Alternatives to Tax Equalization

Responding to New Challenges for Multinational Organizations

By Thomas S. Tilghman and Gardiner Hempel Jr.

A common method to compensate expatriates for perceived higher costs and taxes associated with international assignments is the balance sheet approach with tax equalization as a significant component. This technique has proven effective in helping ensure that expatriates do not lose financially relative to peers at home. However, in recent years, a number of HR professionals have begun to question its use for all international transfers, especially in global companies (Tilghman 1994, Sheridan and Hansen 1996). It is the unusual firm that is not questioning the competitiveness of high costs that can be associated with the balance sheet approach and tax equalization, and whether the series of balance sheet allowances, including tax equalization, creates inequities among employees in international locations.

A major concern in the ongoing debate over the effectiveness of the balance sheet approach to expatriate compensation and the development of alternative approaches has been how to handle the higher individual income tax costs associated with international assignments. The basic tenet of the balance sheet approach is that expatriates should neither gain nor lose financially because of international assignments. In many international transfer situations, part of keeping the promise that expatriates will be kept whole is determining how individual income taxes will be handled.

Evolution of Expatriate Tax Programs

The evolution of expatriate tax programs has paralleled that of the development of expatriate compensation programs. Consider the following types of tax programs:

- *Laissez-faire.* Prior to the development of formal expatriate compensation programs, employees working outside their home countries often were compensated in an ad hoc manner and generally were expected to handle expatriate-related costs, including the possibility of higher home/host country taxes. Under a laissez-faire tax system, expatriates are responsible for paying home and host country income taxes. They do not receive any specific protection from potentially higher taxes related to the international assignment. They pay any higher taxes and get to keep any tax windfalls, although adjustments to base salary or other forms of compensation always can be made to offset the additional taxes or tax windfalls created by the assignment.

An organization with a laissez-faire tax approach likely will address the tax compliance issue through proper reporting of income to tax authorities and by obtaining representation from employees that they have filed all required returns. The organization may require the use (and/or reimburse for the cost) of a qualified tax preparer to ensure that returns are properly prepared, but expatriates are obligated to pay the taxes without direct company assistance. In other words, expatriates are treated for tax purposes as any other employee in the host country – or home country, for that matter. Laissez-faire tax systems are often used for foreign nationals transferred into the United States.

- *Tax protection.* Most organizations that implemented the balance sheet approach in the 1960s as an alternative to ad hoc compensation turned to tax protection to handle the higher costs of home/host country taxes associated with most international assignments. Under tax protection, individuals generally meet their own tax liabilities in the host and home countries, and they are reimbursed for any actual individual income taxes that exceed what is paid by home country peers earning the same compensation. Expatriates who pay lower taxes on assignment are allowed to keep the tax windfall. Because most expatriates have significantly higher amounts of taxable income compared to stay-at-home peers, the actual number of tax windfalls are rare under tax protection, even if host country tax rates on base salary income are lower than home country tax rates.

- *Tax equalization.* As the balance sheet approach evolved, tax protection presented compensation administrators with two key problems:
  - While relatively rare, the possibility of a tax windfall is philosophically inconsistent with the "neither gain nor lose" philosophy associated with the balance sheet.
  - Under tax protection (and more so under laissez-faire), expatriates may make liberal tax rule interpretations when preparing their home and host country tax returns to put themselves in windfall positions.

Tax equalization has been the approach typically recommended by most expatriate tax and compensation experts as the best way to implement the balance sheet's compensation philosophy of keeping the expatriate whole and to ensure tax compliance. Under a typical tax equalization program, the company

- reduces expatriates' compensation by the amount of their hypothetical home country individual income taxes
- determines the actual amount of taxes owed
- pays all the expatriates' actual income tax assessments in both the home and host countries.

Most U.S.-based tax equalization programs base hypothetical tax calculations on federal and social income taxes that expatriates would bear if they were not on international assignment. Fewer include hypothetical state and local taxes in the calculations.

Tax Reimbursement Policy Effects on Individual and Company Costs

The type of tax reimbursement system used by an organization affects individual income and company costs. Figures 1-4 show the impact on the organization and the individual under laissez-faire, tax protection and tax equalization for individuals from the United Kingdom and the United States earning $170,000 in compensation ($100,000 in base and $70,000 in expatriate allowances) who are transferred to Hong Kong (representative of a low tax country) and Germany (representative of a high tax country) before gross-up on any tax reimbursements by the company. Conclusions to be drawn from these examples include the following:

Figure 1

SAMPLE TAX APPROACHES: A U.K. EXPATRIATE ASSIGNED TO HONG KONG

	Laissez-Faire	Tax Protection	Tax Equalization
Base salary	$100,000	$100,000	$100,000
Allowances	$ 70,000	$ 70,000	$ 70,000
Total compensation	$170,000	$170,000	$170,000
Actual Hong Kong tax	$ 18,150	$ 18,150	$ 18,150
Theoretical tax (U.K.)*	$ 31,791	$ 31,791	$ 31,791
Total tax reimbursement due (to)/from company	N/A	$ 0	($ 13,641)
Total tax reimbursement cost to company before gross up	N/A	$ 0	($ 13,641)
Total tax cost to individual	$ 18,150	$ 18,150	$ 31,791

*Tax-related assumptions include the following:
■ £1 = $1.50 ■ a personal allowance of $5,288 ■ marginal tax rates of 20 percent on the first $4,800 of income, 25 percent on income between $4,801 and $36,450, and 40 percent on income in excess of $36,450 ■ a marriage allowance of $387.

Figure 2

SAMPLE TAX APPROACHES: A U.K. EXPATRIATE ASSIGNED TO GERMANY

	Laissez-Faire	Tax Protection	Tax Equalization
Base salary	$100,000	$100,000	$100,000
Allowances	$ 70,000	$ 70,000	$70,000
Total compensation	$170,000	$170,000	$170,000
Actual German tax	$ 49,650	$ 49,650	$ 49,650
Theoretical tax (U.K.)	$ 31,791	$ 31,791	$ 31,791
Total tax reimbursement due (to)/from company	N/A	$ 17,859	$ 17,859
Total tax reimbursement cost to company before gross-up	N/A	$ 17,859	$ 17,859
Total tax cost to individual	$ 49,650	$ 31,791	$ 31,791

■ Tax protection and equalization are the same in terms of costs to individuals and organizations in high tax countries.

■ Laissez-faire and tax protection are the same in terms of cost to individuals and organizations in low tax countries.

■ Laissez-faire can result in a significant tax "penalty" in high tax countries and a significant "windfall" in low tax countries. However, adjustments can be made at the start of the assignment in the underlying compensation program to adjust for these shortfalls or windfalls. In fact a net-to-net approach generally will include an adjustment for such tax effects when the host country base salary is set.

Figure 3

SAMPLE TAX APPROACHES: A U.S. EXPATRIATE ASSIGNED TO HONG KONG

	Laissez-Faire	Tax Protection	Tax Equalization
Base salary	$100,000	$100,000	$100,000
Allowances	$ 70,000	$ 70,000	$ 70,000
Total compensation	$170,000	$170,000	$170,000
Actual Hong Kong tax	$ 18,150	$ 18,150	$ 18,150
*Actual U.S. tax**	$ 0	$ 0	$ 0
*Theoretical tax (U.S.)***	$ 18,296	$ 18,296	$ 18,296
Total tax reimbursement due (to)/from company	N/A	$ 0	($ 146)
Total tax reimbursement cost to company before gross-up	N/A	$ 0	($ 146)
Total tax cost to individual	$ 18,150	$ 18,150	$ 18,296

* No actual U.S. tax; utilization of foreign tax credits (FTCs)
**Tax-related assumptions include the following: ■ equalized on base only ■ personal exemptions of $10,000 ■ standard deduction of $6,550 ■ U.S. tax determined from tax table.

Figure 4

SAMPLE TAX APPROACHES: A U.S. EXPATRIATE ASSIGNED TO GERMANY

	Laissez-Faire	Tax Protection	Tax Equalization
Base salary	$100,000	$100,000	$100,000
Allowances	$ 70,000	$ 70,000	$ 70,000
Total compensation	$170,000	$170,000	$170,000
Actual German tax	$ 49,650	$ 49,650	$ 49,650
Actual U.S. tax	$ 0	$ 0	$ 0
Theoretical tax (U.S.)	$ 18,296	$ 18,296	$ 18,296
Total tax reimbursement due (to)/from company	N/A	$ 31,354	$ 31,354
Total tax reimbursement cost to company before gross up	N/A	$ 31,354	$ 31,354
Total tax cost to individual	$ 49,650	$ 18,296	$ 18,296

Typical Arguments in Favor of Tax Equalization

In the past, arguments in favor of tax equalization have focused on the following issues and assumptions:

- *Individual income tax compliance.* Only corporate assumption of the responsibility for paying actual individual income tax obligations can ensure that expatriates comply with all their income filing and tax payment obligations. This is especially of concern to management because the company may be held liable for any underpayment of expatriate taxes, especially if the expatriate has left the host country and/or is no longer employed by the company.
- *Consistency with the balance sheet approach.* Tax equalization is the only tax reimbursement process that is philosophically consistent with the balance sheet's philosophy of keeping the expatriate whole.
- *Impact on mobility.* Tax equalization promotes mobility, at least on the part of potential expatriates, because it is tax neutral to the expatriate. It directly eliminates the motivation to want to stay in tax windfall situations and/or avoid transferring to tax expensive locations.
- *Competitiveness.* The vast majority of multinational companies use tax equalization.
- *Systematic administration.* Only tax equalization has the systematic focus required to ensure that nothing slips through the cracks and that proper tax planning can take place.

When these issues and assumptions are evaluated in a general sense, perhaps without taking into consideration the changing nature of expatriate assignments and how the tax reimbursement program fits into the international compensation strategy, tax equalization appears to be the logical approach. However, automatic use of tax equalization also assumes the following:

- The balance sheet approach to expatriate compensation is the most appropriate approach for all expatriates.
- Tax compliance only can be ensured through tax equalization.

The problem is these assumptions are no longer as automatically valid as they once might have been. To be appropriate, the balance sheet needs to be consistent with the business, human resources and compensation strategies within which it operates. If non-balance sheet programs are developed that are more consistent with company compensation strategies and/or are better at meeting the needs of new types of expatriates, it can be argued that other tax reimbursement programs may be needed that are more consistent with these new approaches. With respect to the second assumption, as compensation accounting and reporting become more reliable and sophisticated, and as countries' tax laws change, tax equalization systems are no longer necessarily the only way to ensure income tax compliance.

The Changing Nature of International Assignments

The balance sheet approach, including tax equalization, was designed to facilitate the transfer of what are now defined as "traditional expatriates." These are expatriates whose career orientations prior to expatriation have been in domestic operations, and they are assigned to international operations to perform specific assignments for a limited time period (generally, three to five years). At the end of the assignment, they are expected to transfer back to the domestic organization from which they left.

Most traditional expatriate assignments in the past could be categorized as filling one of the following relatively short-term needs in the host location:

- local management
- project assistance
- technology and corporate culture transfer.

As an organization's operations globalize and international operations assume greater importance, there is likely to be a greater differentiation among its expatriate population. In a recent study of expatriate management and compensation conducted by the National Foreign Trade Council Inc. and Towers Perrin and supported by 20 sponsoring companies, participants identified the following types of nontraditional expatriates:

- *Senior executives,* who are part of the worldwide top executive management team that provides global or regional management leadership for significant parts of the business rather than just management direction and control in the host country.

- *Globally mobile executives*, who have provided specific managerial and technical expertise on a number of international assignments and who are not expected to repatriate to their home country.
- *Regional transfers*, who meet managerial and technical needs at the regional level but may never be reassigned to their home location.
- *Developmental transfers*, who may be assigned to work in specific international locations for training and managerial development purposes.
- *Volunteer expatriates*, who request employment in international locations for personal or career reasons.

The balance sheet approach is an effective compensation system for traditional expatriates, for whom it was originally designed. It presumably motivates the traditional expatriate to take the assignment, maintains the family's style of living while on assignment to the extent possible and facilitates repatriation at the end of the assignment.

However, by providing the resources so a family can continue to live as if it were still at home, the organization may not facilitate integration into the host country society, which often is of significant importance in the case of nontraditional expatriates. Furthermore, the "one size fits all" balance sheet program cannot and need not necessarily be applied to all situations. At best, if an organization administers the balance sheet approach to handle traditional expatriates, it undercompensates some nontraditional transfers, its components make little sense to others and it overcompensates the rest (especially volunteer transfers). At worst, the organization administers the program to meet the needs of the most critical group of expatriates and potentially overcompensates everyone else.

Alternative Expatriate Compensation Systems

Most organizations do not rigidly apply the balance sheet but are flexible in its application and have introduced flexibility to make it more consistent with their particular corporate environment and specific expatriate situations (Latta 1995). A growing number of organizations are going even further and implementing alternative expatriate compensation systems to handle a variety of nontraditional expatriate situations. The following methodologies are receiving attention today as global companies develop alternative international pay packages:

- *Modified balance sheet.* This approach is similar to the traditional balance sheet except the cost of living allowance is developed through reference to an expatriate market basket (as opposed to home country market basket) and/or it is based upon extremely efficient purchaser cost of living tables. Furthermore, housing allowances are based on peer host-country housing standards rather than home-country-oriented housing. Home leave and educational allowances are the same as under the traditional balance sheet approach.
- *Net to net.* A host country base salary is developed that will provide similar net spendable income (after housing and hypothetical taxes) to the net spendable income received in the previous location. Home leave typically is provided as well. However, because this approach often is used in intraregional transfer situations, educational allowances may *not* be provided depending upon the degree of difference between educational systems in the two locations.
- *Destination pricing.* A competitive destination-oriented compensation package (salary-and performance-based incentive package) is provided on the assumption that it is sufficient to cover local cost of living and housing costs. The destination base salary and incentive package is determined based on the value of the job in the location for someone with the expatriate's skills and experience. To the extent an expatriate's skills and experience are greater than that of a local national, the base salary and performance incentive opportunities will be greater than that of a local national. Educational and home leave allowances are usually provided to cover the extra costs for these items relative to home/host country peer relationships. In certain locations, housing supplements may be provided to cover the higher cost of providing host coun-

try peer-level housing within more appropriate commuter distances and security levels.

■ *Localization.* The expatriate is compensated the same as a local national without additional allowances or compensation reflective of expatriate status.

Most organizations with alternative approaches in place have implemented multiple systems rather than implementing a single system to replace the balance sheet. Programs are being implemented along a continuum from the balance sheet to localization. (See Figure 5.)

As companies implement these alternative approaches, they need to answer the question of whether they should continue to use tax equalization, which has been closely associated with the balance sheet, or reconsider the alternatives: laissez-faire and tax protection.

Underlying Tax-Related Issues

There are a number of income-tax-related issues associated with international assignments that need to be addressed while determining an appropriate expatriate tax program:

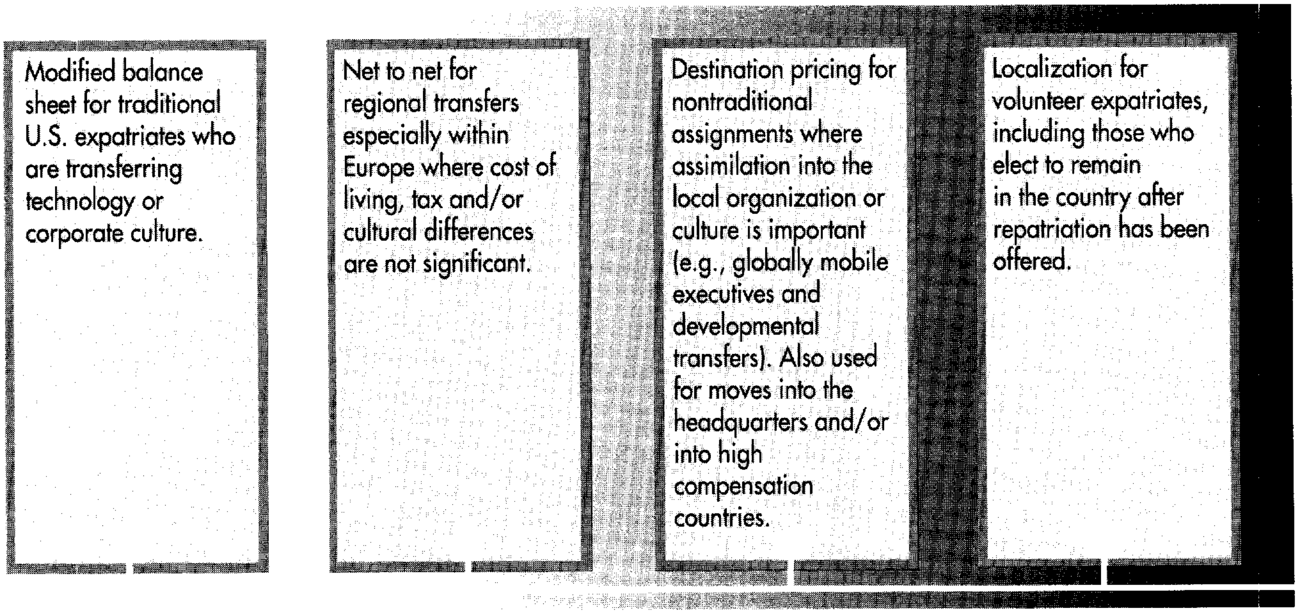
■ *Income reporting to taxing authorities.* Organizations have an obligation to report the income earned by expatriates to appropriate tax authorities. This obligation may include not only the compensation earned and paid in the host country but also compensation paid outside the host country, particularly if such income is charged back to the company within the host country. In addition, employers may have an obligation to withhold taxes from that remuneration.

■ *Income-tax-related requirements in the country of work/residence (including citizenship, in some cases), and income tax rule interpretation.* In many countries, the actual tax treatment of expatriate compensation and expenses, and the timing of when they are recognized for tax purposes, is subject to interpretation. How strictly income tax rules are interpreted when the tax return is prepared can have a significant impact on the amount of tax owed. Although tax returns are the responsibility of the individual, many organizations believe it appropriate to actively participate in determining filing positions. This is because, in part, under tax equalization, actual taxes are a company cost. Conservative tax rule interpretation has the advantage of reducing the risk that individual expatriates will run afoul of local tax authorities and jeopardize their and the company's ability to operate in the country. However, it has the disadvantage of driving up tax reimbursement costs.

■ *Tax return preparation and filing.* Individual expatriates are responsible for filing appropriate tax returns on a timely basis. Due to the complexity of expa-

Figure 5

A CONTINUUM OF ALTERNATIVE EXPATRIATE SYSTEMS



triate returns and the number of different returns to be filed, many organizations provide assistance in the preparation of such returns.

■ *Tax payments.* The organization is responsible for any tax withholding and remittances required by tax authorities. While many firms facilitate the payment of actual taxes owed, expatriates are ultimately responsible for settling their obligations with taxing authorities.

■ *Excess tax reimbursement.* Individual tax costs in excess of what would have been paid if the individual were not on international assignment (i.e., on taxable expatriate allowances or reimbursements) are generally considered to be expenses to be borne by the company rather than the expatriate.

■ *System complexity.* Any human resources program that is overly complex is usually difficult to communicate and difficult for employees to understand. Programs that are simple and straightforward are easier to understand and, therefore, are more easily associated with fairness and equity.

■ *Compensation accounting.* Most companies charge expatriate compensation expenses to the entity for which they perform the work. This suggests that expatriate compensation expenses be charged to the host country company. In the past, companies often found it easier to expense expatriate compensation costs in the home country as a corporate overhead item because expatriates were generally paid on the home country payroll in home country currency. With this approach, expatriate compensation expenses could be charged indirectly to international operations with management fees. As accounting systems, intercompany pricing rules and tax authorities have become more sophisticated, many organizations now directly charge expatriate compensation expenses to the responsible entity, regardless of where these expenses are paid.

■ *Corporate tax deductibility.* In most cases, compensation expense is tax deductible only by the entity for which the work is performed. Thus, if the expense is not charged to the entity for which the work is performed, the company may forgo the tax deduction for that entity. Furthermore, if a corporation outside the country for which the work is performed is charged with the expense, the taxing authorities may disallow such expenses in calculating the tax obligations of the corporation. This may not be an issue if the entity for which the work is performed does not owe any taxes. It is an issue, however, if the entity could use the tax deduction.

■ *Administrative expense.* The expense of any tax reimbursement program includes the time of corporate personnel (including the expatriate) as well as third party fees related to the ongoing administration of the program. The more comprehensive and sophisticated the program, the higher the administrative expense. In some cases, from an administrative perspective, employee tax reimbursement processes duplicate other company programs (such as local payroll reporting) designed to accomplish the same end (e.g., the proper reporting of income to tax authorities).

Figure 6 on page 74 illustrates the extent to which typical tax equalization, tax protection and laissez-faire programs address these issues.

A Strategic Perspective

The key to developing an expatriate tax program is not simply how it addresses the tax-related issues outlined above but its consistency with the organization's overall compensation and business strategies, and how it motivates individuals to avoid underpaying or overpaying taxes. In this regard, the compensation strategy aspects of the three primary tax approaches are as follows:

■ *Laissez-faire.* Philosophically, laissez-faire is consistent with the host country orientation of net-to-net and destination pricing. In effect, expatriates under laissez-faire are treated the same with respect to taxes as any local employee. This facilitates integration into the local culture and organization.

From an administrative perspective, it is the least complicated program because there is no direct administrative process or required reimbursement of excess income taxes. All it requires from a tax calculation perspective is the preparation of the actual returns. This approach assumes that all compliance issues can be addressed through the normally required corporate income reporting and accounting systems.

Figure 6

COMPARISON OF TAX PLANNING APPROACHES FOR VARIOUS TAX ISSUES

Tax Issue	Laissez-faire	Tax Protection	Tax Equalization
Income reporting	Proper payroll accounting is required to ensure compliance in all cases	Proper payroll accounting is required to ensure compliance	Tax returns can be used to report income
Tax compliance	Individual responsibility	Administrative system helps ensure compliance	Administrative system ensures compliance
Degree of conservatism	Tends to be liberal	Tends to be more liberal, especially in windfall situations	Tends to be conservatively administered
Return preparation and filing	Individual responsibility, but it can be made a condition of employment	Individual responsibility, but it can be made a condition of employment	Administrative system ensures compliance
Tax payments	Individual responsibility	Individual responsibility	Administrative system ensures compliance
Excess tax reimbursement	No reimbursement	Company reimburses expatriate	Company pays
Complexity	No more complex than individual tax returns	Moderate complexity	Most complex; requires faith on the part of employees
Compensation accounting	Handled through separate processes	Handled through separate processes	Handled through separate processes
Corporate tax deductibility	Handled through separate processes	Handled through separate processes	Handled through separate processes
Cost	No third party fees except tax return preparation expenses	Lower administrative expense because of the elimination of beginning-of-year hypothetical calculations	High administrative expense and high tax reimbursement because of conservative tax assumptions (offset by company collection of windfall taxes)

One can assume that expatriates under laissez-faire will want to make the most liberal tax rule interpretations possible to reduce their tax expense. Therefore, laissez-faire has the highest risk to the company of nontax compliance, especially if there are incomplete corporate income reporting procedures.

- *Tax protection.* Tax protection is consistent with the philosophy of "reimbursing for any higher cost" associated with the practical application of modified balance sheet programs. Under the modified balance sheet approach, an individual would be tax protected against higher income tax costs compared to a home country hypothetical tax on salary and incentive compensation.

Tax protection is more consistent with the home/host pay equity relationships analysis associated with the net-to-net and destination compensation approaches. It assumes the employee is as responsible for tax compliance as any employee in the host location. In tax protection under the net-to-net and destination pricing approaches, the individual would be protected against the host country taxes applied on any allowances paid over and above base salary and incentives and any residual home country tax.

Administratively, tax protection programs can be designed to require third party tax return preparation – ensuring that returns are prepared properly – without duplicating company income reporting and accounting processes. Tax protection is simpler to administer than tax equalization because it generally does not require an estimated hypothetical calculation at the beginning of the year, although it may be a good idea to prepare a hypothetical tax when beginning an assignment for tax planning purposes. However, tax protection does not ensure compliance with income reporting to the extent tax equalization systems do. Tax protection requires greater reliance on company income reporting and accounting systems to ensure overall compliance with accounting and tax requirements.

Tax protection motivates expatriates to interpret tax rules so as to reduce taxes and, if possible, to create tax windfalls. However, once the individual reaches a point where tax windfalls are no longer possible, the expatriate has the same view of tax reduction as any expatriate under tax equalization.

- *Tax equalization.* Philosophically, tax equalization is consistent with the balance sheet's compensation strategy to keep the expatriate whole. It reinforces the concept that expatriates need to maintain ties with their home country rather than integrate into the local culture and organization. Tax equalization generally is inconsistent with the more host-country-oriented compensation strategies of net-to-net or destination pricing compensation programs.

Administratively, tax equalization addresses the issues of income reporting, compliance, tax return preparation, tax payments and excess tax reimbursement in one single administrative package. However, in the case of income reporting, this can represent a duplicative effort because the company provides the third party tax adviser with the same information provided to the expatriate and tax authorities through the regular payroll reporting process. To the extent the system is operated independently of corporate compensation accounting systems, it does not always ensure compliance with proper income and corporate tax accounting. With its up-front hypothetical tax calculations, company direct tax payments and end-of-year reconciliation, tax equalization is the most complex system to operate and is usually outsourced to a third party tax preparer.

Tax equalization eliminates the pressure on expatriates to interpret tax rules so as to reduce taxes and, if possible, create windfalls. Expatriates who are tax equalized generally agree to file all tax returns in a conservative manner because actual tax costs do not represent a personal cost. Theoretically, assuming that the methodologies of calculating the hypothetical tax and actual taxes are the same, tax reimbursement costs are lower under tax equalization than under tax protection or laissez-faire because the company – rather than the expatriate – gets to keep any tax windfalls. On the other hand, the conservative assumptions used in many tax equalization programs are perceived by some as more costly than the less conservative approaches used in preparing tax returns under tax protection or laissez-faire.

The Need for Tax Planning and Return Preparation Services

Until recently, tax equalization was generally considered the logical tax program for most U.S. companies with even a modest number of expatriates. It was consistent with the balance sheet approach and ensured tax compliance regardless of the state of individual income reporting processes through payroll systems. However, tax equalization may lose some of its appeal as alternatives to the balance sheet are implemented that are philosophically more aligned with laissez-faire and tax protection, and as organizations' accounting and local payroll systems become more sophisticated.

Whether an organization provides tax planning and tax preparation assistance is a separate issue from what type of tax reimbursement program the company should have. One of the advantages of tax equalization is that tax planning and tax return preparation can be designed to be an integral part of the tax equalization administrative system. However, this does not mean that these processes would not be a requirement of any other system, including tax protection and even laissez-faire. In fact, the authors make the following recommendations:

- *Tax and financial planning.* Tax and financial planning should be conducted for anyone who is transferred by the company outside his or her home country. It would be better if this were conducted by a single source familiar with the company's compensation and benefits programs. Tax planning should be conducted prior to the actual transfer, and financial planning should be conducted during the term of the assignment.
- *Tax return preparation services.* The company should provide tax return preparation services and require that all tax returns be prepared by a qualified tax preparer for anyone in a country (local nationals as well as expatriates) above a certain job level. Now, local nationals are rarely provided with tax preparation services.

The level of employee included in the program should be determined on the basis of company exposure if individual returns are not properly prepared and filed. The program could be handled either by a single source familiar with corporate compensation programs or by someone on an approved list of preparers. The key is obtaining an opinion letter from the preparer that the returns have been handled properly.

Note that these recommendations apply to a number of people who might not be included in typical balance sheet/tax equalization programs as currently administered (e.g., U.S. inpatriates, third country nationals on nonbalance sheet packages and, in the case of tax preparation services, high-level local nationals). These programs should include all employees whose personal tax noncompliance could put the company at risk, not just expatriates.

Controlling Future Tax Costs

Organizations are implementing alternative expatriate compensation systems, especially for nontraditional expatriate assignments. Such compensation systems require tax reimbursement programs that are consistent with their underlying philosophies and strategies. The authors believe laissez-faire and tax protection will increase in popularity as alternatives to tax equalization where peer/equity relationships are more host-country-oriented rather than strictly home-country-oriented.

While a single tax reimbursement process could be used for all expatriate situations, organizations are likely to use multiple tax reimbursement programs consistent with their multiple compensation systems to meet specific types of expatriate situations:

- Laissez-faire will likely be used for regional net-to-net and pure localization situations.
- Tax protection, against hypothetical *host* country tax on base salary and performance incentive income, will likely be used for employees compensated under the net-to-net and destination pricing approaches.
- Tax equalization, against *home* country hypothetical tax on base salary and performance incentive income, will continue to be used for expatriates compensated under the balance sheet and modified balance sheet.

The use of alternative tax reimbursement systems will require greater attention to proper compensation accounting and payroll reporting. As these systems become more sophisticated, they will be used to help ensure that organizations meet their tax compliance obligations more efficiently than tax equalization systems have in the past. Once organizations become comfortable with the use of accounting and payroll systems to ensure overall income reporting and tax compliance as well as less conservative income tax rule interpretation, tax reimbursement programs will be redesigned to make them simpler to administer and more oriented toward keeping down corporate tax reimbursement costs.

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