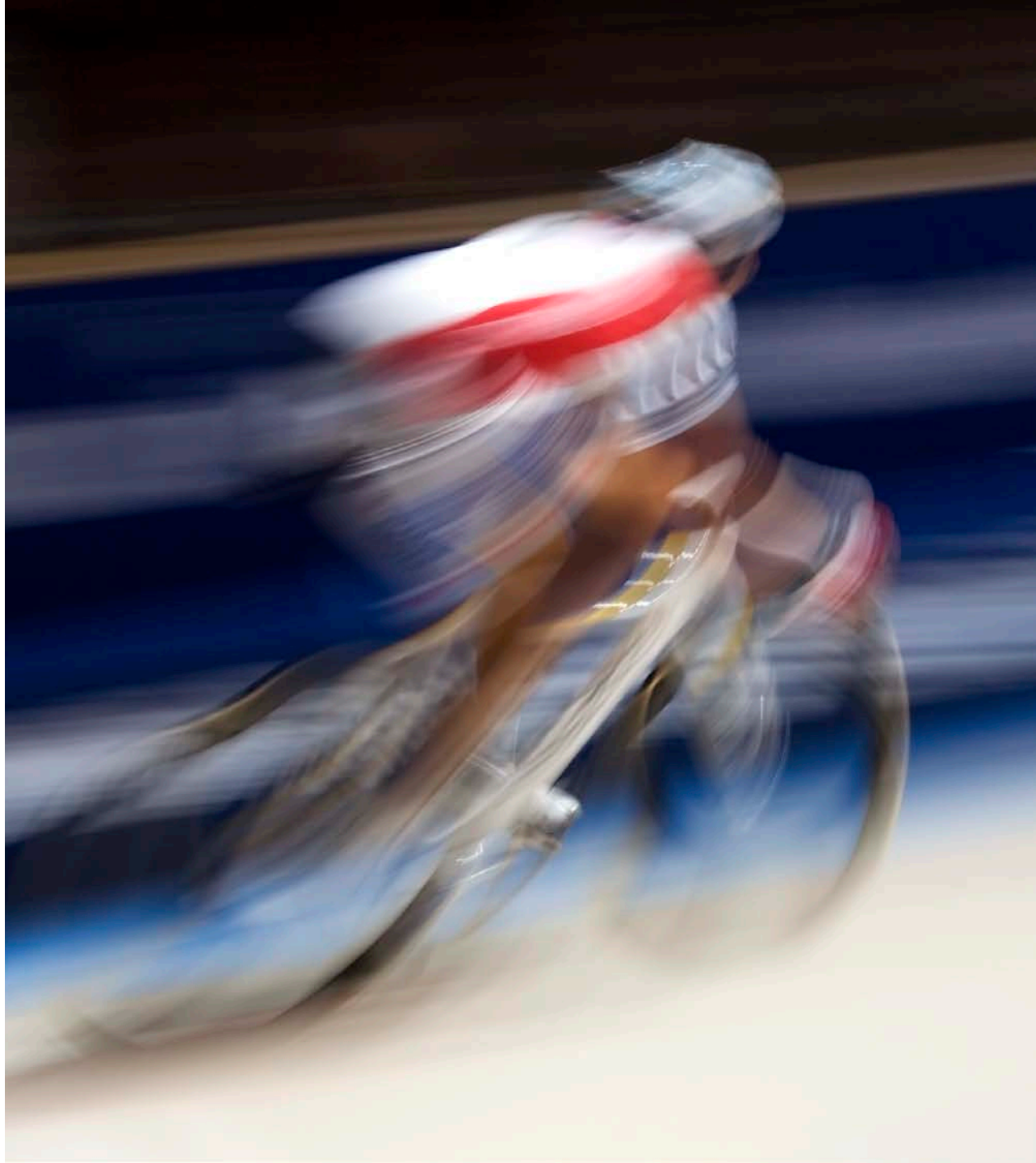




Issues Arising from Relocating Employees Across Borders

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Agenda

Common goals

Understanding three distinct mobile employee personas

Exploring the permanent transfer persona

Exploring the international assignee persona

Exploring the business traveler persona

Questions and answers

Common goals

- Relocating an employee across a geographic border can be a complex exercise, as an employer must harmonize many factors
 - Tax rules
 - Labor or employment regulations
 - Immigration
 - Foreign corrupt practices act
 - Employee expectations
 - Employment benefits
 - Employment costs
 - ROI
- In this session, we will build an understanding of the different types of cross-border employees, better enable discussions with other functions, create awareness of the associated tax risks, provide insights to address these risks, and focus on some of the issues (including, among others, permanent establishment and transfer pricing) faced by employers who are attempting to achieve compliance with tax laws, along with manageable relocation and compensation costs.

Understanding three distinct mobile employee personas

Who are they?

- **Permanent transfer**

Employee who relocates across a border **without intention of returning** to work for his/her home country employer

- **International assignee**

Employee who temporarily works in another jurisdiction on either a short-term (three to twelve months or long term (one to five years) basis **with the intention of returning home** upon completion of the assignment

- **Business traveler**

Employee who **travels in the normal course** of his/her role to perform the regular duties of his/her job function



Exploring the permanent transfer persona

Peter Thompson



Typical business rationale for a permanent transfer deployment



Peter Thompson

- Employee initiated
- Relocation to headquarters
- Relocation of role, such as a corporate inversion or establishment of a principal operating company

Typical employment structure

- Terminate or suspend employment relationship (contract) with home country employer
- Sign new employment contract with host country employer

Typical compensation and benefits package



Peter Thompson

- When Peter Thompson transfers his employment from a U.S. company to a French company, his compensation and benefits packages change dramatically

	U.S. employment package	French employment package
Base salary	<ul style="list-style-type: none"> U.S. \$ denominated 	<ul style="list-style-type: none"> Euro € denominated
Bonus and LTIP	<ul style="list-style-type: none"> Variable pay is a significant component of total compensation 	<ul style="list-style-type: none"> Variable pay is a small component of total compensation
Deployment allowance	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Accommodation allowance paid in cash
Healthcare	<ul style="list-style-type: none"> Mainly funded by employer and employee 	<ul style="list-style-type: none"> Funded by state with small co-pays by employee
Severance pay	<ul style="list-style-type: none"> No statutory requirement 	<ul style="list-style-type: none"> Potentially up to 5.33 months wages
Pension - company	<ul style="list-style-type: none"> 401(K) – up to \$18,000 of employee, employer match of 3% 	<ul style="list-style-type: none"> PERP – voluntary by employee up to approximately €28,000
Pension - public	<ul style="list-style-type: none"> 6.2% for employee and employer on \$118,500 of wages 	<ul style="list-style-type: none"> 8%-20% for employee on uncapped amount of wage 40%-48% for employer on uncapped amount of wages
Working hours	<ul style="list-style-type: none"> Uncapped 	<ul style="list-style-type: none"> Limited, generally 35 hours but can increase to 60 hours
Vacation/Holidays	<ul style="list-style-type: none"> 2-4 weeks vacation/10 public holidays 	<ul style="list-style-type: none"> 5-8 weeks vacation/11 public holidays

Typical tax issues



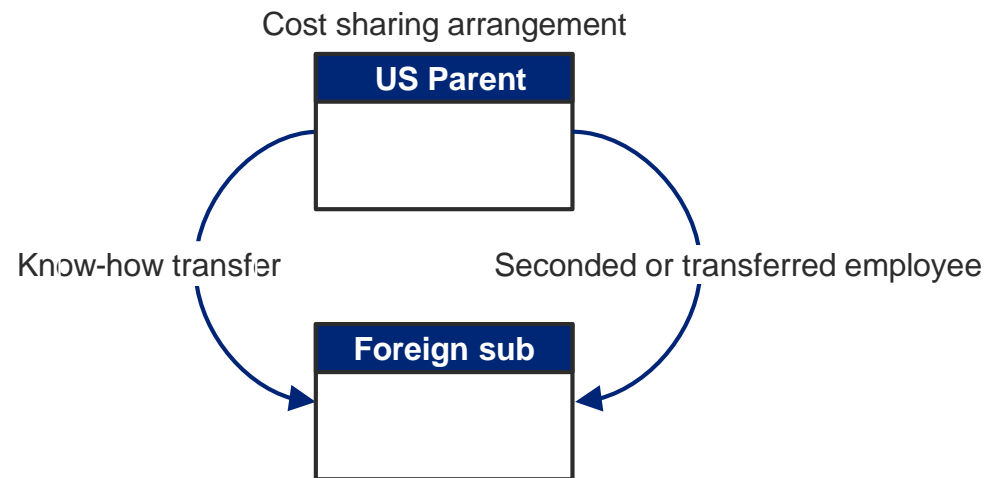
Peter Thompson

	Description	Tax Issues
Corporate Income	Generally easy to manage as employment costs align in the same entity as the economic benefits provided by the employee	
Transfer Pricing	Permanent transfers should not create TP issues unless they are part of large functions mobilization where tax authorities could argue for transfer of intangibles related to workforce in place	<ul style="list-style-type: none"> • Risk of value driver transfer associated with workforce in place • Need to monitor that TP post-transfer properly reflects the new distribution of functions and risks
Indirect Taxes		
Payroll Taxes	Generally, only the new employer will deliver remuneration and have responsibility for payroll taxes	
Individual Income Taxes	Provided employee breaks tax residency in home country, only host country tax applies; When tax residency cannot be broken (such as U.S. citizens moving abroad), taxes paid in host country can be claimed in home country as credits to alleviate double taxation	

Case study I: Inadvertent transfer of valuable know-how through workforce in place

Assumptions

- US Parent and Foreign Sub have entered into a cost sharing arrangement to jointly develop IP
- Employee of US Parent is seconded to For Sub for a multi-year period to assist Foreign Sub with developing the market, providing technical know-how and other valuable information; US Parent recharges to Foreign Sub the cost of the seconded employee plus a mark-up
- Employee of US Parent is transferred to Foreign Sub for a multi-year period to assist Foreign Sub with developing the market, providing technical know-how and other valuable information; Foreign Sub begin to bear the cost of the transferred employee (with no compensation to U.S.)



Potential Issues

IRS may argue that valuable know-how was transferred to Foreign Sub via the secondment or the transfer

Transfers of valuable know-how may require arm's length remuneration that are above cost plus

Workforce in place – regulatory background

- Not listed specifically as an IP in Treas. Reg. §1.482-4 & Treas. Reg. §1.936(h)(3)(B)
- However, PCT can include workforce in place in Treas. Reg. §1.482-7
- 936 Directive (Feb 2007)
 - Taxpayers may improperly classify workforce in place as foreign goodwill and going concern value take the position that workforce in place may be transferred tax free
 - Workforce in place is an intangible asset for purposes of section 936(h)(3)(B)
 - Must be analyzed: 1) under section 367(d), if transferred offshore under section 351 or section 361; or 2) under section 482 in the case of all other controlled transactions
- Not an intangible, but a comparability factor, under revised OECD Chapter VI

Transfer or secondment of workforce in place

- Cost approach aspect and from transferee's point of view
 - Not intended to suggest that transfers or secondments of individual employees should be separately compensated as a general matter
 - Comparability factor: Appropriate to reflect time and expense savings or liabilities in transferring workforce
- Compensation should be more than at cost if
 - Valuable know-how is transferred in association with employee transfer
 - MNEs may consider leveraging the above OECD “replacement cost” approach to compensating assembled workforce
 - IRS may try to impose a “cost plus” type of aggregated valuation method (e.g., by lumping the valuation of the workforce in place in with other valuation of other intangibles in the income method)
 - Certain tax authorities may impose exit tax
 - Access to an assembled workforce without transfer of employees where such access increases the value of intangibles transferred at the same time

Workforce in place – principal company planning

- Includes transfer of trade and/or marketing intangibles
- Includes transfer of (and hiring) of personnel
- Value in transferred workforce separate from value of trade/marketing intangibles
- Exit charges from foreign companies providing personnel

Exploring the international assignee persona

Isaac Anderson



Typical business rationale for this type of deployment



Isaac Anderson

- Business need driving a temporary redeployment of talent
- Employee perceives a disruption of career path

Typical employment structure

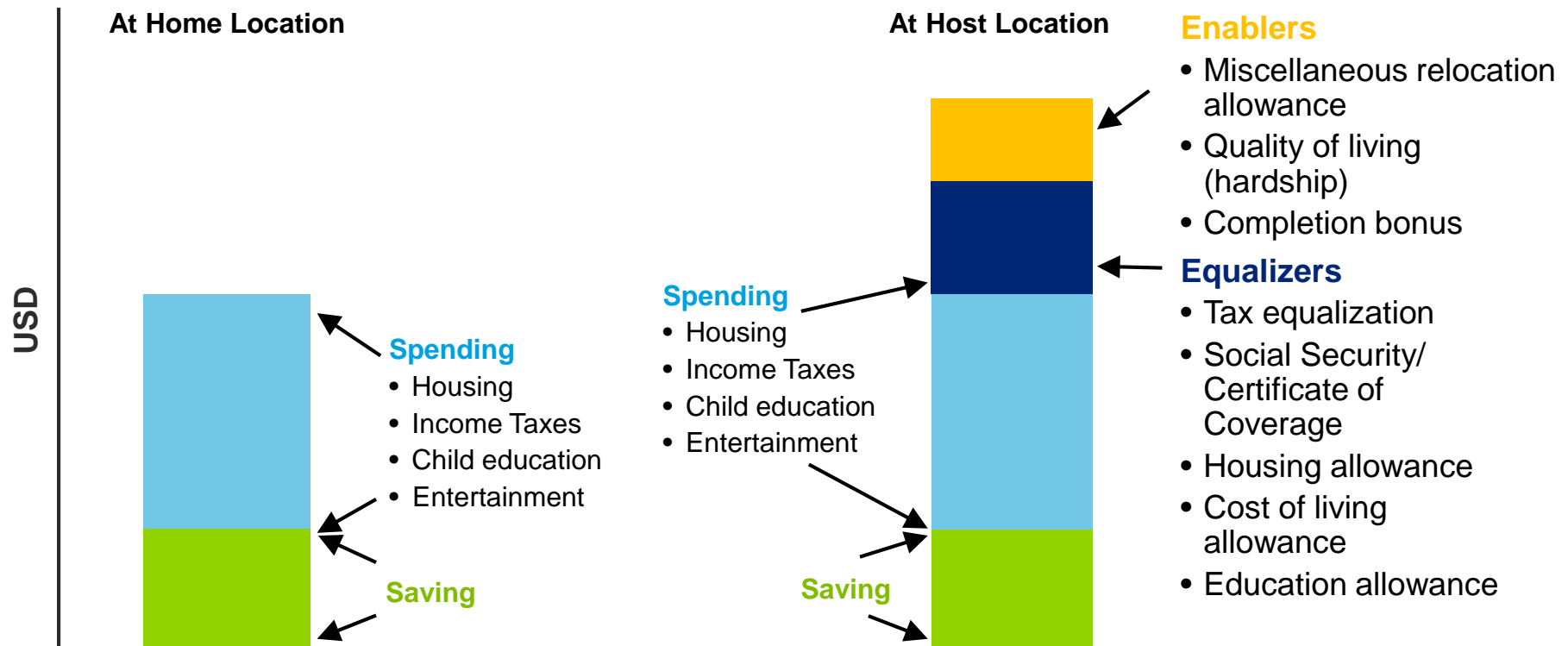
- Retain legal employment relationship with home country employer
- Supporting documentation
 - Secondment agreement, whereby home country employer loans employee to host country employer
 - Intercompany invoices for use of the employee
 - Intercompany payments to settle invoices

Typical compensation and benefits package



Isaac Anderson

- When Isaac Anderson accepts an international assignment from U.S. to Brazil, his compensation and benefits packages change accordingly



Typical tax issues



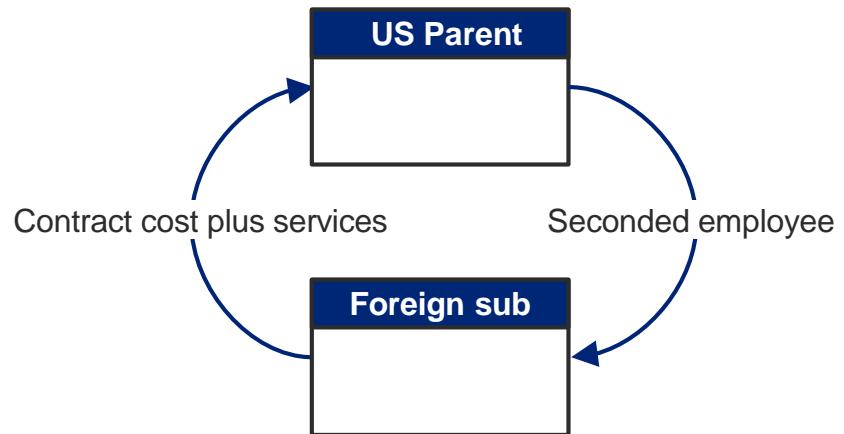
Isaac Anderson

	Description	Tax Issues
Corporate Income	Employment costs may not be borne by entity receiving the benefits of the employee's services	Tax deductions for compensation expense may be claimed in incorrect jurisdictions
Transfer Pricing	Transferees should not create TP issues unless they are part of large functions mobilization where tax authorities could argue for transfer of intangibles related to workforce in place	<ul style="list-style-type: none"> • Risk of value driver transfer associated with workforce in place • Need to monitor that TP post-transfer properly reflects the new distribution of functions and risks
Indirect Taxes	May arise on intercompany invoices	Potential to manage this cost via the delivery of remuneration
Payroll Taxes	Challenging to get correct as remuneration may be delivered from multiple sources	Payroll reporting accuracy more critical from a social tax than an income tax perspective
Individual Income Taxes	Employee will pay tax in host location, and if residency cannot be broken a tax filing in home location may also be required	Generally, foreign tax credits can be claimed to alleviate double taxation

Case study II: Seconded U.S. employee provides services to foreign entrepreneur

Assumptions

- US Parent seconded employees for multi-year period to Foreign Sub to assist the Foreign Sub in performing certain routine functions(e.g., contract R&D, sales and marketing services, etc.)
- Under the transfer pricing policy, US Parent charges Foreign Sub cost plus a mark-up for the seconded employee's compensation



Potential Issues

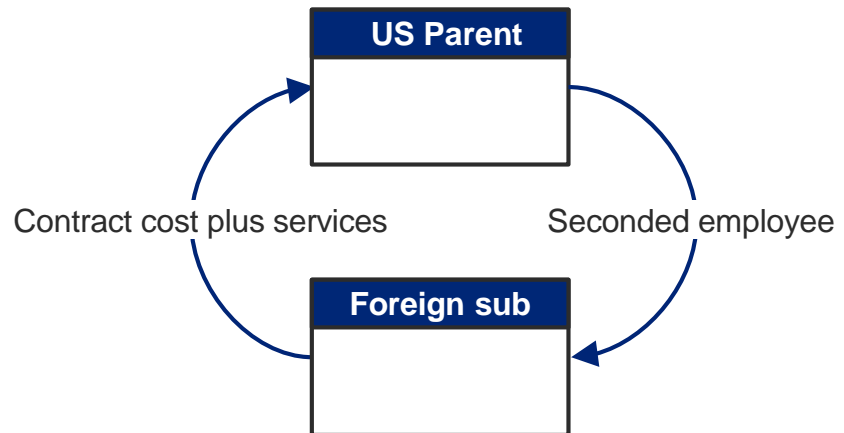
Local tax authority may disallow employee costs since services are not domestic in nature

Impact on DTA due to different corporate tax rates on deferred compensation

Case study III: Stewardship activities

Assumptions

- Foreign Sub provides contract services to US Parent (e.g., contract R&D, etc.)
- Under the transfer pricing policy, Foreign Sub charges US Parent cost plus a mark-up for services rendered
- US Parent seconds to Foreign Sub senior executive with global responsibilities to assist with financial statement audit and monitor US Parent's investment in affiliate
- US Parent recharges to Foreign Sub the cost of the seconded employee



Potential Issues

Activities of executive may be characterized as “stewardship”

Under U.S. and OECD TP regulations, stewardship costs are not subject to reimbursement

Foreign Sub's deduction may be disallowed

Exploring the business traveler persona

Brooke Tanner



Typical business rationale for this type of deployment



Brooke Tanner

- Role requires employee to travel to various sites to complete job responsibilities
- Generally, employment costs remain with home country employer

Typical employment structure

- Retain legal employment relationship with home country employer
- No employment relationship between employee and other group companies

Typical tax issues



Brooke Tanner

	Description	Tax Issues
Corporate Income	Business traveler could create a PE by virtue of activities performed or duration in location visited	
Transfer Pricing	<ul style="list-style-type: none"> • Traveling person can create significant TP challenges. Profits should follow where costs are incurred and functions are performed. • To the extent that costs are incurred in a location different from where the functions are performed, appropriate TP is necessary 	<ul style="list-style-type: none"> • PE issue • Where should the profit associated with the person/function be recognized?
Indirect Taxes	VAT, which may be recoverable, is usually charged on hotel stays in Europe and Asia	
Payroll Taxes	If a payroll tax obligation arises from business travel, it is usually the responsibility of the home country employer	
Individual Income Taxes	For international travel, treaty provisions can insulate many travelers from host country income tax liabilities; note that for US domestic travel the thresholds for generating tax liabilities is much lower.	

Permanent establishment

- Definition
 - A permanent establishment (“PE”) is a fixed place of business through which business is wholly or partly carried on
 - U.S. MNEs doing business in foreign countries (and foreign based MNEs doing business inside the U.S. or foreign countries other than their own) are typically subject to the domestic tax laws of the countries where they engaged in business activities
 - However, if the corporation’s home country has entered into a tax treaty with the target country, the treaty will typically provide a higher threshold for taxation than the domestic tax laws applicable in the target country. That higher threshold is commonly referred to as a PE (e.g., the U.S. agrees to tax business profits of a treaty resident only if the profits are attributable to a PE in the U.S.)
- An agency relationship may for instance create a PE

Permanent establishment (cont'd)

- On October 31, 2014, the OECD released a Discussion Draft on Action 7 in relation to preventing the artificial avoidance of PE status
 - This Action is focused on the need to update the OECD tax treaty definition of PE (Article 5 in the OECD model treaty) in order to prevent abuses of the threshold allocating taxing rights for trading activities to different jurisdictions
 - As part of this work, for instance, the OECD is considering the modernization of the PE threshold in relation to digital cross-border business, in line with the work on Action 1
 - As a result, going forward, exempted activities such as preparatory work or extensive digital presence in a country may become subject to PE rules

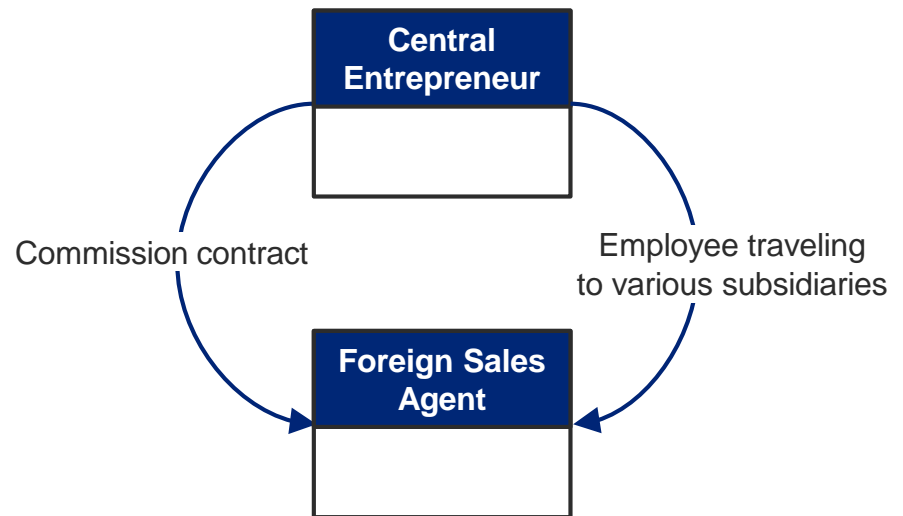
PE considerations and PE risk management approach

- Areas of concern
 - Principal maintains a fixed place of business in a local country
 - Combination of the principal's activities in the local country
- Risks
 - Local tax authorities will argue that local fixed place of business will cause principal to have a local PE
 - Profits of principal attributable to that PE will be subject to local country tax
- Risk management approach
 - All principal employees need to work in the principal's office, approve all strategic decisions in the principal location and not have an office available to them locally
 - Use of LRDs rather than commissionaires
 - Balance of control at the Principal and "limited risk" taking locally
 - Focus on appropriate transfer pricing based on functions and risks

Case study V: Creating a PE through an agency relationship

Assumptions

- Foreign Sub is a sales agent who helps identify leads and negotiate contractual terms but cannot conclude contracts
- Central entrepreneur concludes contracts with customers. Central entrepreneur employs a sales manager, who travels to Foreign Sub to assist in final negotiations and conclude contracts



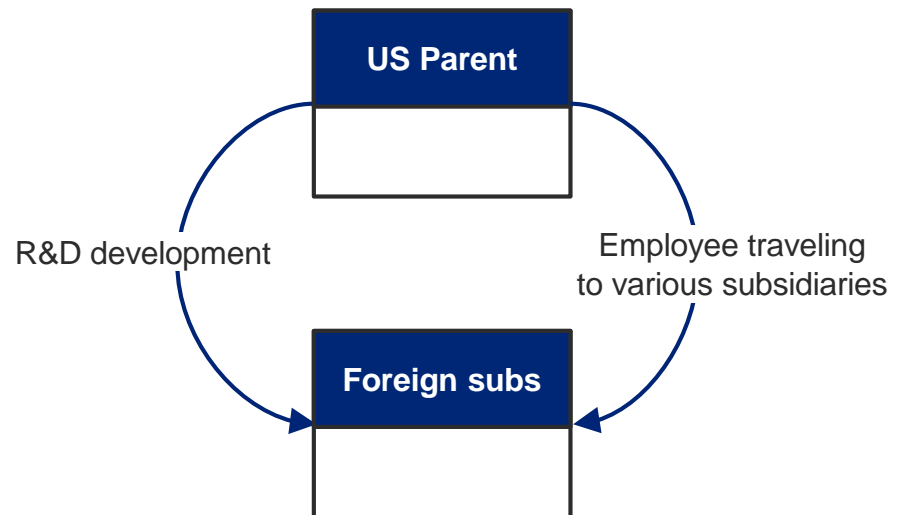
Potential issues

The contract conclusion activity performed by the sales manager may risk the Foreign agent being characterized as a PE

Case study VI: Global or regional mobile resources

Assumptions

- US Parent employs head of R&D, who travels to various countries to help negotiate set-up contract R&D facilities.
- Foreign Sub manufacturers pay US Parent a 5% royalty for license of IP. In addition, they are reimbursed cost plus 10% for their contract R&D expenses
- The costs associated with this employee (salary and overhead expenses) are allocated to the various foreign affiliates at cost plus 5% based on time spent



Potential issues

The activities performed by the head of R&D may be considered as IP generating, and hence their associated costs should be borne by the IP owner and should not be charged out

Alignment of profit realization and value creation – is the U.S. still the economic owner of the IP and is it still entitled to the residual profit if the head of R&D is conducting work at non-US locations? Does merely bearing the costs for the R&D head justify US' IP ownership?

Questions and answers

Please remember
to complete your
evaluation

Appendix

Compensation reporting for mobile employees is complex

Home Country

- Employer Issues: Wage reporting, income tax withholding, payroll taxes, corporate deduction
- Employee Issues: Individual income tax filing, accumulation of social tax benefits

Host Country

- Employer Issues: Wage reporting, income tax withholding, payroll taxes, corporate deduction, intercompany payment
- Employee Issues: Individual income tax filing, reimbursement

Corporate HQ

- Allocation of equity plan costs
- Monitor newly issued vs treasury share fulfillment
- Withholding practices preserve ability to utilize equity accounting

Mobile Employee Compensation Summary										
		Home Employer				Host Employer				Headquarters
<u>Compensation</u>	<u>Amount</u>	Payroll	Accounts Payable	Expense Report	Other	Payroll	Accounts Payable	Expense Report	Other	Other
Salary	\$150,000	X								
Bonus	\$75,000	X								
COLA	\$14,000	X								
Education	\$18,000						X			
Home Leave	\$12,500			X						
Host Housing	\$84,000						X			
Utilities	\$2,000						X			
Host Taxes	\$120,000					X				
Tax Equalization	(\$4,500)		X							
Stock Options	\$115,000									X
Actual Co Cost										X
28,000										
Home Co Income										
CO2										
14,000										
Host Co Income										
Engine Volume										
18,000										
RSUs	\$60,000									
Temp Living	\$8,500							X		
Moving Expense	\$24,000				X					
Automobile	\$28,000								X	
ER 401(K)	\$10,000	X								
EE 401(K)	(\$16,500)	X								
Hypothetical Tax	(\$195,000)	X								
Language Lessons	\$4,500							X		
Percentage of Total		7%	-1%	2%	5%	24%	20%	3%	5%	34%
Total by Source	\$509,500	\$37,500	(\$4,500)	\$12,500	\$24,000	\$120,000	\$104,000	\$13,000	\$28,000	\$175,000

Speaker bios

Ronald DaBruzzo is a Tax Principal leading the Global Strategies Group of Deloitte Tax LLP in Chicago.

With over 18 years of experience in international tax, Ron specializes in conducting International Strategic Tax Reviews to help U.S. and foreign multinational corporations develop a long-term global tax and treasury strategy. Since joining the Global Strategies Group, Ron has helped develop and administer a tested approach and tools to assist companies in analyzing their current tax and treasury posture and designing approaches to meet their tax and treasury objectives. Ron has also led multi-disciplinary teams and worked closely with in-house tax, treasury, HR, legal, and business personnel to successfully implement several complex global restructurings, including the realignment of Mexican maquiladoras. Typically, Ron has focused on tax planning that involves integration of mergers or acquisitions, global operational initiatives, U.S. foreign tax credit management, local country tax planning, cash mobilization and repatriation, and transfer pricing.

Ron obtained his B.A. in Political Science from New York University, his J.D. from American University Law School, and his LL.M in Taxation from the New York University School of Law. Ron is a member of the New York State Bar.

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John Jennings is a Tax Partner, based in Chicago, in the Global Employer Services group of Deloitte Tax LLP.

For nearly 20 years, John has assisted multinational organizations address the HR and tax challenges of transferring personnel and compensation plans across borders. With an international portfolio of clients, John has led numerous projects that restructure the employment and deployment of talent for companies across a wide array of industries. He has assisted corporations with the various facets of their talent strategy, including long-term incentive, retirement and severance plan design, improving the financial statement impact of compensation programs, establishing controls to enhance compliance, change management and developing special employment structures, policies and procedures to address the complexities associated with cross-border employees.

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Speaker bios

Eva Parenti is a Principal in the Chicago office with 14 years of Transfer Pricing and Valuation experience. Eva has been serving for many years large domestic and foreign multinational companies, covering several industries, in the context of planning, documentation, and audit defense.

Eva has extensive experience with global strategic tax reviews and business model optimization strategies, including IP optimization, supply chain restructuring and procurement companies.

Eva has assisted in the development of Deloitte's proprietary Digital Global Steps ("DGS"), an interactive software tool linking tax planning strategies to ETR modeling and tax compliance. Eva is also the regional champion of the Deloitte Global Dox Platform™ for which she served as a critical member of the core global development team.

She has extensive dispute experience including a recent case related to a Cost Sharing Agreement under the new Cost Sharing Regulations.

She is a frequent speaker at CITE and TEI both on the topic of global documentation and IP optimization and has been recognized by Euromoney as a leader in global transfer pricing and she is been featured in the *2013 Guide to the World's Leading Transfer Pricing Advisers*.

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