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The Hon Wayne Swan MP
Treasurer
PO Box 6022
Parliament House
Canberra ACT 2600

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Dear Treasurer

Limiting the income tax exemption for Australians working overseas

The Taxation Institute of Australia (**Taxation Institute**) has concerns regarding the proposal to limit the scope of s 23AG of the *Income Tax Assessment Act 1936* (**ITAA 1936**) (i.e. the income tax exemption for Australians working overseas) solely to aid, charitable and certain government workers. Our concerns include the following:

- it will add complexity to tax law and administration which will impact unfairly on ordinary Australians working overseas and Australian businesses;
- it will impose additional costs on Australian companies employing Australian residents overseas and therefore reduces their competitiveness; and
- the proposals have been introduced without sufficient opportunity for consultation on the impact of the changes for ordinary Australians and Australian businesses competing internationally.

Background

Generally, the taxing right in respect of salary income is allocated to the country of source under Australia's double taxation agreements (**DTAs**). Section 23AG of ITAA 1936 was introduced as part of the foreign tax credit system for the purpose of ensuring the administrative integrity of the then foreign tax credit system by removing many small taxpayers from its operation (see *Explanatory Memorandum, Taxation Laws Amendment (Foreign Tax Credits) Bill 1986 (Cth)*, 22). Therefore, s 23AG effectively only applied to exempt foreign source personal service income in circumstances where the posting was to a non-DTA country for a period of 91 days or more or to a DTA country for a period exceeding 91 days, but not greater than 183 days.

Thus, both the original foreign tax credit rules in the ITAA1936 and the revised the foreign tax offset (**FTO**) rules in Division 770 of the of the *Income Tax Assessment Act 1997* (**ITAA 1997**) were designed only to deal with foreign tax offsets of sophisticated taxpayers and on the rare occasions with the small amounts of foreign income not excluded by s 23AG (as illustrated by the $1,000 limit under s 770-75(2) of the ITAA 1997).

The pay-as-you-go (**PAYG**) withholding rules do not apply in relation to income which is exempt under s 23AG. However, as a result of the proposed changes to limit the scope of s 23AG, many employees who were previously exempt from the PAYG withholding provisions will now be subject to those provisions. A corresponding number of employers will have Australian PAYG withholding

obligations based on the gross foreign salary of the employee. Double PAYG withholding could arise, for example, where an individual taxpayer is working in a non-DTA country (eg Greece) and being paid by a non-resident employer. Assuming that the relevant non-DTA country imposes PAYG withholding on the individual, the individual could be subject to double PAYG withholding (i.e. PAYG withholding overseas and PAYG in Australia). This will depend on the timing, availability and quantum of FTOs in respect of any foreign tax "paid" by the individual as the relevant individual's PAYG instalments should be determined taking into account any FTOs which are available.

Employers are exempt from fringe benefits tax (**FBT**) in relation to fringe benefits provided to Australian resident employees working overseas if the income paid to the employees is exempt under s 23AG. However, as a result of the proposed changes to limit the scope of s 23AG, some employers who were previously exempt from the FBT provisions in respect of fringe benefits provided to employees working overseas will now be subject to those provisions. Double FBT liabilities could arise, for example, where fringe benefits are provided to an individual taxpayer working overseas who is personally subject to FBT in the overseas jurisdiction and whose Australian employer is also subject to FBT under Australian tax law.

Issues with complexity in detail

With over one million Australians working overseas the compliance cost impact of the measure is immense as every tax agent in Australia is likely to have at least one client who has worked overseas during the year. Given this multi million dollar compliance cost imposition the Taxation Institute is concerned that there has been no attempt by the Government to ameliorate the impact of these compliance obligations nor deal with the harsh financial imposts arising from the interaction between s 23AG, the FTO, PAYG, FBT provisions and Australia's tax treaties. The compliance cost concerns arise primarily from the fact that the FTO rules in Division 770 of the ITAA 1997 are ill equipped to deal equitably with the large number of affected ordinary working Australians as it was designed within the policy setting of only a small number of individual taxpayers being within its scope (via s 23AG of the ITAA 1936).

There are also compliance costs associated with employers determining whether each employee in a foreign job is in fact a resident of Australia before seeking to make PAYG withholding in respect of the gross foreign sourced salary of that employee. It is likely this will result in a structural change to the manner in which foreign postings are arranged in the future, with a shift in the identity of the employer to a foreign entity. It will also favour foreign multi-nationals as against Australian employers.

Given the lack of consequential amendments in the exposure draft of the proposed amendment to s 23AG, released on 12 May 2009, it appears that no consideration has been given to modifying the FTO rules to reduce the large compliance burden imposed by the proposed change on unsophisticated taxpayers. In particular, how the "tax paid" requirement will affect the cash flows of these salaried taxpayers has not been considered.

Given that the ATO has accepted that fringe benefits provided to an employee who is within the present s 23AG are not caught by the FBT legislation and do not give rise to an FBT liability, there will also be a significant change in the complexity of reporting and paying tax in respect of those fringe benefits plus the actual compliance costs. The effect of this is also going to make Australian companies seeking to use Australian employees in their foreign activities less competitive

Consultation

The 18 May 2009 closing date for comments on the exposure draft reflects the lack of thought to the complexity and associated issues of fairness and equity and international competitiveness noted above and is disappointing given your Government's commitment to the fundamental principle of consultation. The Taxation Institute is concerned that the issues we have identified with the proposed change have not been addressed.

Recommendation

Given the high compliance burden imposed by this decision, the Taxation Institute urges the Government to reopen consultation and authorise the Treasury to consult on possible consequential amendments that would reduce these compliance burdens and remove adverse interactions.

If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

Joan Roberts
President