, companies are also confident that their plans are compliant. Ninety-eight percent of respondents claimed that their plans were compliant in the headquarter country, 76% claimed that their plans were compliant in all other countries; and 22% stated that their plans were somewhat compliant in other countries. However, there are clues scattered throughout the Survey—disconnects in the actual practices that companies are using to manage compliance risk—that indicate many companies may be less compliant than they think.

Companies should administer a global equity review as a ‘health check’ of their compliance status, followed by periodic updates to practice and policy in order to ensure that their compliance practices are kept up-to-date with developments.

A successful compliance model for international equity compensation rests on four broad practices: tracking, sourcing, withholding and trailing liabilities.

Tracking

To a greater or lesser extent, international income taxation of equity compensation is dependent upon where a particular employee has been working over the life of any given award. Therefore, ensuring tax compliance without a system to track employee assignment history, as well as equity grant and vest history will become very problematic.

The Survey asked companies to share how they track employee mobility, which resulted in a broad range of

responses. Some companies assign this responsibility to the equity compensation team; others, to global mobility. However, an alarming percentage of companies—35%—admitted to having no procedures in place for tracking mobility. Of this 35%, over half considered the size of their internationally mobile population to be too small to warrant prioritizing this task, and another third said they were still developing an effective tracking strategy.

This is a concerning statistic. Without the ability to track employee movement, any further attempt to ensure tax compliance of an equity plan will be severely hampered. To meet global compliance challenges, the first simple step for any company is to review the current tracking system in place and make regular, necessary improvements to ensure accuracy. Without tracking—at a minimum—the assignment dates, locations and tax residency status of globally mobile employees, it is impossible to determine the correct reporting of income and withholding of taxes. The sophistication of a tracking application will depend on the size of the mobile population, as well as the prevalence of equity compensation in the organization.

Sourcing

Having collected the necessary employee assignment data, procedures must also be put in place to use this information toward accurately sourcing equity compensation according to domestic income tax and security requirements, or to the provisions of double tax and totalization agreements. Again, the Survey findings here appear to be at odds with the initial confidence in compliance. Only 47% of respondents said they source equity income in relation to awards provided to expatriate or cross-border employees.

With less than half of respondents citing appropriate sourcing of equity income, a gaping margin of error in global compliance is coming to light.

Withholding

Income tax withholding (federal and state)—and to a lesser extent, social security and Medicare tax withholding—is generally dependent upon the allocation of income specific to the particular circumstances of the individual. The number of companies reporting that they do not withhold taxes from equity income is reassuringly low, at 3%, and 74% of respondents indicate that tax withholding is operated by the broker or payroll. However, with regard to restricted stock units (RSUs), the Survey took a deeper dive and asked how the withholding rate was determined. Six percent of companies indicated that RSU income from outside the US was not subject to withholding at all; 43% of respondents said that a generic withholding rate was used based on requirements in the country of vest; and 37% said that withholding rates were calculated individually based on total income reported in payroll.

Although it is possible that either of the second two approaches above may produce compliant results in certain circumstances, the fact that thirty-five percent of companies are not tracking mobility and more than half of companies are not sourcing equity income means that for those companies, compliance with reporting and withholding obligations in all countries concerned is most likely impossible.

Trailing liabilities

Simply put, trailing liabilities are tax liabilities generated by equity income earned in a particular country but recognized only after departure from that country. Although correct liability reporting and withholding would be handled by a thoroughgoing set of procedures in place to handle

tracking, sourcing and withholding of equity income, the difficulties in managing trailing liabilities are more acute as they are often determined by facts separated from the date of income recognition by several years.

Once again, there is a marked discrepancy between the companies' confidence in the compliance of their plans versus actual practice: only 46% of companies consider trailing liabilities once an expatriate or cross-border employee leaves a particular country. This disconnect might be understandable if companies were faced with a degree of ambivalence on the part of taxing authorities. However, such is not the case, and companies today are well aware of the current climate.

In addition to indicating that compliance is the biggest challenge when administering a global equity plan, companies have reported a remarkable uptick in audit activity in almost every country. Almost 45% of companies were subject to a tax audit with regard to their equity plan over the past three years in the US and over 30% in the UK (up from 20% and 12% respectively, in 2006). This trend of increased audit activity was borne out in almost every country (only the Netherlands and Canada reflected modest declines in activity).

Not only is audit activity on the rise, but the procedures that taxing authorities put into place to ensure compliance are becoming more sophisticated. For tax authorities and companies alike, tax compliance in the assignment country at the time that equity income is recognized is less problematic than when income is earned in the country but recognized postdeparture. Therefore, many compliance initiatives have concentrated on these trailing liabilities.

A call for improvement

Companies are generally that are positive about the value of their stock plans and benefits provided to their internationally based employees, but their processes for managing the resulting global compliance challenges are shaky, at best. The 2007 Global Equity Incentives Survey shows an interesting and concerning dichotomy between—on one hand—the recognition of the inherent value in a global equity plan and the acknowledgment of resulting compliance challenges in addition to tax audit risk and—on the other hand—the limited application of appropriate practices required to facilitate compliance in terms of data tracking, income sourcing and accurate tax withholding.

Perhaps the clearest indication of this contradiction is illustrated in the following survey results: although 74% of companies identified compliance as the biggest challenge to administering a global equity plan, only 3% of respondents considered the tax function to be one of the key decision makers for their equity compensation plans.

Of course, tax compliance is just one aspect of managing a successful global equity plan. However, the risks to companies that fail to address these challenges appropriately are significant—both in terms of sanctions imposed by taxing authorities and in the potential damage done to the viability of what companies view as a key tool to incentivize and align the efforts of employees with the ultimate goals of the company. Clearly, much improvement is needed in order to better address the challenges of equity compensation compliance for the globally mobile workforce.

What some countries are doing to help address trailing liabilities

Preventing revenue leakage in the form of undisclosed trailing liabilities lies in the accurate gathering of information to substantiate when income recognition events have occurred—a challenging task in itself.

To help minimize the margin of error, the UK requires the annual filing of form 42, which requires the employer to provide full details of equity awards to HMRC. This information includes the names and tax identifying numbers of employees receiving awards, the exercise price and the market value of the stock on date of exercise. Gathering data in this way allows for cross-checking against income reporting and tax withholding through the UK payroll, in addition to individual income tax returns.

The UK is not alone in putting such measures in place to ensure accurate data collection:

- Circular 35 in China requires that the plan documents and a list of eligible employees be registered with the local tax authority.
- In Ireland, grants and exercises of stock options must be reported on form SO2 each year.
- Hong Kong requires that grants of options predating the Hong Kong assignment that have not yet vested be reported when an individual is transferred into Hong Kong on the commencement notification. Similarly, annual reporting of stock grants made to individuals while on assignment in Hong Kong is also required on form IR 56G.
- In addition, a small number of countries have used an exit tax to capture trailing liabilities at the time that an employee departs the country. For example, Singapore has exit tax procedures that require companies to request tax clearance for departing employees at least one month before the individual departs the country.



Balloon festival in South Africa

Africa: Challenge or opportunity?

Felix Mwamba Kasanganayi

Think “Africa” and what comes to mind? Unexplored wilderness and remote villages? Pockets of political unrest and poverty? This is one face of Africa. But Africa is also a land of tremendous business opportunities and a vast, largely untapped market of people and other resources. It is a continent that is changing rapidly, and many of those potential markets are now being tapped—successfully.

This article provides insight into the current business climate in Africa and discusses some of the common global mobility issues facing companies moving into the continent.

Africa 101

Africa is a huge—and hugely diverse—continent. It is more than three times the size of the continental United States; the nations of West Africa alone cover the size of the continental US. Africa has over 50 countries, more than 1,700 languages and over 700 million people.¹ (A comparison: the United States has over 300 million people.)

Africa is generally divided into five cultural-geographic regions: North Africa, West Africa, Central Africa, East Africa and Southern Africa. While many people think of Africa as having vast stretches of desert and jungle, the Sahara Desert covers only approximately one-third of the continent, and only a small percentage of the continent is rainforest (along the Guinea Coast and in the Congo River Basin). Most of Africa’s forests, like the forests of Europe and North America, have been eliminated to create farmland. The largest vegetation zone in Africa is tropical grassland known as savanna.

The continent is a land of extreme contrasts in many other ways. For example, in certain parts of Africa, there are large, modern, cosmopolitan cities not unlike any in

Europe or the US, while a country like Somalia suffers from severe underdevelopment and constant war.

The development of these “Western” urban centers can be largely attributed to the European colonization of Africa in the 1800s, which had major effects on African culture that are still felt today. In 1880, Africans ruled approximately 90% of Africa under local and traditional rule. However, by 1900 nearly all of Africa had been consolidated into 50 countries ruled by European nations—primarily Great Britain, France and Belgium.

This “scramble for Africa,” as it was known, resulted in dramatic cultural, political, and religious effects on the African continent. The artificial divisions disregarded Africa’s physical landscape, indigenous cultures and linguistic differences, separating coherent groups of local identities and combining disparate groups who often did not get along.

Colonization resulted in broader use of common languages, primarily English and French. The colonists also made massive infrastructure improvements, providing roads, railways, harbors and ports, and utilities, although many of these improvements were built with African forced labor. Colonial rule also imposed new legal systems based upon European concepts of law, often at variance with indigenous legal systems. On the other hand, though the colonists were from democratic countries, colonial rule was not democratic, with little or no input from locals.

In spite of European colonization, the development of economic and political stability in many countries is an ongoing challenge, while at the same time “democracy is spreading across Africa. Twenty years ago, the continent

¹ <http://www.indiana.edu/~rcapub/v21n3/p02.html>

had very few democracies. Today, although people debate exactly what constitutes a democracy, most scholars would agree that 50 to 60 percent of African countries are now democracies. South Africa is probably the most dramatic example of a country that has moved from an extremely authoritarian regime to an open democracy, when apartheid came crashing down in 1994.”²

Africa supplies the world with many natural resources—from agricultural products including coffee and tea to industrial resources such as copper and cobalt. More than half of the world’s diamonds and gold are supplied by African countries.³ It is also a continent with huge oil and gas reserves, as described later.

A changing business environment

Twenty-first century Africa offers vibrant opportunities for business. According to the United Nations Economic Commission for Africa (UNECA), African countries have the highest rate of return on investment in the world.

Further, Africa is of increasing strategic interest to the global economy because of its oil and gas resources. The continent has the world’s highest ratio of what is known in the industry as “light” and “sweet” crude oil (i.e., highest quality), preferred by refiners in big consuming countries, and in the past 10 years, Africa has experienced an unprecedented boom in oil and gas investment.⁴ In 2006, US President George W. Bush set forth a strategy reducing oil imports from the Middle East that is likely to result in even greater strategic importance for Africa.⁵ China and India are doing significant and rapidly increasing business with Africa, and the top supplier of oil to China is now a single African country: Angola.

According to Doing Business Report 2008, an annual survey produced by the International Finance Corporation and the World Bank, Mauritius ranks eighth globally for ease of starting a business, and South Africa is in the top 10 for strength of investor protections. This is not to say that there are not challenges facing companies doing business in Africa. There can be high regulatory burdens for companies wishing to start a business, difficulties with corruption and contract enforcement, infrastructure issues and the consequences of disease. For example, the prevalence of AIDS is a clear problem for employers.

There are large available unskilled workforces with labor costs significantly lower than Europe and North America. However, finding well-trained, highly skilled labor can be a challenge and many companies seek to bring experienced people in from elsewhere to work with and train local labor forces. In addition to the recruitment of individuals born and raised in other countries, there has also been a movement seeking to bring back Africans who have moved elsewhere, often to obtain an education. Interestingly, however, while employees are commonly offered salary premiums to work in Africa, the salaries offered to returning Africans are often lower than those offered to other relocating workers.

Transparency in corporate reporting has also been a challenge; however, in recent years much has been accomplished by multiple international organizations to improve corporate governance reform and strengthen institutional frameworks for corporate reporting.

As John Luiz points out in *Managing Business in Africa*, “‘Africa is not for sissies’ is a common refrain that encounters investors looking at expanding their foothold into the continent.”⁶

² <http://www.indiana.edu/~rcapub/v21n3/p02.html>

³ <http://www.indiana.edu/~rcapub/v21n3/p02.html>

⁴ Financial Times, January 28, 2008 (Africa: Oil & Gas special report).

⁵ Ibid.

⁶ *Managing Business in Africa: Practical Management Theory for an Emerging Market*, Oxford University Press, South Africa, 2006.

HR challenges—an overview

In 2005, PricewaterhouseCoopers conducted a survey, *HR Challenges: Yesterday, Today and Tomorrow*, on behalf of the World Federation of Personnel Management Associations, which gathered responses from some 200 companies in more than 35 countries. In response to the question, “Please choose three areas that represent significant challenges for you today,” the top issue most often chosen by the African participants was change management (63%). When asked what they expected the top challenges to be in three years, the top two responses were organizational effectiveness (44%) and leadership development (38%).

As one representative noted, the key is “working with line managers across cultures to challenge prevailing ‘authoritarian’ thinking, to [move toward] a climate which promotes personal responsibility and freedom.” Another pointed out that “managing diversity in the local context is [an] enormous [challenge] in a fast-changing technological and economically liberalized environment.” Bureaucracy can also be a problem, presenting “the need to consider doing things differently in order to eliminate bottlenecks and red tape.” Looking forward, empowerment of local managers was seen as a priority issue.

HR effectiveness presents a challenge when, in one representative’s words, “line managers think performance management, job evaluation, monitoring and evaluation [are] a waste of time. This attitude bogs down the efforts by the HR team.” Or, as another put it, “staff still have a negative view of HR, look at it as bad news bearers.”

The survey noted that leadership development is a key issue in a region with “high labor turnover” and a “young and inexperienced work force.” This may be a particular challenge in a region faced with the enormous impact of the AIDS virus and regional wars. Due to the combination of a large proportion of the workforce ailing and the introduction of new industries and businesses that require local talent who are currently not trained to meet those needs, there is a vacuum for HR professionals to fill.

The survey respondents also indicated that events such as the AIDS epidemic, the democratization and liberalization process occurring in many countries and the turmoil stemming from the political and economic climates impacted the ability of organizations in the region to source, engage and retain their workforces.

Cultural differences

With over a thousand languages and, by one count, almost 80 ethnic groups, Africa is a rich mosaic of cultures that does not lend itself easily to sweeping generalizations. Yet there are some tendencies that international assignees should be aware of—the most challenging for those coming from North American or northern European countries is perhaps the African notion of time. Africans are generally described as being “polychronic”—highly flexible with regard to time, carrying out tasks in an opportunistic rather than logical manner, intertwining projects and agenda and often doing several things simultaneously.⁷ In a work environment, this can easily mean that people show up late—or not at all—for meetings; it may take far longer than anticipated to obtain needed or requested information; deadlines can be difficult to meet; and considerable follow-up may be

⁷ Luiz, p. 177.

necessary. Assignees coming from North America in particular will need to adjust to the fact that holidays and other breaks can be significantly longer than they are used to; for example, a factory may close for four weeks.

For individuals educated in North America or Europe, it is important to be aware that local nationals may not have the same type of business skills, knowledge and training and that conveying these views may be an ongoing process. In addition, a manager coming from a Western culture and its value on individual achievement will find an African workplace that generally places a higher value on collective behavior. “These realities suggest that the prescription and more importantly, the application of standard management tools cannot always be expected to work.”⁸

Expat managers need to be sensitive to race, class and tribal issues. For example, if a business appoints a Hutu supervisor for a Tutsi worker, there will almost inevitably be clashes between the two individuals. Race also presents a wide range of implications. For example, South Africa had an apartheid regime until 1994, and international assignees must be cognizant of its legacy. South Africa now has an affirmative action policy; many industries also have black empowerment targets. Businesses have to be BEE (Black Economic Empowerment) compliant to obtain public-sector work.

Another layer of complexity arises from the increasing numbers of workers from China in certain industries, such as construction, who have different notions of time and urgency. A manager will thus need to understand not only the values and work habits of African workers but those of foreign workers as well.

Language is another area in which the expat worker can expect adjustments. For example, in Cape Town, South Africa, meetings are likely to take place in Afrikaans. Across Africa, the language barrier can be significant even if English is used, because it is often a second and imperfectly acquired language for many workers. It can be quite helpful to learn a bit of the primary local language.

Companies and workers should also be aware that, due to a heavy bureaucratic hand, setting up an operation can take significant time. Timing must also take into account that if multiple regulatory permissions are needed, as is generally the case, the process is sequential—only one can be obtained at a time. For example, a business license may be required before tax registration can be arranged.

Health and safety

Disease and violence are facts of life in certain areas of Africa. For example, according to UNAIDS estimates,⁹ the average HIV prevalence in 2003 in the countries of Southern Africa was 16%, in East Africa 6% and in West and Central Africa 4.5%. (In North Africa the incidence is far lower, at less than 0.1%.) In addition, in the later stages of AIDS, infected individuals are more susceptible to tuberculosis. But what do these conditions really mean for a company or worker coming to Africa?

With respect to both HIV/AIDS and tuberculosis, the same precautions that an individual would take anywhere else are necessary in situations involving risk of transmission. In addition, the disease carries several particular implications for employers in Africa. The prevalence of both diseases can result in high employee absentee rates. With respect to HIV/AIDS, on worksites that are subject

⁸ Luiz, p. 132.

⁹ http://data.unaids.org/Publications/IRC-pub07/jc1058-aidsinafrica_en.pdf

to a higher risk of occupational accidents employers need to ensure workplace safety training. With respect to tuberculosis, employers need to be aware of the symptoms, since the disease is highly contagious. Once recognized, an infected employee can be sent home, limiting exposure to other employees, and provisions can be made for appropriate medical treatment. Employers also need to educate employees about the symptoms, since the disease is highly treatable in its early stages. Expat managers hiring local workers need to understand how local medical aid funds work and what the standard benefits are—and that such benefits are not costed in the same way as they might be costed elsewhere. In addition, many expatriate employees employ domestic workers who may be infected with HIV/AIDS; expats may need to provide for long-term care for these domestic employees.

Personal safety is a legitimate concern. However, international assignees moving to Africa learn which communities and neighborhoods are safe and what precautions to take, then make residential and work arrangements accordingly. Do they feel safe? One person interviewed for this article works in a South African city that he considers quite safe for work, as long as he does not wander about the city during the workday. However, he would not want his family to live there, so he has chosen a long commute. In the community where he and his family live, he has no safety concerns. Another expat manager lives, as do most foreign workers in her city, in a guarded compound. She is not worried about her safety and points out that she is sure to drive with the car doors locked, but is quite comfortable walking her dogs alone.

In areas where security may be volatile, it is helpful to provide expatriates with security updates on a regular basis, as well as someone local they can contact for emergencies or concerns.

Taxation

Given Africa's 50+ countries, the tax picture is a varied one. PwC's 2008 report *Paying Taxes 2008—the Global Picture* includes a list of which countries made paying taxes easy or difficult. For purposes of that report, ease or difficulty was determined based upon statutory tax rates, the number of payments and time required to comply. In the report, four African countries (Mauritania, Dem. Republic of Congo, Central African Republic, and Gambia) made the list of the 10 countries that make paying taxes most difficult.

Consider some of the complexities: According to the report, to comply with regulations on taxes and contributions in the Republic of Congo, a company must make 89 payments a year, and fill out 50 pages of forms for corporate income taxes, 50 for labor taxes and contributions and 36 for consumption taxes. Although Zimbabwe is not in the top 10, another example from the report cites this country as being difficult because the taxpayer must attend a meeting, in person, to discuss calculations with a tax officer.

On the other hand, the report also indicated that Botswana ranks 4th globally for ease of paying taxes and the Middle East and North Africa have the lowest global tax rates. Further, it points out that a number of African countries have either eliminated or reduced taxes. For example, Ghana cut its corporate tax rate by 4.5 percentage points in 2005 and another three points in 2007, and Mauritius is gradually replacing its standard profit tax of 25% with a new rate of 15%. Likewise, Côte d'Ivoire (Ivory Coast) reduced its 2006/2007 corporate tax rate from 27% to 25%.

Figure 1. African Union comparison of total tax rates, from PwC publication, *Paying Taxes 2008—the Global Picture*

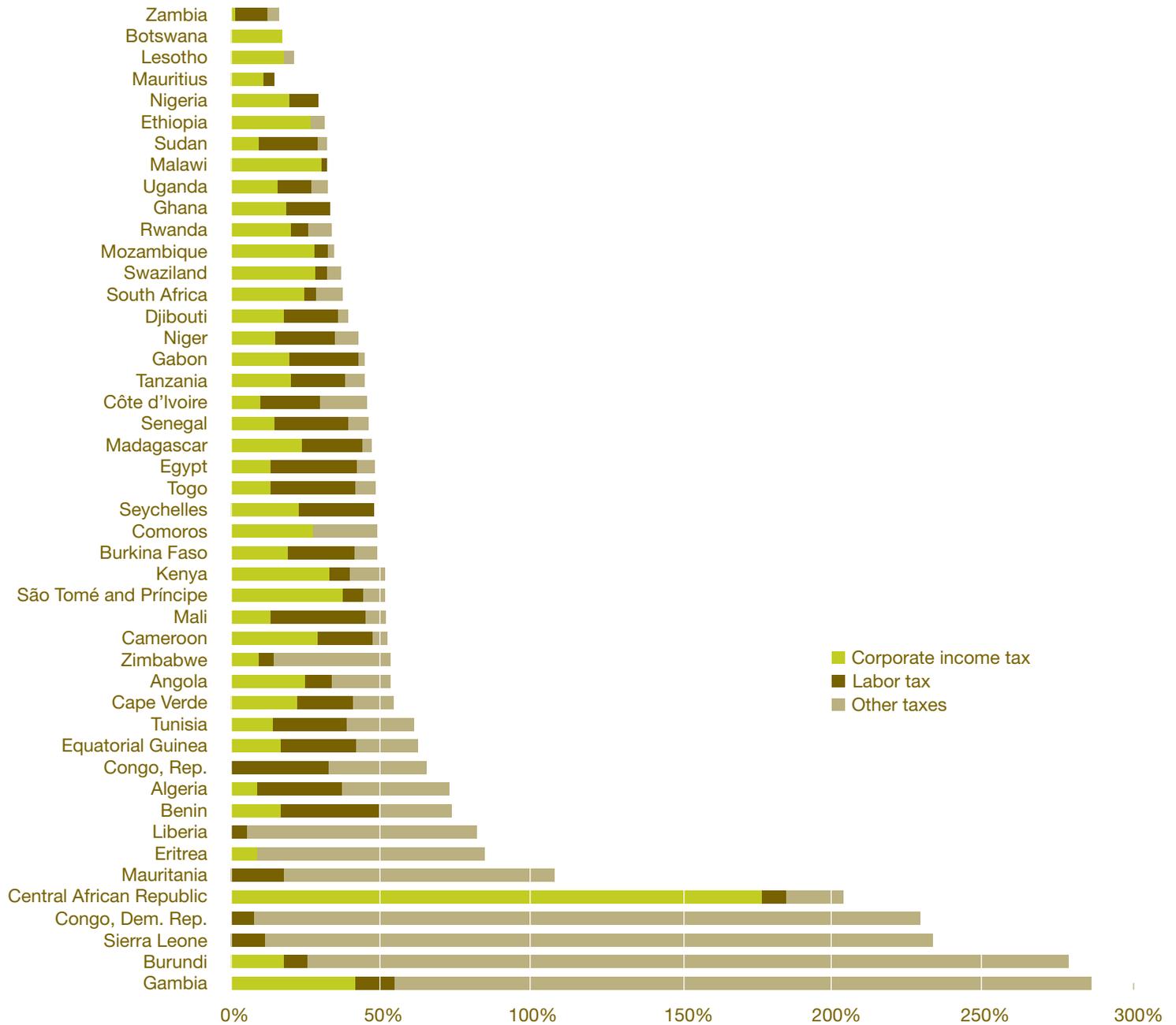
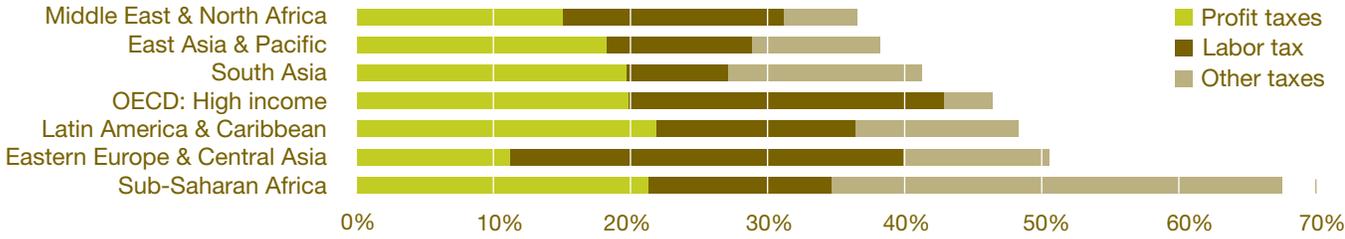


Figure 2. Total tax rate (% of profit), from PwC publication, *Paying Taxes 2008—the Global Picture*



From an individual viewpoint, the tax picture is complex. Some tax regimes are quite developed and sophisticated, while others are not. In addition, as with corporate taxes, individual taxation regimes can vary widely from one country to another. For example, individual taxation in South Africa depends on whether one is considered a tax resident. Residency status is usually only from the beginning of the sixth year of physical presence. Until that time, non-South Africa income is generally not taxable. Limited nontaxable allowances or tax structuring opportunities are available for international assignees other than employer-provided accommodations, which are tax-free for two years, subject to monthly capping and anti-avoidance provisions.

Regardless of country-specific tax provisions, expatriate employment agreements usually include tax equalization and settlement provisions. It is important to provide explanations to employees about these processes and the related calculations.

Immigration and other global mobility issues

Across Africa, incoming foreign workers are required to have immigration and work permits. Transferring workers can generally expect significant paperwork and time requirements for obtaining necessary documents, and it can be difficult for trailing spouses to get work permits. From an HR perspective, expatriate employees will need support in obtaining proper visas, residence cards and local contracts that are needed for compliance with government processes.

There is a wide range of permits and other required documents, and consultation with an immigration practitioner is vital.

HR can assist incoming foreign workers by providing transitional support services such as arranging for temporary living accommodations, destination and settling-in services, cultural and language training and job-seeking assistance for trailing spouses. Other means of assistance include arranging for someone to meet workers at the airport, local medical and security briefings, a local office orientation, and an introduction to other expats, including a “buddy system.”

Africa is considered a hardship location and can be expensive for expatriate workers; compensation packages generally reflect hardship and cost-of-living allowances. The cost of living in Africa can vary widely. For example, in Tanzania, food, housing and electricity are expensive, as is water, since it is brought in by truck. Medical care can be poor, and foreign nationals need private health coverage. Secure accommodation can be expensive. State schooling is generally considered inadequate by expat standards, and children usually attend private schools. However, in some areas, there may be few schools available for expats and those that do exist may be full or hard to get into, making boarding school in another country the only option in some cases. Private schools are also expensive, although expats generally receive an educational allowance.

Because many African currencies are volatile, most expatriates will prefer to be paid in their home currency or in a common hard currency such as the US dollar.

Challenge or opportunity?

Doing business in Africa is surely not business as usual. But many companies and many international assignees are finding that the rewards far exceed the risks.

With respect to businesses, the PwC publication, *African Oil and Gas: The New Horizon* points out that Africa yields the highest return on investment—four times more than in the G7 countries, twice more than in Asia, and two-thirds more than in Latin America.

For individuals, the rewards can be equally significant. As one individual from western Europe who now lives in Africa puts it: “We’ve had to make some accommodations to deal with the challenges but they’ve been well worth it.

Before I moved, my life was unquestionably safe ... but it was suffocatingly expensive and it wasn’t enjoyable. My standard of living has tripled here. I have a four-bedroom house with a pool, a guest cottage and household help. We can afford for my wife to stay home with the children. My commute, admittedly, is long so that my family can live in a safe place, but it’s worth it. I used to live in a cold, wet, miserable climate and now my children can be outdoors eight to ten months a year. I now live in an outstandingly beautiful country where there are magnificent wine estates and we can easily hike in the mountains and spend time at the ocean.” One final note: He and his family do not intend to return to their country of origin anytime soon. One clear vote for opportunity.

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