

Human Resource Services

HR Quarterly

Sharing good practice*

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From the editor

Since our last issue, the economic downturn has become even deeper and the issues more critical. It is doubtful whether companies can still rely on the key success factors that have stood them in good stead over the past few years. The status has changed to one of “survival” and in order to survive and succeed despite this uncertainty, boardrooms will have to identify what their businesses and employees should be doing differently to ensure they emerge strong and agile for the future.

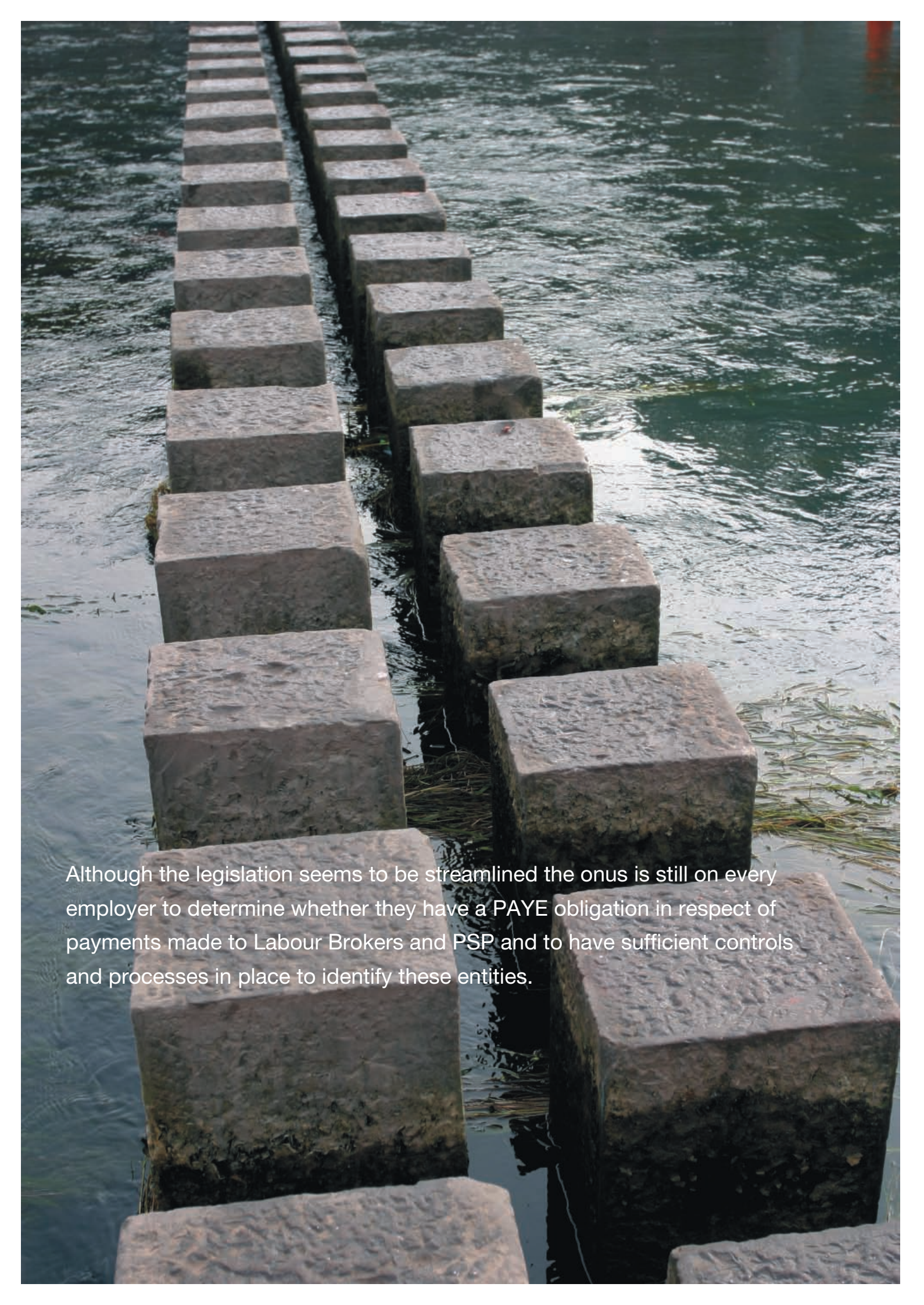
Retention immediately springs to mind as one of the first critical steps – businesses will need to identify the talent that they cannot afford to lose. As highlighted in our last issue of HR Quarterly, ensuring the correct reward structures are in place for employees will be imperative and could keep you ahead of your competitors.

Companies that manage people costs effectively, whilst motivating their employees to flex their output according to business needs, will survive where others fail. Identifying ways to keep the employees who are vital to the business and drafting communications to engage staff effectively during these times are critical.

Although incentives (bonuses) are perhaps the number one area of pressure in the current turbulent times, we also need to keep an eye on the horizon for coming challenges, such as the retirement fund industry’s reform and the introduction of a social security system in South Africa.



Gerald Seegers
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A long, narrow path of rectangular stone blocks extends from the foreground into a body of water, receding into the distance. The blocks are arranged in two parallel rows, creating a central channel. The water is dark and rippled, with some green seaweed visible on the right side. The perspective is from a low angle, looking down the path.

Although the legislation seems to be streamlined the onus is still on every employer to determine whether they have a PAYE obligation in respect of payments made to Labour Brokers and PSP and to have sufficient controls and processes in place to identify these entities.

New PAYE tax treatment of Labour Brokers and Personal Service Providers – “streamlined”?

In our issue of October 2008 we commented on the draft legislation relating to the proposed “streamlining” of the rules that require certain entities to be treated as employees for employees’ tax (“PAYE”) purposes. This legislation was promulgated on 8 January 2009 with effect from 1 March 2009. In terms of the promulgated legislation the following new rules must be considered to determine whether an entity is considered to be an employee for PAYE purposes

These changes are effective for all Labour Brokers

The definition of a Labour Broker remains principally unchanged except that the amended definition now only includes natural persons where previously it included corporate entities (companies, trusts and close corporations). Other than the exclusion of entities, Labour Broker services are still regarded as services where the labour broker makes, at a cost to the client, the productive capacity of skilled persons available to such client.

What is the good news?

The practical implication of the above amendment implies that where an employer currently makes use of a Labour Broker operating through an entity, as opposed to a natural person, the employer will no longer have an obligation to withhold PAYE from the Labour Broker entity. Further, where a natural person operating as a Labour Broker is in possession of an annual exemption certificate (“IRP30”) there will be no

obligation on the employer to withhold PAYE.

The amendment is especially welcomed by Labour Broker entities, as they are now absolved from the administrative burden of applying for an IRP30 certificate from the South African Revenue Service (“SARS”). In the past where a Labour Broker entity could not obtain an IRP30 from SARS, an employer had to withhold PAYE at a rate of 33% and the entity was further limited as they could only deduct expenses for income tax purposes in respect of their employment costs (salaries paid to the employees of the labour broker).

In the case where an employer make use of a Foreign Labour Broker Entity the amendment will also apply and welcomed as in the past the Foreign Labour Broker Entity had to apply for a “costly” Advanced Tax Ruling from SARS to obtain an IRP30 certificate.

The downside?

Payments made to natural persons operating as Labour Brokers will most likely remain within the PAYE

net where they are not in possession of an IRP30. An employer will therefore still be obliged to withhold PAYE, either according to the statutory tables or as per a directive issued by SARS, from payments made to a Labour Broker where the Labour Broker is not in possession of an IRP30 certificate.

Employers are therefore urged to obtain a valid IRP30 (on an annual basis) from natural persons operating as Labour Brokers and to withhold PAYE from payments until an IRP30 is obtained to avoid being held accountable by SARS for the under payment of PAYE, together with interest and penalties.

Natural persons operating as a Labour Broker will therefore still need to apply for an IRP30 certificate from SARS, which SARS may not issue in certain instances such as where the Labour Broker is contractually obliged to provide a specific employee (of the Labour Broker) to render any service to a client.

Where an employer fails to withhold PAYE from a PSP, SARS will hold the employer accountable for the under-deduction of PAYE, together with interest and penalties, and not the PSP.

Personal Service Providers

The earlier definitions of a personal service company and personal service trust have been replaced by the definition of a Personal Service Provider (“PSP”). In essence the definition and rules of a PSP is the same as that of the earlier definitions of a personal service company and trust prior to the amendment. The only difference is that the earlier definitions of a personal service company and trust specifically excluded a company which was a Labour Broker, whereas the definition of a PSP now includes any company or trust.

What does this mean?

The fact that the new PSP definition refers to “any company or trust” means that a Labour Broker entity, excluded from the new definition of a Labour Broker, may still fall within the scope of a PSP if a connected person (defined in the Income Tax Act) of the Labour Broker entity render services personally to clients. An employer will therefore still have an obligation to withhold PAYE from such a Labour Broker entity.

Any other company or trust will only be excluded from the definition of a PSP where such company or trust

throughout the year of assessment employs three or more full-time employees who are on a full-time basis engaged in the business of such company or trust. These employees will not include shareholders, members or connected persons of the company or trust.

If the above exclusion does not apply a company or trust will still be considered to be a PSP and an employer will still have the obligation to withhold PAYE at a rate of 33% or according to a directive from a PSP company and at a rate of 40% or according to a directive from a PSP trust. Where an employer fails to withhold PAYE from a PSP, SARS will hold the employer accountable for the under-deduction of PAYE, together with interest and penalties, and not the PSP.

Although the legislation seems to be simplified or “streamlined” the onus is still on every employer to determine whether they have a PAYE obligation in respect of payments made to Labour Brokers and PSP and to have sufficient controls and processes in place to identify these entities.

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Executive compensation -What goes up, must come down



It is true to say that over the past decade, we have seen an extraordinary and uninterrupted increase in executive pay. As we continue to experience the full impact of the economic downturn, Remuneration Committees will be spending much time in deliberating the impact of this economic downturn on executive pay packages.

Continuing to pay bonuses when share prices are in freefall is not a comfortable place in which to be. Whilst the Remuneration Committee's primary duty is to motivate and retain its existing executive team, it runs the danger of penalising executives performing at a high level during these difficult times. Lowering bonus targets to reflect these uncertain times could also increase the tension between the Committee and executives. So, managing the trade-off between performance and retention will be a major challenge for Remuneration Committees.

We have experienced consistent increases in executive pay over the past year, despite falling share prices and declining corporate performance. Although the structure of incentives has changed radically over the same period, what comes out of them continues to rise.

But will this be allowed to continue?

Already we have seen examples of company responses, including:

- increased focus on (more controllable) short-term incentives;
- adjustment of long-term incentives targets for the future awards; and
- use of one-off retention plans to plug the 'gap' left by long-term incentives that are now unlikely to vest.

These types of actions simply add to shareholder concerns about the link between pay and performance. There is a strong expectation from shareholders that executives will share the pain that has been felt through falling share prices. Remuneration Committees will therefore have to be very careful in assessing the level of bonuses that are to be paid, if any.

So what do Remuneration Committees need to consider when making judgements on the bonus?

There must be a link between pay and performance.

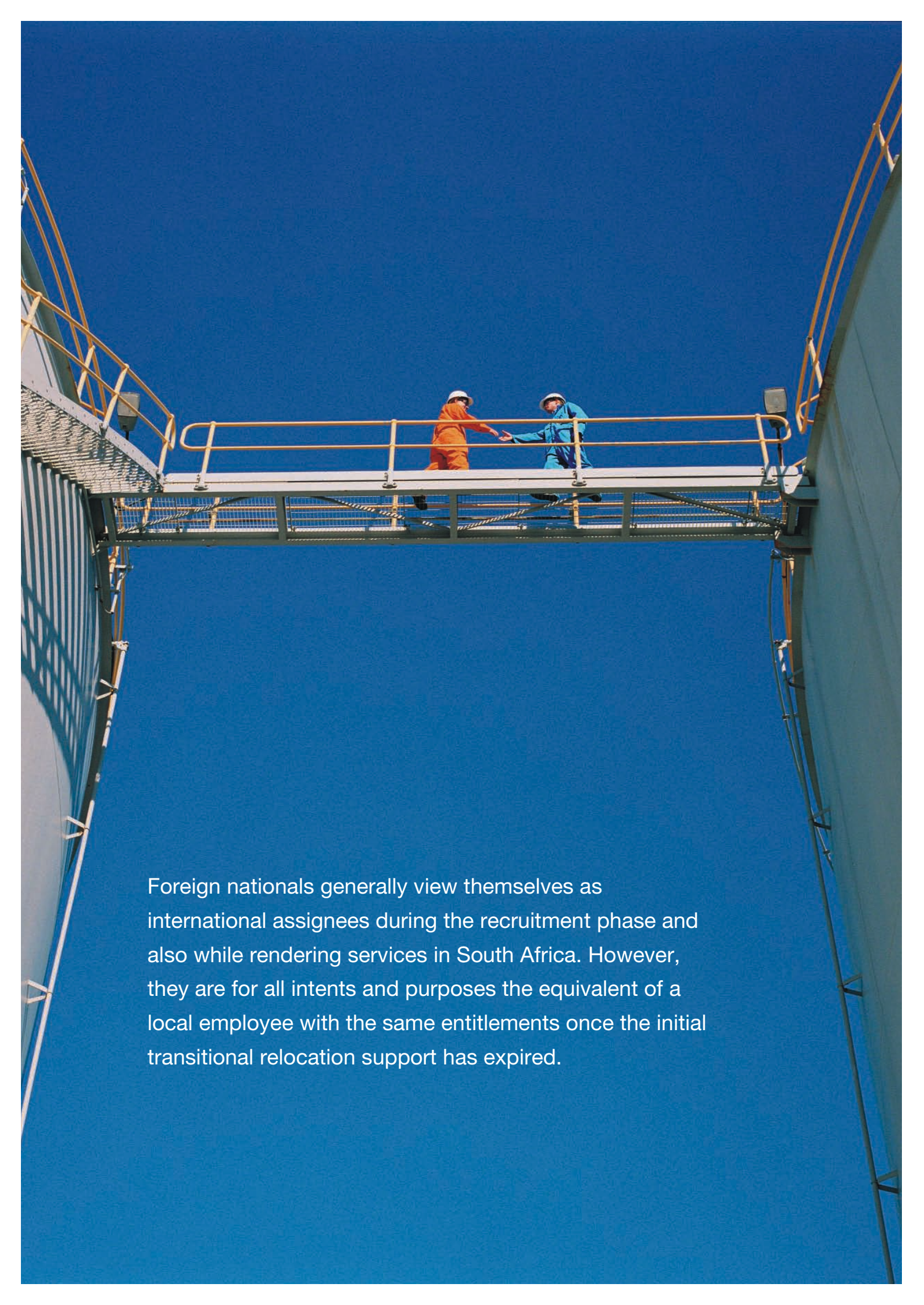
The current level of shareholder and public anger should not be underestimated.

Arguments about retention should be considered, but with scepticism.

Adjustments should be made on the basis of demonstrable strong performance across a range of areas, not as a reward for effort.

The chairman of the Remuneration Committee will have to look in the mirror and say "I did the right thing". The concern this year, is that doing the right thing is going to be tougher than ever before.

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A low-angle photograph of two workers on a metal walkway. One worker is wearing an orange jumpsuit and a white hard hat, while the other is wearing a blue jumpsuit and a white hard hat. They are shaking hands. The walkway has yellow railings and is set against a clear blue sky. The structure appears to be part of an industrial facility, possibly a water treatment plant, with large cylindrical tanks visible on the sides.

Foreign nationals generally view themselves as international assignees during the recruitment phase and also while rendering services in South Africa. However, they are for all intents and purposes the equivalent of a local employee with the same entitlements once the initial transitional relocation support has expired.

International assignees vs foreign national local hires

The difference between international assignees and foreign national local hires may be evident to the employer but this distinction is often blurred by the foreign national employees.

International assignees

International assignees are traditionally viewed as employees sent to render services in a host country on behalf of their home country employer for a defined period of time. International assignees remain on the headcount and payroll of their home country employer and receive assignment allowances/benefits during the defined assignment period in terms of the relevant organisation's international assignment allowances policy.

International assignees are usually provided with additional administrative assistance through the respective mobility department or third party provider with respect to immigration and individual taxation compliance in the respective jurisdictions. They are subject to either tax equalisation or tax protection to ensure that they suffer no adverse tax consequences as a result of the international assignment.

Foreign national local hires

Foreign national local hires, in a South African context, refer to foreign nationals recruited internationally who relocate to South Africa to render services under a local contract of employment. The foreign nationals

are remunerated through a local payroll and treated as a normal employee subject to being provided with relocation benefits/allowances for a defined period of time to assist with transitional expenses associated with the relocation to South Africa.

Foreign nationals only receive relocation allowances for a defined period of time, remain responsible for all individual tax obligations and resultant liabilities in South Africa and internationally and do not receive compensation for any additional tax differentials or double taxation that may arise in the respective jurisdictions.

The difference between international assignees and foreign national local hires may be evident to the employer but this distinction is often blurred by the foreign national employees. South African companies are increasingly encountering difficulties with foreign national local hires comparing the remuneration, benefits and administrative support provided to them against those enjoyed by international assignees.

Discrepancies

There are large discrepancies in terms of continuing allowances and benefits, which have resulted in certain foreign nationals demanding

either equitable treatment or additional support with respect to their relocation benefits.

Foreign nationals generally view themselves as international assignees during the recruitment phase and also while rendering services in South Africa. However, they are for all intents and purposes the equivalent of a local employee with the same entitlements once the initial transitional relocation support has expired.

Foreign nationals are encountering difficulties in South Africa with affordability of housing and cars, cost of living differentials, tax issues and general logistical support to deal with local bureaucracy. Foreign exchange fluctuations coupled with the ongoing need to finance home country obligations, while remaining responsible for South African expenses (double housing costs etc), further decrease net spending power.

The key theme from foreign nationals is the discrepancy between pre-employment expectations and actual circumstances in South Africa. The recruitment phase is often perfunctory with limited information about job roles and local living conditions being imparted to the prospective foreign national recruit.

Foreign nationals should ensure that they conduct independent investigations into the cost of living and day-to-day conditions in a prospective host country prior to offer acceptance.

Foreign nationals, in many instances, accept gross Rand based remuneration packages without seeking confirmation from the prospective employer on the applicable South African/international taxes and statutory deductions, exchange rate implications and resultant net take home pay.

Foreign nationals experience a perceived lack of response to issues raised upon arrival in South Africa when the reality of the situation hits home. Local Human Resource departments' inability to respond to these issues is understandable, as they are outside the scope of normal employees.

Foreign nationals need to accept a large degree of accountability for the difficulties encountered. They should ensure that they conduct independent investigations into the cost of living and day-to-day conditions in a prospective host country prior to offer acceptance.

A crucial determinant is the net take-home pay based on the gross remuneration offered. Foreign

nationals must clarify applicable tax and statutory deductions in South Africa and internationally and weigh up the net remuneration against anticipated expenditure, in South Africa and home country liabilities, to reach an informed decision prior to offer acceptance.

Employers need to ensure that a defined relocation policy and procedure manual is in place for foreign national local hires. The employment contract must support the employer requirements and clearly outline employer and employee responsibilities and entitlements.

Effective corporate governance

Immigration and individual tax management are crucial for effective corporate governance and defined policies need to be in place outlining the responsibility and processes to be followed to ensure compliance.

Each affected employer has to weigh up the value contributed by foreign nationals against the additional cost of rectifying existing grievances

and/or remuneration discrepancies when addressing concerns.

Employers are entitled to expect foreign nationals to investigate the implications of the remuneration package and relocation benefits provided and make an informed choice about whether to accept the offer of employment or not. However, the employer needs to ensure that all policies and supporting documentation are in place to provide transparency, maintain compliance and ensure equity amongst foreign national recruits.

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Employer sales of low cost residential units

Where an employer provides residential units in respect of a housing project, consisting of at least five residential units to be occupied by or let to employees, the employer is, as a general rule, entitled to an initial allowance of 10% and an annual allowance of 2% of the cost as a tax deduction.

Where the employer sells such unit to an employee, the employer currently enjoys no favourable tax treatment. The Revenue Laws Amendment Act (the "Act") proposes to give employers tax relief in respect of the transfer of ownership of qualifying units to employees on loan account. The Act entails that the amount of the loan provided by the employer will be deductible at a rate of 10% of the balance of the loan amount at the end of each year over a 10-year period. There will be a recoupment of the deduction as and when the employee repays the loan capital.

According to the Explanatory Memorandum to the Revenue Laws Amendment Bill (the Bill), the proposal has its roots in Government's initiatives to provide an environment conducive to home ownership.

Requirements

In order for the incentive to apply, the following requirements must, *inter alia* be met:

The unit must be a low cost residential unit, in other words, a



unit whose cost does not exceed R200,000 inclusive of land but not bulk infrastructure, or an apartment, the cost of which does not exceed R250,000.

The employer must sell the units to its employees or employees in the same group of companies.

The employer must be the sole financier and the loan must not be secured or guaranteed by any third party.

The agreement may further not be subject to any condition that entitles the employer to re-acquire the unit at any price that is less than the market value of the unit, unless the employee's employment is terminated or if the employee defaults on the loan repayment.

The disposal must not exceed the actual cost of the unit and the land

(excluding borrowing and finance costs).

The employee must not be required to pay any interest on the loan.

The incentive would appear to be welcomed, especially in light of the interest shown by certain employers to sell residential units by reason of property ownership being a deviation from their core business activities.

Teething problems

It is almost certain that the application of the incentive may have initial teething problems, in particular as -

the Seventh Schedule has not been amended to exclude the interest-free portion of the loan from being a fringe benefit in the hands of the employee;

the employer would be entitled to repurchase the unit at cost as

opposed to market value upon termination of employment. It is arguable that such termination may or may not include retrenchments, or even death or disability of the employee. Although the events above in one way or the other constitute the termination of employment, it would appear to be inequitable that an employee who has retired, died or who has been retrenched, should be treated in the same manner as an employee who voluntarily chose to leave the employer's employ or an employee who is dismissed for bad conduct or poor performance;

the employer would be entitled to repurchase the unit at cost as opposed to market value upon "consistent failure to repay the loan for a period of three months". It is not clear how this phrase could be interpreted, in particular whether the once-off failure for a period of three months would suffice, or if an employee should consistently fail to make payment for periods of three months and then, how many times would there have to be a failure for a period of three months so as to be viewed as consistent;

from a VAT perspective the employer would originally have incurred expenditure in relation to the housing project for the purpose of supplying the employer-owned accommodation to employees, which supply would not have been subject to VAT. Where the employer changes its intention so that it will sell the units to employees, it may be argued that the subsequent supply of the units would be subject to VAT and, conversely the employer

would have to make an input tax adjustment, where applicable, in respect of expenditure previously incurred. Where this is the case, the selling price would probably have to be adjusted to make provision for the VAT charge. One should also bear in mind that where the sale does not constitute a supply for VAT purposes, the transaction may or may not be subject to transfer duty. As a general rule, transfer duty would only be levied where the value of the property acquired by an individual exceeds R500,000. As the incentive would only apply to the sale of property not exceeding R500,000 it appears at first glance, that no transfer duty would be payable. However, transfer duty is levied on amongst others, the higher of the consideration or the fair market value. Where the fair value of the property is greater than R500,000 transfer duty may nevertheless be levied on the transaction;

if the employer has enjoyed a deduction in respect of the cost of the unit in the past, the allowances previously granted must be included in income in the year the unit is sold to the employee;

many of these units might have been erected a long time ago and it could be that the current market value of such unit would not warrant the sale thereof at the cost price to the employee.

It follows that the incentive offers a carrot to employers to dispose of low-cost employee housing units.

Examples

The practical application of the incentive could be illustrated by the following two examples:

On 1 January 2009 Employer Y (who has a 31 December year end) transfers a qualifying house with a cost to Y of R200,000 to employee X on a non-interest bearing loan account. The loan is repayable in equal instalments over a 20-year period. The effect is that Y gets a R19,000 deduction in year 1. In year 2 there is a deduction of R18 000 and a corresponding recoupment of R10,000 of the Year 1 allowance (being the loan repayment in year 2 by X). After 10 years Y would have obtained a net deduction of R55 000. Only in year 16 will the aggregate recoupment equal the aggregate deduction.

The facts are the same as above, with Y selling the house to X on the condition that if X or his working unit does not adhere to specified performance targets, Y would be entitled to repurchase the property at cost. The effect of the agreement is that the Y would not be entitled to the incentive as Y may not impose a condition to repurchase the property at cost other than when X's employment is terminated or where X defaults on his loan payment.

Please feel free to discuss the impact and requirements of this incentive in further detail with us.

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Managing tomorrow's people – global survey¹ reveals what the millennial² generation want from work

Training and development is the benefit the millennials value most highly - particularly coaching and mentoring

Millennials do not expect to reject traditional working practices

Robust corporate responsibility is critical to attracting and keeping the new generation of workers

61% of CEOs say they have difficulty attracting and integrating younger workers

The perception that the new generation of workers, the 'millennials', are disloyal and will reject traditional work practices is a myth, according to a new global report published by PricewaterhouseCoopers in December 2008.

The 'Millennials at work' research is part of PwC's ongoing 'Managing tomorrow's people' series and is based on survey responses from over 4,200 graduates. Individuals in 44 countries were asked to respond anonymously about their expectations of work and careers.

The findings show that - while global opportunities and robust corporate responsibility are critical to the millennials - they expect to be predominantly office-based, work regular office hours and have a small number of future employers. The research therefore suggests that some companies should



re-assess their efforts to attract and retain younger workers to ensure they are channelling their investment effectively, particularly in light of current cost pressures.

The importance of this is reinforced by findings from the 12th annual PwC CEO Survey, to be published at the end of January this year, which show 61% of CEOs say they have challenges recruiting and integrating younger employees.

With the global economic downturn presenting organisations with serious immediate challenges, businesses need to work even harder to balance short-term pressures with long-term objectives. This means acting now to manage the demographic changes that will impact their ability to compete effectively.

Eventually, in many parts of the world, fewer younger people will

¹ 'Millennials at work – perspectives of a new generation' is based on 4,271 survey respondents in 44 countries. The research was conducted in September 2008. The majority of respondents were new graduates who were due to start work for PwC.

² Millennials refer to individuals who entered the workforce after 1 July 2000.



be working to support a significantly larger older population, making people supply a critical factor for business success and potentially changing the power dynamic between employer and employees.

Global mobility and working practices

Respondents were very open to overseas assignments, with Indian graduates showing the greatest appetite for working overseas (93%) compared with 62% of those from the Netherlands. 80% of all respondents want to work internationally.

In South Africa, 93% of the respondents believed they would work across geographic borders with Western Europe and the USA being the preferred destinations.

Seventy percent of respondents expect to use another language at work. While only 38% cited English as their first language, 83% expect to use English at work.

Globalisation and opportunities in emerging markets mean mobile workers are an increasingly valuable asset to organisations. The millennials' desire to work overseas and use other languages could mean greater movement between countries at more junior employee levels, which would decrease some of the cost burden associated with incentivising senior executives to work abroad.

Interestingly, while international travel is high on the agenda, home working and flexible hours are not. Just 3% of the SA respondents expect to work mainly at home and only 15% expect to work mainly outside regular office hours with 64% of them expecting to work regular office hours with flexible working hours. Three-quarters of all respondents (SA 73%) believe they will have between two and five employers in their lifetime. These findings appear to debunk the image of the millennial characterised by lack of loyalty and avoidance of traditional working practices.

Technology and information sharing

The research confirmed that millennials view technology as key to socialising and networking, with 85% as members of a social networking site such as Facebook (SA only 61%).

Of the SA respondents, 100% have a mobile phone, 52% have an iPod/MP3 player, with only 12% having a handheld computer (e.g. blackberry).

The millennials' adeptness with technology brings benefits in terms of knowledge sharing, and savvy companies are already taking advantage of this by replicating Facebook-style sites in-house. But companies need to manage the reputational risks associated with this open and instant style of communication.

40% of respondents are comfortable about giving employers greater access to their personal information in the interests of personal and business security. Additionally, two-thirds of millennials would embrace the provision of personal services - such as housing, food and regular health appointments - by their employer. This raises interesting questions about whether the lines between work and home will blur in future.

What is new is younger people's ability to mobilise into another job if their expectations and ideals are not met.

CSR expectations

Tomorrow's workers expect their employers to behave responsibly, with 88% stating they will seek employers with corporate social responsibility (CSR) values that reflect their own.

Additionally, 86% would consider leaving an employer who's CSR values no longer reflected theirs – Argentina (94%), the US and Brazil (both 92%) are home to the most idealistic graduates in that respect (SA 86%). Indian respondents were least likely to leave (66%). An employer's policy on climate change is seen as important or very important by the majority of graduates globally (58%) with only 46% of the SA respondents believing this to be important.

Reward and personal development

Training and development is the most highly valued benefit for millennials in the first five years of their career – with one third of respondents electing this as their first choice benefit (aside from salary). This is three times higher than the proportion that chose cash bonuses. In South Africa, the respondents' first choice was flexible working hours with training and development as their second choice and financial assistance with housing as their third choice. Almost all

respondents (98%) stated that working with strong coaches and mentors is important to personal development.

Most businesses only provide coaches and mentors to senior employees, but providing this kind of one-to-one development to new graduates could help ease the sometimes bumpy transition from university to the workplace, while breeding goodwill and engagement at a relatively low cost. Instead of reacting to cost pressures by cutting training budgets, organisations should ask if they are spending where it will be most appreciated and bring the greatest benefit to long-term business health.

Despite their CSR expectations, only 7% cited time off for charity or community work as a top three benefit. Over half of the sample (57% - in SA this is much higher at 78%, emphasising the need for proper and informed personal wealth planning) believes they would personally fund their retirement, with only 5% stating the Government/ state would fulfil this role and 17% nominating their employer.

Many similarities

In conclusion, millennials want many of the same things from work as the generations before them so

companies do not need to tear up their people strategies to manage the new generation of workers. What is new is younger people's ability to mobilise into another job if their expectations and ideals are not met. To manage this difference, companies need to think creatively about reward strategies, using metrics and benchmarking to segment their workforce in a similar way to how many companies segment their customer base.

We think CEOs are struggling with millennials because they need more information about what drives them, and because they need to adapt their traditional approaches to attracting and integrating employees. This means focusing on the things that millennials really want, such as training and development. Articulating employer brand and clearly stating corporate responsibility values will also be critical.

The millennials' expectations bring opportunities as well as challenges - those organisations that adapt fastest will be best placed to succeed in good times and bad.

For further information, materials or to download the full 'Millennials at work – perspectives of a new generation' report, please visit www.pwc.com/managingpeople2020.

About PricewaterhouseCoopers

PricewaterhouseCoopers provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 146,000 people in 150 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

PricewaterhouseCoopers Human Resource Services

PricewaterhouseCoopers' Human Resource Services practice works with clients who strive to make their people a sustainable source of competitive advantage. Our strategy is built on our own belief in developing our people to be creative and effective team players committed to outstanding client service.

We bring the ability to take fresh perspectives, to think differently, and to develop and implement new and value-adding solutions. We work in close relationships with clients to offer practical, multi-disciplined approaches to the increasingly complex challenges facing businesses. One of the main challenges is to create environments in which their people can work most effectively. Our Human Resource Services practice brings together all of the professionals working in the human resource service arena – tax, benefits, retirement, communications, financial planning, international assignment, equity, culture and change, compensation, strategy, regulatory, legal, and process management – affording our clients an unmatched breadth and depth of expertise, both locally and globally.