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Review Of Business Taxation - Taxation of Inbound Expatriates

Dear Dr Preston

This is a submission to the Review of Business Taxation in response to the discussion paper *A Strong Foundation*, released in November 1998. We acknowledge your objectives as set out on Page 62 of the paper.

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Executive Summary

- The current taxation in Australia of inbound expatriates imposes an impediment to economic growth;
- this impediment takes the form of a high taxation cost burden of employing inbound expatriates;
- the way expatriates are taxed in Australia should be revised by:
 - providing tax non-resident status for short to medium term inbound expatriates;
 - exempting from fringe benefits tax, tax payments made under tax equalisation arrangements; and
 - exempting expatriates from the superannuation guarantee scheme whilst they are here on temporary visas.



1. An Impediment to Economic Growth

1.1 Depleted Skills Base

Due to the rapid pace of change in technology, Australians do not always possess all the necessary knowledge and skills needed to sustain an internationally competitive organisation. Foreign nationals expatriated to Australia are able to supplement the skills of the Australian work force. Not only do these expatriates utilise their special skills for the benefit of the local organisation, they are able to pass those skills onto Australian workers, thus building the skill base of Australian organisations.

It is well accepted that it costs an employer two to three times as much to employ an expatriate compared with a local employee. In Australia, a heavy cost burden is imposed on employers of expatriates, which discourages companies from sending expatriate employees with these necessary skills to this country. As a result of this, Australian organisations are either not expanding their skills base, or are incurring additional costs in sending employees overseas to learn new skills.

1.2 Discouragement for Australian Operations

Most foreign nationals expatriated to Australia are tax equalised, meaning the expatriate bears only the taxation cost that would have applied in their home country, and the employer bears the additional Australian taxation cost. It is not only the additional income tax cost that expatriate employers must bear. They must also pay substantial on-costs such as Pay-roll Tax, Worker's Compensation premiums and Superannuation Guarantee contributions together with Fringe Benefits Tax (FBT) on many of the benefits provided to the employees. (It is acknowledged there are some existing FBT concessions for expatriates).

The additional tax costs borne by the expatriate employer act as a disincentive for companies considering setting up operations in Australia. Companies may choose to set up regional headquarters or other operations elsewhere than Australia in order to take advantage of more competitive tax regimes.

Although surveys indicate tax is not a primary consideration when multinationals decide where to locate regional headquarters, Australia must compete with other countries in the region, many of which have our advantages of political stability, an educated work force, good infrastructure, etc. In these cases, tax **does** become a significant factor which increases the cost of doing business in Australia.

Many countries provide incentives for companies to establish operations in that country. This is done through offering lower tax rates and tax concessions. It can be argued that through its taxation of expatriates, Australia actually provides disincentives and operational barriers to companies establishing operations in Australia.



2. An Inequitable Taxation System

2.1 Residency

The amount of taxation an expatriate employee must pay depends upon whether the expatriate is a resident or non-resident of Australia for taxation purposes. In this regard many expatriates have created and retained substantial private wealth prior to coming to Australia. The income from these home country investments, which is already being taxed in the home country, becomes taxable also in Australia if they are treated as residents.

The question of residency is addressed in several public tax rulings issued by the Australian Taxation Office (ATO). Those rulings have made it clear that the facts of each case must be considered before a decision as to the residential status of an expatriate can be made.

In a recently issued controversial public tax ruling (TR98/17) the ATO has espoused a “six month rule”, which if followed, would result in virtually every inbound expatriate being taxed as a resident. Despite the denials of the ATO, expatriate tax practitioners are unanimous that this ruling **does** represent a change from the long accepted practice of applying a “two year rule” on residency.

Treating inbound expatriates as tax residents will require them to submit their worldwide income to Australian tax. When overlaid with our draconian FIF and CFC rules, this can create an intolerable burden for expatriates and their employers.

2.2 Expatriation Costs

Employers face large taxation costs with regard to expatriate employees. Many payments made in respect of expatriate employees, such as the payment of Australian income tax under tax equalisation amounts, are subject to FBT. The FBT payable on tax equalisation payments is effectively a tax payable upon an already imposed tax, namely the income tax.

This is an unfair and inequitable imposition upon expatriate employers which discourages organisations from establishing operations in Australia. **The reality is the expatriate receives no benefit from the payment of his/her Australian tax by his employer; it is simply part of the contractual arrangements made for the assignment.**

In most cases employees expatriating to Australia must participate in the Superannuation Guarantee Scheme, meaning their employers must make contributions on their behalf into complying Australian superannuation funds. This is not only an unnecessary cost for employers, but it also impacts unfairly on the expatriate themselves. Once the period of expatriation has terminated, the expatriate is unable to access the superannuation contributions if less than 55 years of age, not even to transfer them to a similar fund in their home country.



This is an inequitable imposition upon expatriate employees and imposes onerous administrative requirements on fund managers to maintain accounts for long departed expatriates. In most cases, the amount of money held in the superannuation fund on behalf of each individual expatriate, would be modest.

The intention of the preservation rules is to ensure people living in Australia save for their retirement. In the case of expatriates here on temporary visas, they have no plans to retire in our country. Should an expatriate wish to return or remain here on a permanent basis, it is open to the Australian Government to insist they have adequate means of support before granting permanent residency status. This is commonplace in other countries.

Other taxes such as the Medicare Levy affect the expatriate employee directly if they are taxed as residents. Expatriates subject to the Medicare Levy, which is 1.5% of their taxable income, are often unable to gain full access to the health benefits the Levy was originally designed to fund.

3. Complexity of the Taxation System

Current methods of determining the residency status of an expatriate involve detailed analysis due to the need to consider the circumstances of each individual expatriate. This need to analyse each case creates complexity, uncertainty and decreases voluntary compliance, as it is uncertain where compliance should occur.

4. Solutions

In order to overcome the economic growth impediments, the complexity of the taxation system and the inequitable taxation of expatriates, a number of measures need to be implemented. These include the introduction of a statutory rule on residency, an FBT exemption and exemption from the Superannuation Guarantee Scheme for expatriate employees. Our recommendations follow:

4.1 Residency

A statutory rule on residency would reduce compliance costs, not only for expatriate employers but also for the ATO. This is due to the fact that the need to consider each individual expatriate case would be replaced by a standard rule which could be uniformly applied. Not only would this rule enhance the simplicity, certainty and stability of the taxation of expatriates, but it would be a much more equitable method to determine residential status. Foreign nationals visiting Australia in similar circumstances would be taxed in the same manner.

Our recommendation is that all inbound expatriates entering Australia under Class 457 Visas be treated as non-residents of Australia for the initial term of their visa, to a maximum of 4 years.'

We note the tax legislation (section 23(c)(vi) and (vii) of the ITAA 1936) provided for many years up to 1973, complete exemption from Australian tax for the income of so-called "visiting industrial experts".



4.2 Fringe Benefits Tax

The exemption from FBT of payments of Australian income tax for expatriate employees would eliminate the single most costly item from the FBT net, and also eliminate the double taxation of benefits provided to expatriate employees. This exemption would therefore reduce the costs to an employer of hiring an expatriate.

Our recommendation is for Australian tax payments for expatriates who are non-residents of Australia (as per 4.1 above) to be made exempt from FBT.

4.3 Superannuation Guarantee Charge

The cost to employers of providing superannuation support is another unnecessary imposition upon expatriate employers. This is also an unfair imposition upon employees due to their inability to repatriate the superannuation benefits back to their home country prior to reaching retirement age.

Our recommendation is for employers to be exempted from the Superannuation Guarantee Charge provisions in respect of expatriates who are non-residents of Australia (as per 4.1 above).

5. Conclusion

We submit these recommendations for your consideration. We believe they will simplify the taxation of inbound expatriates and, more importantly, will provide a positive impetus to the transfer of knowledge and skills to Australia

We would be pleased to elaborate on any of the comments made in this submission.

Yours sincerely,



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