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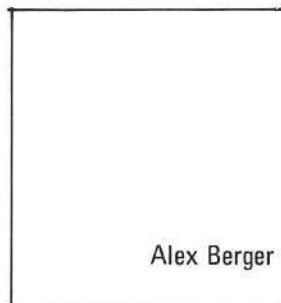
# Compensation for U.S. Personnel Overseas

by Alexander Berger

*This article offers a rounded picture of how to develop an overseas compensation plan. The International Coordinating Office's interest in this field grew out of its program of placing CPAs from the U.S.A. firm in key spots in our International Group. The I.C.O.'s experience is available to any Touche, Ross office having clients with similar problems.*

In a recent four-year period, more than 1,800 new U.S. enterprises were started in Europe. In the European Common Market alone, the book value of direct investment by U.S. firms rose from \$1.9 billion in 1958 to \$5.4 billion in 1964. These statistics do not show the number of U.S. personnel moving to overseas jobs, but we do know that the number of U.S. personnel working overseas today is larger than ever before, and that this number continues to increase.

These facts are significant in many ways. Not the least is that personnel departments and wage administrators have had to make comprehensive studies on compensation for U.S. citizens employed in foreign countries. Indeed, after his preliminary survey the salary administrator arranging a compensation package for personnel going overseas is apt to wish for the good old days when he was only concerned with employees in the U.S. That compensation package was simple and straightforward. He was concerned only with such matters as straight time pay or salary, arrangements for overtime, insurance and pension plans, profit sharing, bonuses, attracting those men with the highest potential, keeping up with or ahead of the



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competition, and the like. For the U.S. citizen employed in a foreign country (commonly referred to as an expatriate), all of these matters are still involved, but many other factors must also be considered.

Compensation of an employee in the U.S. is usually determined by agreement with the employee himself. But, send the same employee overseas, and you may find the employee's wife making demands. Even if she doesn't, a potential move to a foreign country is bound to be a matter for family discussion and decision.

All of this adds up to the need for a carefully planned system of overseas compensation that is fair to all concerned. The inadequacies of a poorly conceived compensation plan may be discovered too late, only



after an employee has moved overseas. By that time many thousands of dollars will have been spent in moving the entire family to the foreign country. Not only can this investment be lost, but the end result can be the loss of a valuable man.

The purpose of this article is to show how to avoid such disastrous results. Especially for companies just entering the international field, the policy decisions required and the necessary ingredients of a compensation package will be indicated. But first, let's discuss preparation for that overseas job.

#### *ORIENTATION FOR OVERSEAS EMPLOYMENT*

One requirement, almost an essential, in selecting an employee for an overseas assignment is interest and willingness on the employee's part. Interest and willingness are, of course, requisites for any job, but since an overseas job means living in a different environment, the employee's attitude to this experience is important in adjusting to the new culture. And living in a new culture means more than the ability to handle another language and outlook on the world. It includes such everyday matters, perhaps, as not being able to buy pasteurized milk, or living without electricity for six hours each day, or not having a good dentist readily available, as well as being separated from relatives and friends, and finding oneself the "outsider" who is expected to explain things like U.S. treatment of Negroes and what the U.S. is doing in Vietnam.

Some find the adjustment to a new environment more difficult than others. The term "cultural shock" has been used to describe severe cases of poor adjustment. To help smooth the transition from the States to a foreign environment, some companies send employees to special schools which have been set up for that purpose. The Business Council for International Understanding, Inc. offers at The American University in Washington, D. C. an intensive four-week course which includes a foreign language. This course, given five times a year, is particularly valuable for executives who will be dealing with government officials and other top level people in the foreign country.

The American Institute for Foreign Trade offers nine-month courses at Thunderbird Campus in Phoenix, Arizona. They also offer key man courses which provide six weeks of concentrated language study. Other schools also educate the U.S. employee in the foreign culture and some of them study the U.S.—a deeper understanding of his own country often enables the

expatriate to cope more readily with a foreign culture.

As a minimum, the expatriate should learn the foreign language, and both he and his family should read some books about the country in which they will reside. There are two points of view about language instruction. One view emphasizes conversational ability with the thought that full language capability will develop rapidly once the expatriate is in the country involved. The other view emphasizes grammar and structure. This view is based on the idea that fluency will develop even more quickly in the foreign country if the basic foundation for the language is already built.

#### *THE BASIC POLICY DECISIONS*

There is one basic policy decision which influences the handling of all other compensation factors. Should the expatriate's compensation enable him to maintain his U.S. standard of living in a foreign country, or should he be expected to live in the manner of a foreign national at the same job level?

As a practical matter, reduced living standards will not attract U.S. executives to overseas assignments. Therefore, most companies enable an expatriate to maintain his usual living standard in the foreign country, with all this implies. For one thing, it can be costly. If a Japanese executive, for example, working in the U.S. insisted on eating the food he was accustomed to in Japan, and demanded other accoutrements of Japanese life, the cost of importing these things to the U.S. would undoubtedly make his cost of living higher than it had been in Japan. Similarly, a U.S. executive in Japan who insisted on having everything imported from the U.S.—from toothpaste to reading material to apple pie—would find the cost of living in Japan quite high. The point is this: The usual policy decision which enables an expatriate to maintain his normal living standard is (1) costly, (2) involves determination of how a standard of living is measured, and (3) can result in reciprocal expatriates (Frenchmen working in the U.S. and Americans working in France) both receiving extra compensation to support their customary living standards.

Another basic policy matter is whether or not to pay a premium for overseas service. The fact is that many companies do—anywhere from 10% to 40% of the normal base pay that would be paid for a comparable job in the U.S. The justification of an overseas premium is based in part on some of the factors already mentioned—the added problems of living in a foreign



country, learning a foreign language, being separated from relatives and friends, etc. Added justification is the fact that an overseas job usually carries more responsibilities than the equivalent job in the U.S. For example, the typical overseas job will carry responsibility for training local nationals, and for representing the company to a greater extent than in the U.S. Also, the overseas employee tends to be on his own; he often doesn't have supporting services, company manuals at his elbow, and someone across the hall with whom he can discuss a problem.

For reasons such as these, and sometimes simply to meet competition, many companies offer a premium for overseas employment. Other companies do so indirectly by offering expatriates faster promotions, or larger or more frequent salary increases.

Companies that offer overseas premiums sometimes increase their basic pay levels to include a premium, but it is generally better to handle base pay and overseas premiums as separate amounts. If they are combined, the employee who returns to the U.S. from overseas is apt to feel that he is taking a cut in pay. Keeping them separate avoids this, and tends to make more understandable and acceptable compensation changes due to overseas transfers involving areas where different overseas premiums are paid.

It is also important that a premium paid for foreign employment is not confused with pay for other differentials, discussed in the following paragraphs.

#### *Hardship Differential*

A hardship differential or allowance is not paid in the typical case. When paid, it is considered extra compensation for unusual difficulties or dangers, such as living in a war zone, or in geographic isolation, or in a very high altitude, or in an area with many endemic diseases and few medical facilities, or in an area where the prevailing winds rarely cease. Living where the wind blows constantly may not strike you as an unusual difficulty, but after a few wind-lashed weeks, it is easy to understand why such an area might qualify for a hardship differential.

#### *Shelter Allowance*

A shelter allowance is designed so that an expatriate living in an area where shelter costs are high will spend, roughly, the same percentage of his income for shelter as he did in the U.S. Currently, for instance, Tokyo is an area where shelter costs are very high. In Tokyo today, living quarters that might rent for \$200

per month in the U.S., would perhaps cost \$600 or more. Therefore, for an expatriate to retain his U.S. housing standard would require a shelter allowance of \$400 per month. The U.S. State Department publishes a "Quarters Allowance" which is useful for determining shelter costs in various areas, and other organizations publish similar guides to shelter costs.

In some places, the cost of shelter may be lower than in the U.S. In this reverse situation, companies should deduct what may be termed a negative shelter allowance from the expatriate's compensation. This negative allowance is the other side of the coin. *If an expatriate's compensation should enable him to live as well in a foreign country as in the U.S., it should not enable him to live better.* After all, he is already receiving a premium for overseas service. Therefore, the shelter allowance, whether positive or negative, should enable him to do no more than match his U.S. standards. This same principle applies in other types of allowances which are part of the compensation package.

The shelter allowance and the other allowances which will be discussed are really nothing more than equalizers. That is, they equalize the compensation of expatriates employed in high-cost areas and low-cost areas. Since expatriate compensation can be worked out in a less scientific manner, an obvious question is what purposes do these equalizers serve other than providing a basis for compensation that is both rational and fair to the company and the employee. Primarily, the equalizers serve two purposes:

1. They keep the overseas force mobile. Without them, an expatriate in a country with low living costs would object to a transfer to a country with high living costs.

2. They tend to reduce the cost of overseas employment. Historically, expatriate compensation developed in terms of extra compensation for cost of living, shelter, and the like. Now, in some areas, it is obvious that the extras are not justified, and that "negative allowances" are more in harmony with the facts.

#### *Post Allowance*

A post allowance is probably more clearly described as a cost of living allowance, but excludes housing which is covered by the shelter allowance. Here, too, in a high cost area the expatriate should receive an extra amount, and in a low cost area he should lose a certain amount. Comparisons of living costs may be



based on State Department tables, or on tables obtained from the Industrial Relations Counselors Services, Inc., an organization that does a great deal of work in the field of expatriate compensation. There are other sources for cost of living comparisons, and some large companies base their cost of living comparisons on their own research.

Post allowances are particularly important in countries undergoing a rapid inflation, such as Brazil at the present time. It is not true, as may be maintained, that an increase in living costs is always matched by an increase in the rate of exchange of the dollar for local currency. Studies have shown that dollar exchange rates and prices are often out of alignment with each other.

#### *Tax Allowance*

In about two thirds of the countries where U.S. expatriates are employed, income taxes are higher than in the U.S. On the same principles as for other allowances, an expatriate should receive an additional allowance for higher-than-U.S. taxes, and should lose an appropriate amount for lower-than-U.S. taxes.

Some companies agree with the premise stated above, but do not wish to have any involvement with their employees' tax returns. This position is certainly understandable, and some companies simply ignore the impact of foreign income taxes in their compensation packages. Others have found ways to equalize the tax factor without looking at or otherwise getting involved in employees' tax returns. The simplest method is to hypothetically compute an employee's U.S. income tax by using his salary income, his actual exemptions, and an arbitrary percentage of gross income, say 10% to 15%, in lieu of itemized deductions. Then, use the same formula to determine foreign income taxes. The comparison of the tax results is the basis for a positive or negative tax allowance.

Tax allowances, of course, are often more complex than was outlined above. The matter of state and sometimes city income taxes may come into the picture, as well as the practice in some countries of "negotiating" tax payments. Also, social security and similar taxes may be required in a foreign country and, since the typical expatriate will not be in a position to benefit from such payments, he should be reimbursed for such tax items. On the other hand, he may gain from compulsory profit sharing and similar employee benefits and these should be considered either in computing his tax allowance or in some other category.

Frequently, the expatriate employed by a foreign subsidiary wishes to maintain his U.S. social security account. This can be worked out; it is merely another item to be planned for in the total compensation package.

#### *Education Allowance*

For families with children of school age, a satisfactory local school system or an adequate substitute is usually a precondition for the acceptance of foreign employment by the breadwinner. Therefore, the first issue to be resolved is whether or not the local school system is adequate. The major test of adequacy is whether or not a child can move from his school grade in the foreign country to the next grade in the U.S. Some educational authorities, but not all, would include instruction in English as another test of adequacy.

To educate youngsters in countries where local school systems are not adequate, more than 700 private schools are currently functioning, and several correspondence courses are also available. Most U.S. companies add to employees' compensation, where necessary, an allowance for educating children. This equalizer, of course, is always a positive amount.

To obtain information on many of the educational problems that arise (what happens when the family moves overseas in the middle of a school term), non-profit organizations, such as the International Schools Services, 554 Fifth Avenue, New York City 10036, are available. This organization not only provides information about schools in all parts of the world; it also sets up schools in remote areas and may even operate them if requested. Dr. John Sly, president, believes that although there are some disadvantages in foreign education (high turnover of student body and faculty), the overall experience of studying in a foreign country usually results in a net gain for the child. Among other groups, the U.S. State Department is also helpful in providing information on the quality of schools in different areas and on the amount of educational allowance that may be required.

#### *The Balance Sheet Approach*

In discussing compensation with a potential expatriate, it is most useful, informative, and friction-reducing to show him how his compensation package is determined. The following is a hypothetical monthly package, not representative of any particular country, which includes the elements that have been discussed. This

method is often referred to as the balance sheet approach. This term grew out of the philosophy that an expatriate's net worth at the end of his overseas employment should be the same as it would have been if he had remained in the U.S., except of course for any direct or indirect overseas premium and assuming similar living standards.

#### *Monthly Compensation*

Regular base pay		\$1,000.00
Overseas premium		200.00
Total regular compensation		\$1,200.00
Shelter allowance	+ \$75.00	
Post allowance	+ 50.00	
Tax adjustment	- 40.00	
Educational Allowance	+ 90.00	
Govt.-required social security	+ 25.00	
Total adjustments		+ 200.00
Total monthly compensation		\$1,400.00

#### *Method of Payment*

After the full compensation package has been determined, there are still many questions to be decided. One is whether to compensate the expatriate in dollars or in local currency. Typically, the expatriate is paid in a combination of dollars and local currency. The split is usually somewhere around the 50-50 mark, with the actual percentages determined by the following factors:

1. The employee's need for dollars to meet continuing U.S. obligations, and his need for local currency. The U.S. dollars can also be used to continue the employee's fringe benefits in the U.S.
2. The amount of the company's foreign earnings.
3. Tax factors which may vary from country to country.

#### *Relocation Expenses*

Although relocation expenses, strictly speaking, are not part of a compensation package, they are so much a part of the move to an overseas job that they are also usually handled by international personnel departments. The chief items of relocation expenses are transportation for the employee and his family, the cost of sending his furniture overseas or storing it, the disposal of a private house or its routine maintenance, and handling of the employee's automobile.

Although an overseas move creates many problems in these areas, and may be quite costly, company policy covering relocation within the U.S. is often a useful guide. The only really new factor is the situation in a specific country. If furniture can be purchased quite cheaply in the foreign country, for example, there might

be an advantage in requiring the employee to sell or store his furniture rather than ship it. If furniture costs are high, on the other hand, shipping everything might make more sense.

The same reasoning is often applied to an employee's automobile. Certainly, the U.S. family that is used to an automobile may find it difficult to function without one. However, U.S. cars are not suitable for all foreign countries. Roads may be too narrow, gasoline costs too high, and the lower cost of a smaller foreign car may make shipping a U.S. car overseas a foolhardy exercise. On the other hand, in some countries a U.S. car may be sold at a premium. A reasonable approach to a policy on automobiles, as with furniture, is not to be rigid, and to take into account the actual situation prevailing in each country at the time of relocation.

#### *Other Matters*

The more important elements of expatriate compensation have been discussed, but there are still many minor matters that require at least a brief mention.

*Normal leaves and home furloughs.* Policies in this area are very diverse. Historically, two or three months' home furlough for the entire family was granted every second or third year and normal vacation leaves every year. However, the cost of losing an employee's services for such a long period, and the drop in transportation time and cost of air fare has produced a trend toward annual home leave each year in place of a local vacation, sometimes combined with a training or reporting session at the home office.

The question of home leave also arises in emergency situations such as serious illness or death of an employee's relative. Similar situations arise when an employee's son or daughter who is attending a university in the U.S. wishes to rejoin the family during the school vacation period.

Practice varies. Most companies, in their overseas employee manuals, do attempt to set policy for such matters (for example, it is common practice for companies to pay for one round trip a year to a college-age offspring), but it is good judgment to leave some room for handling each such situation on its merits.

A problem related to home leaves or emergency home visits is which point in the U.S. is considered to be the employee's home. If his previous home was in Chicago, and the company home office is in New York, is the expatriate flying home for an annual vacation in San Francisco entitled to air fare for his family and himself to New York, Chicago, or San Francisco. The point here



is not to recommend one location as against another, but to point up the necessity for including this matter in the company policy manual—which all companies with more than a few overseas employees should have.

#### *An Overseas Employment Manual*

Although any company that sends executives overseas will have carefully considered their compensation policies, it does not follow that every such company needs a manual. The large investment of time and effort to develop a manual should be made only when a clear need exists. When a company is sending from five to fifteen executives overseas each year, it has reached a plateau where the development of a company manual can save on the administrative time spent in processing each overseas employee; it is at that point where it is probably time to develop a book of rules.

Good manuals are not born, they are the product of experience and revision as well as of careful planning. Thus, the looseleaf type is preferable because of the ease of changing it. For international employment, a manual is apt to be more useful if it lays down broad policy rather than the details of a compensation package. For example, it might say that a cost of living allowance should be given when there is a difference in the cost of living in an overseas post and in the U.S., and it might indicate the method of determining the cost of living. Details of the amount of the cost of living allowance should be avoided because the situation in one country is apt to be different from that in another country and, even in a particular country, conditions change frequently.

All of the other rules of manual preparation apply, of course, to an overseas employment manual. It should be easily understandable, not ambiguous, and should be checked for internal consistency and accurate reflection of company policy. The manual should be distributed only to management, in fact only to managers who are interested in overseas employment. Companies that want to distribute the manual to expatriates to keep them informed on company policy should include a statement that the manual is for information only and is not to be considered as forming any part of an employment contract. Another informative and satisfactory approach is to give each expatriate a concise summary of his compensation package. These can be preprinted with names and amounts left blank and inserted later.

Manuals should start with a general statement of company policy. At that point or at the end of the manual it is useful to have a glossary which defines terms used

such as expatriate, family, point of assignment, home, home leave, emergency situation and the like.

The main section of the manual should deal with the topics that have been discussed in this article. Such matters as a premium for foreign service, a hardship allowance, shelter allowances, educational allowances for children, moving expenses, tax factors, and other compensation factors should be discussed in individual sections and as briefly as possible. For example, a section on the method of payment might contain only the following:

“Wherever possible, 50% of the expatriate’s salary will be paid in the currency of the area to which he is assigned. Allowances for the cost of living and for the education of minor children will also be expressed and paid in local currency. In the United Kingdom, however, living allowances will be paid in U.S. dollars.”

One possibility not to be overlooked in a manual is that the employment overseas may end sooner than anticipated or that the executive’s employment itself may have to be terminated. A company that sends large numbers of men overseas, runs into the statistical probability that these events will occur. For such cases, the policy outlined in the manual should cover all of the usual conditions of severance from the company and, also, the return of the employee and his family to their point of origin in the United States.

As is true of any manual, an overseas compensation manual is useful only to the extent that it is alive and current. As policies change, which they must, the manual must also change. This constant updating is the key to an overseas compensation manual that will serve the purpose for which it was designed.

The day is undoubtedly coming when it will be possible to board a plane or a rocket ship in the U.S. and forty minutes later—standard commuting time—land in Paris. (Of course, the ride to the airport will still take an hour and a half.) Nevertheless, when that day arrives, a special compensation system for overseas personnel may be a relic of the past. Until then, however, we probably have no choice but to continue with the compensation system that has been outlined here, and to hope that Paris, Rome, and Kuala Lumpur will continue to attract enough Americans to meet overseas staffing requirements. Judging by the increasing number of Americans traveling in foreign countries, it appears that the “older” countries will continue to lure and appeal to the residents of the new world.