How Effective Shadow Payroll Management Makes A Big Difference To Your Business

Managing Mobility: Enabling Today's Global Workforce

The international employment environment has changed beyond recognition in recent years. Traditionally, it was characterised by periodic and pre-defined expatriation assignments. 'Expats' would move abroad for medium to long-term time lengths to a particular country, and be situated in a specific office working for their chosen company.

However, with the advent of technology and the evolution of multi-national organisations – together with the rise of new economies – the expat culture is giving way to more fluid, fast-moving and far-reaching professional landscape. We are living in an age of total global mobility. There are no barriers to business. Employees work across countries and continents. As they become more readily mobile, the pace of this change accelerates in turn, with shorter-term assignments, greater geographical spread, borderless financial transactions, and so on.

This brave new world of mobility is delivering huge commercial benefits, with even bigger opportunities still to be realised. However, it has created significant challenges for employee management.

Moving people around the world is a hugely expensive operation. Historically, hiring expats has been vastly much more expensive than employing local people. The same is true today. Uprooting someone and relocating them and their family incurs a wide array of overheads, in packages and relocation costs. But organisations have to maintain freedom of movement to maximise commercial advantage.

As such, as companies continually look to reduce costs, the expat model is giving way to shorter-term, fluid migration. In a world where the relative cost of relocated labour is far higher than using local employees, and the company has to pay considerable associated relocation costs - such as living away from home allowance, relocation allowance, schooling, hardship allowance, air fares and tax equalisation – more enterprise organisations are now reconsidering their 'Buy, Build or Borrow' strategy: where Buy means hiring someone, Build means training someone, and Borrow means outsourcing them.

> Reputationally, the consequences of not getting employment tax right are great – and can extend beyond the tax sphere. So, shadow payroll simply has to run on rails. It can't be done as an afterthought. It must be resourced properly, given clear accountability and be completely joined up
>
> *Andy Seear, Global Head of Employment Taxes, AIG*

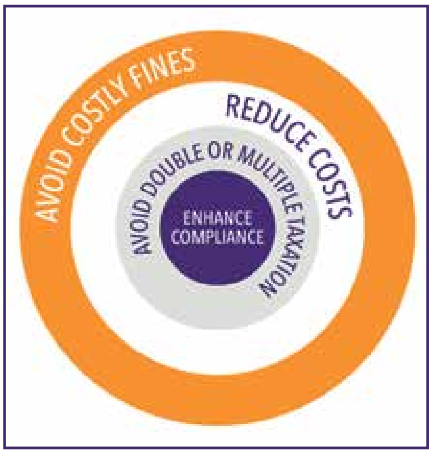
International Employees: An Expensive Affair

For a business to be successfully globally, it must have the right people in the right place, at the right time. Moreover, it must achieve this affordably, while always remaining legally and financially compliant. This is a considerable challenge, but when movement of employees across international borders is factored in, it can become a minefield – with the potential to impact the entire organisation.

To be clear: when we refer to an international employee, we are talking about an individual working on a traditional long-term assignment ("expat"), someone partaking in a formal short-term assignment abroad for a specified period of time, or those working on informal assignments ("loaned labour") – as opposed to short-term business visitors or foreign nationals transferred or hired on local terms and conditions.

Employment Taxes represent one of the largest costs associated with this process – typically around a third of the total employment costs of an international employee. What's more, international cost management, in the form of payroll and taxes applicable between the relevant countries, is extremely complicated. It's also scrutinised more closely than ever before.

In a bid to address these demands, many organisations have progressively addressed different aspects of these taxes. In the past, employee experience was the overriding priority when relocating, so all focus was on the relocation process and ensuring the employee settled in well to their new host country. As a consequence, immigration compliance and taxes were ignored. Today, immigration compliance is far better understood; however, taxes are still relatively ignored. Little time to



date has been spent proactively managing foreign employment taxes, otherwise known as the 'shadow payroll'.

This has to change... and fast.

HOW INTERNATIONAL EMPLOYEE TAXES WORK

Typically, an International Employee will be responsible for their actual or deemed ("Hypothetical") Employment Tax in their home country. This liability is limited to the Employment Tax due on their standard "stay at home" remuneration package. Their employer is then responsible for actual taxes in their host location, plus any additional or reduced taxes in the home location which arise as a result of the particular assignment.

Shadow Payroll Explained – And Redefined

Let's be clear about what we mean by an organisation's 'shadow payroll': Shadow payroll manages the "Employment Tax" liabilities relating to overseas employees when they move to another country on a temporary basis. This includes personal income tax and social security. Functionally, it runs alongside the standard payroll process, so it 'shadows' it, as such.

> Automating shadow payroll solution reduces your business risk and cost, ensures you report the right information in real-time from day one, and enables you to make better business decisions
>
> *Damian Walsh, Partner, Savannah Group*

Traditionally, shadow payroll has been defined as:

"A method of maintaining international tax compliance while an employee works abroad. A process in which a US employee working overseas, for example, receives compensation and benefits in the host country that are shadowed, or mirrored, in the US for calculating, reporting and remitting taxes." Bloomberg BNA

In contrast, Certino defines shadow payroll as:

"A comprehensive employment tax management system that covers everything from pre-move planning, monthly income tax and social security calculations to inter-company rebilling and posting of transactions in accounts".

Shadow payroll works by calculating what Employment Taxes are due in respect of each employee based on the corresponding requirements of the country they're working in, and any other country in which an Employment Tax liability arises by virtue of citizenship or ongoing tax residence. Once established, the tax payments due are processed in the normal way. This sounds simple enough in theory, but the reality can prove to be very different.

There is a lack of awareness in HR, Payroll and Finance departments regarding shadow payroll best practice. There is no set role or responsibility for it, and as such, no conventional method of calculating it. Rather, it is the elephant in the room: those involved know it needs to be tackled, but are reluctant to do so directly. Many would prefer to pass the task to someone else, or outsource it altogether to a perceived payroll expert.

A Challenging Calculation

There are several challenges with accurately calculating shadow payroll. Probably the biggest lies simply in determining which factors should be calculated, reported and remitted, as well as how and when to do so. To make things more complicated, these various income sources come from a range of different places.

For example, an employee's payroll might be managed by one source; their benefits by another; their expenses by another, stock payments by another, location tracking by one more, and so on. Identifying, following and managing this long trail is difficult and time consuming, especially as most organisations' mobility teams are small in number. It's also constantly changing due to the large number of data inputs, which makes it complex for most organisations' existing payroll systems to cope.

Shadow payroll also requires broad familiarity with a number of specific issues which fall outside the remit of the average, domestically-orientated payroll professional. Issues including "expatriate" tax regimes, split pay, hypothetical tax, tax equalisation and tax protection.

In short, shadow payroll represents an enormous administration burden within the context of a traditional organisation's payroll set-up, so most simply do the best they can. They believe that the annual tax return process is sufficient to manage everything, not least because they're not aware of any alternative process. Many outsource shadow payroll to their chosen specialist tax partner, or rely on their local Payroll or Finance functions to manage as best they can.

While this seems logical enough, the lack of shadow payroll specialism often prevents organisations from truly minimising their tax liabilities in this area. Usually, by the time the annual tax return is prepared, it's too late to comply with monthly withholding and reporting requirements, and unnecessary taxes and fines are paid along the way. There is also the relatively high price of outsourcing in the first place.

Employment taxes represent around 33% of the total cost of moving staff across borders

Despite this, organisations struggle on – because they're not aware of any better way, and they have an obligation to be compliant.

> In HR, an industry where value is notoriously difficult to measure, shadow payroll automation provides a tangible way to categorically record the commercial value of what you're saving the business – day by day
>
> *Didier Charreton, Chief HR Officer, Anglo American*

Tax Compliance: A Risky Business

As mobile working increases and compliance demands intensify, governments expect every organisation to manage its payroll activity tightly, regardless of geography. This creates pressure to maintain effective tax systems. However, many existing HR systems are not inherently designed to cope with the high volumes and fast speed of people moving locations. They cannot track them accurately, or on time. Too often, they simply generate a long list of invoices, a paper trail that attempts to track employees down and that remains one step behind the real-time situation.

Not only can this lead to incorrect tax calculations, but it can have more wide-reaching implications. Incorrect financial statements may mean that costs are retained on the company's balance sheet, rather than in its P&L. Valuable resources are tied up and poorly used in managing the whole process, and ultimately these inconsistencies can put the entire company at risk of failure in the event of tax audits.

This is a headache for shadow payroll compliance. It runs the risk of substantial fines, wasted man hours and resources, a lack of individual accountability and needless additional tax payments in the form of double or multiple taxation. Not to mention potential reputational damage. Government tax authorities around the world are being urged to maximise revenues to take advantage of today's global mobile workforce. Naturally they are targeting organisations that move employees across borders, as they offer potential rich pickings with relatively low risk.

The objective is clear: businesses must get shadow payroll right, in real-time.

BEPS – AND WHAT IT MEANS FOR 'GLOBALLY MOBILE' ORGANISATIONS

Base Erosion and Profit Shifting (BEPS) aims to tax the profits of companies based on where they are actually conducting their business and creating tangible value, rather than where they choose to file their tax returns. BEPS is set to majorly impact the way in which organisations manage and report on their globally mobile workforce: and shadow payroll will be a key factor.

As BEPS gains momentum, organisations must (a) know where employees are, what they're doing, and to be able to report thereon; and (b) make decisions on where tax liabilities arise for employees who cross international borders.

Recommendations For Best Practice

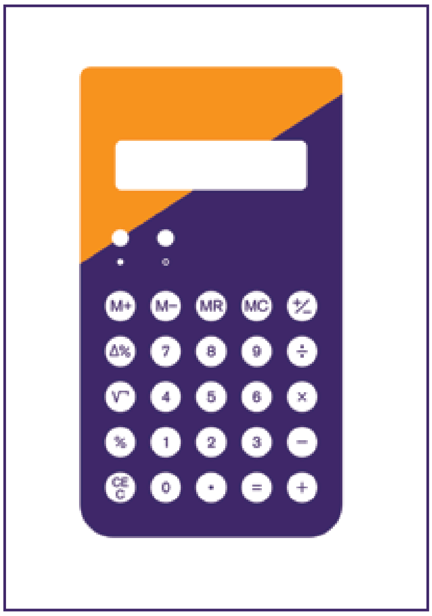
Above all, shadow payroll best practice is about 'Getting It Right First Time': through the effective planning, deployment and tracking of employees as they move from place to place. With existing hardware, personnel and processes seemingly lacking, this might seem like a mountain to climb, and even impossible to achieve in the timescales required. But there is good news.

Organisations do not need to invest money in advanced infrastructure, expensive systems and manual processes to make shadow payroll work for them. Instead, they can automate the entire function – removing the chance of human error, reducing internal resources, ensuring compliance in real-time, and saving money.

Ultimately, this automated solution provides peace of mind that you're paying the right amount of tax in the right place, at the right time. All of which significantly reduces your overall employment costs (including administrative and compliance expenditure, and 'excess' taxation).

> Shadow payroll has traditionally been seen as just a compliance process, with no tangible commercial benefit or advantage per se, and zero influence on a positive employee experience. To get shadow payroll right, your compliance must be completely under control, but now there are clear commercial benefits to managing it effectively as well
>
> *Chris Debner, Founder, Strategic Global Mobility Advisory*

An automated shadow payroll solution can consolidate your systems and run data on your behalf, scrutinising its accuracy and authenticity to provide reliable oversight for consistency and compliance purposes.



Because this process is ongoing, you're never left vulnerable and always enjoy an optimised tax position with minimised tax liabilities.

How It Works

Employment tax is an environment experiencing heavy compliance demands and constant cost cutting. Existing processes are rather fragmented. Policies and processes are managed by HR rather than tax experts; payroll is outsourced (along with shadow payroll); re-billing and accounting procedures are handled by the finance department; and annual tax returns are also outsourced to someone else. Tasks are disparate, and difficult to track and manage as a whole.

Therefore, the ability to automate the entire end-to-end process represents an incredible opportunity to save significant time and money across the board.

Now, at a glance, you get an overview of all your tax liabilities and everything you need to pay in every market you're working in. This information updates as it happens, with changes recorded accurately in a format that's easy to understand.

When you need to pay tax, this is managed better too. Automation optimises your payment calculation by taking a global perspective of your tax landscape across all active markets you're operating in, as opposed to a local, market by market approach, which someone based in an individual tax office would usually do.

In Conclusion

Global workforce mobility is creating exciting new possibilities for organisations all over the world. As technology advances and economies evolve, employees are moving faster and further than ever before. But alongside the substantial commercial benefits, there are increasingly complex challenges for those tasked with managing this migration.

> "When someone relocates, the last thing they want to worry about is tax. They've got so much else going on – a new job to start, a new property to move into, a different culture and environment, possibly schooling for the kids... but with an automated payroll system, employers don't have to worry about the tax processes either"
>
> *Simon Rogers, Managing Partner, Talent Mobility Search*

International employment is vastly expensive. From an HR perspective, there is a wealth of factors to consider. As legislation increases and compliance demands intensify, HR professionals must strike a balance between legal practice and freedom of movement, all while reducing costs. Failing to achieve this can put an organisation at great risk, ethically and financially. With employment taxes representing one of the largest costs associated with employee mobility, innovation in this area can pay large dividends.

Shadow payroll is a great example. But unfortunately, it's not well understood. That must change - but how? Above all, organisations need to 'Get It Right First Time': by tracking employees accurately and promptly as they move from place to place. This is hugely time-consuming and expensive using conventional approaches. However, there is a better alternative.

Shadow payroll automation removes human error, reduces man hours, and ensures compliance while saving money. So, you enjoy peace of mind that you're paying the right amount of tax in the right place, at the right time.

RICHARD MCBRIDE

Richard is the founder and managing director of Certino, which has been formed specifically to help international businesses with complex mobile workforces to address the massive challenge of managing their shadow payroll.

Prior to founding Certino, Richard set up and led the global mobility function at Baker Hughes, one of the world's largest oil field services companies, where he delivered more than $250 million in employment tax cost savings over eight years (2008 – 2016).

If you would like to discuss any of the issues raised in this article or learn more about Certino, please do not hesitate to contact Richard on +44 (0) 020 7118 1405 or email him at richard.mcbride@certino.com. Alternatively, you may wish to visit www.certino.com for more information.