# Tax Equalization or Tax Protection – Which is Better?

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With globalization and the surge in worldwide economic activities, companies often need to send their employees on overseas assignment to fulfil business requirements. Moving the employees (and family) to a foreign location is not an easy task and the least the employees should worry is their taxes. To eliminate such concern, companies may tax equalize or tax protect the employees during their overseas assignment.

What is Tax Equalization and Tax Protection, what is the main difference between the two and which is a better approach?

This article aims to provide some insights on the concept and mechanism of a Tax Equalization and Tax Protection arrangement and their main differences.

## Tax Equalization

In general, most companies will adopt the tax equalization approach when an employee is sent on an overseas assignment. The objective of the tax equalization policy is to ensure that the employee's worldwide tax liability does not increase nor decrease as a result of the employee accepting an overseas assignment.

The underlying rationale is to ensure that the employee pays no more or less tax than what he would have paid had he remained working in his home location.

This policy aims to eliminate personal tax concerns of the employee when he is deciding whether to accept the overseas assignment. Income taxes, both at home and host countries should neither be a deterrent nor an incentive in his decision making process.

The first step to the tax equalization approach is to determine the employee's stay-at-home hypothetical taxable income. These are generally items of compensation that the employee would have received if he remained at home for e.g. salary, bonus, commission, transport allowances, etc. It may also include equity compensation. All assignment-related allowances and benefits (for e.g. hardship, foreign premium, overseas housing allowances, education fees, etc.) would be excluded. Personal income is generally excluded from the hypothetical taxable income.

Once the total hypothetical taxable income has been ascertained, the employee's home country's (i.e. Singapore) applicable deductions and reliefs, exemptions, credits and tax rates would be applied as if the employee is a tax resident, to calculate the amount of tax he would have had to pay if he remained in home location. This is called the "stay at home tax" or "hypothetical tax".

Companies will generally deduct an estimated hypothetical tax (calculated at the beginning of each assignment year) from the employee's gross salary and settle the host location taxes. At year end, there will be a reconciliation of any 'unders' or 'overs' when the actual hypothetical tax is determined based on the employee's actual compensation earned during the year.

From the Singapore tax reporting perspective, inbound expatriates who are with companies using the tax equalization approach will have their Singapore taxes (and home country's taxes, if any) paid by the company. Any excess of the Singapore taxes (and home country's taxes, if any) over the amount of their hypothetical taxes will constitute taxable income and subject to tax-on-tax regrossing calculation to arrive at the final tax payable by the company.

Outbound employees for example, Singaporean employees who are posted to work overseas will have the tax regrossing calculation in the host location. There will not be any tax liability where the employment source is not in Singapore – this means that there is no tax reporting nor any tax liability on the employment income earned during the period when the employee is working outside Singapore on an overseas assignment.

**Tax Protection**

In a tax protection policy, the employee does not suffer more tax than what he would have paid had he remained working in his home location. The rationale is to 'protect' him from any additional tax cost as a consequence of taking up the overseas assignment. For example, if the host location taxes are say, S$5,000 and his home hypothetical taxes are say, $3,500, the company will reimburse the difference of $1,500 to the employee for payment of his host location taxes.

Where the host location taxes are lower than what he would have had to pay at home, he will enjoy the 'windfall'. This will be the situation where the ~~foreign~~ employee is posted to a tax haven host location such as the UAE where there is no personal tax to pay and at the same time, he probably has no tax to pay in the home country as he is not working there.

In a tax protection policy, the company generally does not deduct any hypothetical taxes from the employee's payroll. Instead, the company will reimburse the employee for any additional taxes incurred as a result of the overseas assignment. In certain cases, the company may advance some monies to the employee to settle his host location taxes so that he is not 'out-of-pocket' during the overseas assignment especially in host locations where there is a "pay-as-you-earn' scheme in place. For such cases, the company will generally do a reconciliation to determine the 'unders' or 'overs' to be settled, at year end.

From the Singapore tax reporting perspective, inbound expatriates whose companies use the tax protection approach and who have excess of the Singapore taxes (and home country's taxes, if any) over the amount of their home hypothetical taxes will be subject to tax-on-tax regrossing to arrive at the final tax payable by the company.

Outbound employees, for example Singaporean employees who are posted overseas, will have the tax regrossing calculation in the host location. There will not be any tax liability where the employment source is not in Singapore – this means that there is no tax reporting nor any tax liability on the employment income earned during the period when the employee is working outside Singapore on an overseas assignment.

**Which is better – Tax equalization or tax protection?**

Companies who have global employees moving from one location to another will usually adopt the tax equalization approach as this allows them to provide a consistent approach for their employee's tax cost management. Hypothetical tax withholding will be easier to implement on a global basis as compared to the tax protection policy.

**Conclusion**

The tax equalization and tax protection policies are in essence private arrangements between the company and its employees and the decision is made solely at their discretion, in accordance to the company's policy and practice. There may even be hybrid situations of both schemes depending on the company's policy on the management of their employee's overseas posting.


**About Ms Jennifer Ng**
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Jennifer has more than 18 years of experience in Singapore personal taxation and is an Accredited Tax Advisor (Income Tax). Formerly a senior manager with the Big Four Accounting Firms – KPMG and Ernst & Young, she has extensive experience in the management of expatriate tax matters for Singapore and Global multinational companies. Besides tax preparation and review work, her areas of expertise include advisory work relating to remuneration structure, tax equalization policy and hypothetical calculation, equity compensation, due diligence / tax investigation work.


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