

Expatriate Tax Update

In the Federal Budget handed down on 12 May 2009, it was announced that a major change will be implemented to the Australian tax treatment of employment income earned overseas by an Australian tax resident.

Changes to the exemption for foreign employment income

Current system

Currently foreign employment income that is earned overseas (section 23 AG ITAA 1936) by an Australian tax resident is exempt from Australian tax provided:

- The employment period overseas is for a continuous period of least 91 days; and
- The salary and other employment income is subject to tax in the foreign jurisdiction (with some limited exceptions).

If the exemption applies, then the foreign income is included in the individual's Australian tax return as "exempt foreign earnings", and is taken into account in calculating the tax rate on their taxable income. No Australian tax is paid on the "exempt foreign earnings."

New measures

Under the proposed measures, employees who remain tax residents of Australia and work in a foreign country will be required to report their foreign employment income in Australia as assessable income, and Australian tax will be imposed on this income at the individual's marginal rate, a credit would be allowed in their Australian returns for any tax paid in the foreign country on that income.

An exemption will still be available for income earned by:

- An aid or charitable worker employed by a recognised non government organisation; or
- A government aid worker; or
- A specified government employee (for example, defence and police force personnel deployed overseas). The current exemption for employees working on an overseas project approved by the Minister for Trade (section 23AF ITAA 1936) will remain.

The Treasurer indicated in a Budget press release that there will be industry consultation concerning the legislation and administration arrangements for the changes. No implementation date has been provided, but we might anticipate that the changes could take effect as early as 1 July 2009.

The new measures would generally apply to employees working overseas for periods of less than 2 years. The tax exposure to the individual may be significant depending on the host location where the employee is working and

the differential between the employee's host country tax rate and their Australian marginal tax rate.

For example if an employee was working in Hong Kong and the tax rate paid on the foreign income was at 15%, then in Australia the employee may be required to pay on this income at a rate of up to 45% (depending on their level of other income and foreign income).

Based on the current application, Medicare Levy (1.5%) and Medicare Levy Surcharge "MLS" (i.e. 1% of adjusted taxable income but subject to new rates from 2010) would still apply to the employee's taxable income. The requirement for an employee living outside Australia to hold Australian private health insurance seems ridiculous, however this may be necessary in order to avoid paying MLS.

Employers who provide an employee a guaranteed net salary while living in the host country will need to review the remuneration arrangements with the employee before the new measures are introduced.

Fringe benefits provided to employees working overseas are exempt from Australian FBT, where the foreign salary is exempt from Australian tax. With the removal of the foreign salary exemption, the employer would become liable to Australian FBT on fringe benefits provided. The host country may also tax those fringe benefits, so double taxation becomes a risk unless a double tax agreement provides an exemption. (Currently, very few Australia double tax agreements include an article covering fringe benefits). This issue may be addressed as part of the consultation process, for the new measures.

Action

Before the new measures are implemented employers:

- 1 need to review employment arrangements with their employee's working offshore,
- 2 to consider the employee's after tax position,
- 3 review the term of the appointment for non resident tax status,
- 4 consider the effect on any fringe benefits provided to the employee offshore,
- 5 check the employee's exposure to Australian MLS on the foreign employment income.

We will continue to monitor the position of the new measures through the consultation process and will keep you informed of any developments.

Your local RSM Bird Cameron accountant can be contacted as follows:

Australian Capital Territory

Canberra (02) 6247 5988

New South Wales

Sydney (02) 9233 8933

Albury (02) 6041 3700

Goulburn (02) 4821 1066

Wagga (02) 6921 9055

Victoria

Melbourne (03) 9286 1800

Ballarat (03) 5330 5800

South Australia

Adelaide (08) 8232 3000

Mt Gambier (08) 8724 8100

Port Lincoln (08) 8682 2077

Western Australia – Metropolitan

Perth (head office) (08) 9261 9100

Fremantle (08) 9336 1266

Mandurah (08) 9535 1744

Western Australia – Regional

Albany (08) 9841 2766

Bunbury (08) 9722 5600

Busseton (08) 9752 1406

Corrigin (08) 9063 2154

Esperance (08) 9071 1888

Geraldton (08) 9920 7400

Kalgoorlie (08) 9021 1499

Katanning (08) 9821 1277

Manjimup (08) 9771 1244

Merredin (08) 9041 1655

Moora (08) 9651 1606

Narrogin (08) 9881 1611

Northam (08) 9622 2822

Quairading (08) 9645 1166