

Tax Update - Expatriate Tax

Australian PAYG-W obligations extended to certain non-resident employers

Expatriate taxation is becoming significantly more complex since the changes to the Australian tax treatment of foreign employment income came into effect on 1 July 2009.

The critical question is - does the employee remain a resident of Australia for tax purposes? If so, employers whether Australian resident or non resident, need to ensure they understand their Australian employment tax obligations. This can have a material adverse effect on the actual tax cost of the foreign assignment!

Removal of the foreign employment income exemption

Just to recap, from 1 July 2009, if an employee remains a tax resident of Australia while they are on assignment working overseas, then their employment income earned overseas will be taxable in Australia and a credit is allowed for the taxes paid in the host location. This ensures that employees pay top up tax in Australia up to their marginal tax rate including Medicare Levy and Surcharge if applicable. The employment income earned overseas by a tax resident of Australia will only be treated as exempt income in Australia, in very limited circumstances. The exemption will still apply where an employee is engaged:

- As an employee of an aid or charitable organisation or other recognised non government organisation;
- As a government aid worker;

- As a person deployed outside Australia as a member of a disciplined force (eg. defence or police force personnel); and
- On an overseas project which is approved by the Minister for Trade (section 23AF ITAA 1936).

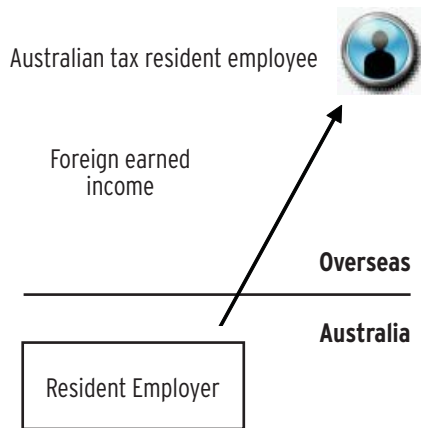
Employer PAYG-W obligations

Whether an employer will be obligated to withhold tax from salary payments (PAYG-W) made to an Australian tax resident employee, and the extent of those PAYG-W obligations, will depend upon:

- Whether the employer is a resident or a non-resident of Australia;
- If a non-resident, whether there is a 'sufficient connection' with Australia for PAYG-W; and
- Whether the employee is working in Australia or overseas.

The Australian Tax Office has recently issued a Tax Determination (TD2011/1) setting out where a foreign entity may be:

- obligated to withhold tax under PAYG-W; and therefore
- be subject to FBT obligations



Foreign employment income subject to Australian PAYG-W, but only if the employee remains a tax resident of Australia.

Resident Australian employer

An Australian resident employer (payer) is already obligated to withhold tax under PAYG-W in respect of salary payments made to an Australian resident employee. Where that employee is working outside Australia, the employer's PAYG-W obligation is limited to the shortfall between the tax rate in the host country and the employee's marginal tax rate in Australia. In addition, Australian FBT is payable by the employer on any benefits provided.

Non resident employer

The ATO view is that where a non resident entity pays an Australian resident for work performed overseas, the non resident entity will be obligated to comply with Australia's PAYG-W provisions, but only if it has a 'physical business presence' in Australia.

The ATO expands on the concept of physical business presence in Australia in the Determination to include where the non resident entity carries on an enterprise or

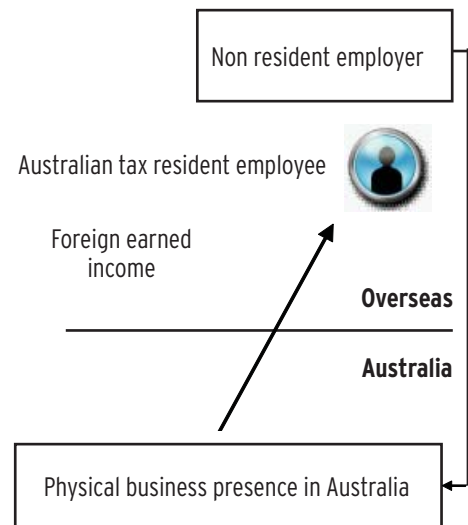
income producing activities in Australia, and has a physical presence in Australia. This may include having an office, business operations, trading presence or having employees in Australia.

If a related company or parent company is located in Australia this will not in itself create a physical business presence for the foreign entity.

It gets messy when trying to determine which entity should have the Australian tax obligations; the company which pays the employee, or the company which employs the employee. The ATO has expressed the view the obligation rests with the payer of the salary for the employee.

But even if a non-resident employer has no physical presence in Australia (and so no PAYG-W obligation for payments made to Australian tax resident employees working overseas) the assignment costs will still skyrocket! This is because the employee will be taxed on the value of all benefits received. FBT will not apply, so there will be no exemptions or

concessions, with the employee taxed at marginal rates on the value of the benefits received. Stand by for the employee to demand a hefty pay increase!



Foreign employment income subject to PAYG-W but only if the non-resident employer has a 'physical business presence' in Australia. There is no PAYG-W obligations if the non-resident employer has no Australian presence.





Law to be reformed?

The Assistant Treasurer announced in a press release on 18 November 2010 that the Government has asked Treasury to develop a discussion paper to resolve the anomaly of the tax treatment of non cash benefits that has resulted from the change in the tax treatment of foreign employment income for tax residents.

At the date of this update (late March 2011), Treasury has not issued the discussion paper, nor opened a consultation phase.

Conclusion

Employers engaging Australian's on foreign assignment must be aware of the additional complexities following the 2009 change in law, with the possibility of substantial increases in assignment costs.

Management of the assignment costs and complexities will be assisted where the employee qualifies as an Australian non-resident.

Where the employee remains an Australian tax resident, payments should be made via

an Australian resident employer, or via the Australian physical presence of a non-resident employer.

Employers now need to know an employee's personal tax position in order to correctly determine its own PAYG-W and FBT obligations.

Taken together, the system is heavily loaded against Australians working offshore - this can be seen as one way to ensure there is not a skill shortage in Australia!

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