

Tax treatment and work rights of non-residents

- 5.1 Tax treatment of non-residents was raised by the ANAO in relation to shortcomings in coverage of withholding arrangements, the need for streamlined TFN registration for new arrivals and as an explanation for excess and inactive TFNs. These issues are addressed in detail in Chapters 7, 4 and 2 respectively.
- 5.2 During the course of the Committee's inquiry, the issue of tax treatment of non-residents has been highlighted as a much broader problem. In particular, the use of TFNs in a work context has been shown to be an area of particular concern.

Tax treatment of non-residents

- 5.3 The ATO advises taxpayers that:

The tax rates that apply to your taxable income depend on whether or not you are an Australian resident. A higher rate of tax is applied to a non-resident's taxable income and they are not entitled to a tax-free threshold.¹

- 5.4 The Australian system applies differential treatment to non-residents for tax purposes in terms of a range of concessions and penalties that apply in different circumstances. For example, for the financial year 1998-99 a non-resident for tax purposes would have paid a greater rate of tax on income up \$20,700, resulting in up to \$2,943 extra tax². However, non-residents for tax purposes are eligible to pay a flat rate of tax on investment of

1 Exhibit 8. Australian Taxation Office. 1999. *Tax Pack 99*. Canberra, Australian Taxation Office, p.8.

2 Exhibit 8, *Tax Pack 99*, p.114.

10 per cent, which in some cases may result in a lower tax obligation than if this interest were treated as income as in the case of residents.

5.5 This variation in tax treatment means that it can be beneficial for non-residents to misrepresent their taxation status in order to lower their taxes.

5.6 This situation is further complicated due to the fact that:

The standards the ATO uses to determine your residency status are not the same as those used by the Department of Immigration and Multicultural Affairs.³

5.7 In particular, there is no close correlation between visas types granted and tax treatment, nor is there any correlation between visa type issued and the need for an individual to obtain a TFN.

5.8 The Committee received three submissions from ATO officers⁴, and all three submissions raised the issue of non-residents as a concern with the current tax system.

5.9 Ms Mackenzie raised the issue of the fraudulent use and sale of TFNs issued to non-residents and the need to refine 'the method of issuing TFN's to immigrants and persons working temporarily in Australia'⁵ including through improving PoI processes.

5.10 Mr Deane noted 'the simplicity of changing residency status under 'self-assessment''⁶, the resulting ability of non-residents to avoid tax and the difficulties this caused for ATO counter staff.

5.11 In his submission to the Committee⁷, Mr Johnston, an ATO officer, provided detailed information on the ways in which non-residents can currently avoid tax. For example:

- *self assessment* – self assessment means that non-residents can tick the residency box on their tax assessment form and pay tax at resident rates⁸;
- *long stay student visa* – international students taking courses of less than six months are taxed as non-residents. By applying for a seven month visa, the student is treated as a long stay student and taxed at resident rates⁹; and

3 Exhibit 8, *Tax Pack 99*, p.8.

4 Ms Mackenzie, Submission No.1; Mr Deane, Submission No.3; Mr Johnston, Submission No.20.

5 Ms Mackenzie, Submission No.1, p.1.

6 Mr Deane, Submission No.3, p.1.

7 Mr Johnston, Submission No.20.

8 Mr Johnston, Submission No.20, pp.5, 6&7.

9 Mr Johnston, Submission No.20, p.7.

- *protection visa* – visitors can arrive on a visitor or business activities visa and then apply for a protection visa once in Australia. This means the ATO classify the individual as a resident – so they get working entitlements with resident rates of taxation for up to three years (depending on time required to process protection application), regardless of the outcome of their application or whether they actually stay in Australia¹⁰.
- 5.12 Mr Johnston also noted that non-residents can often end up avoiding tax unintentionally due to the complexity of the current system and through misinformation from employers. For example:
- tax treatment can vary between ATO offices and ATO officers depending on their interpretation of standards¹¹;
 - student visas and taxation vary depending on length of course and length of stay¹²;
 - short stay students are issued with ‘no work’ visas but are able to upgrade to ‘work limitation’ once they have arrived in Australia¹³; and.
 - there is anecdotal evidence that employers of fruit pickers have wrongly advised that the reduced tax rate for fruit pickers applies to ALL fruit pickers, where as it only applies to residents¹⁴.
- 5.13 Mr Johnston recommended that in order to ensure a fair system, processes should be made stricter and clearer or differential tax treatment of non-residents should be removed. In his *Residency report*, an attachment to his submission, Mr Johnston listed 65 potential changes to fix the problems in relation to residency (some of which are now in place).

10 Mr Johnston, Submission No.20, p.10.

11 Mr Johnston, Submission No.20, pp. 4,7,9&11.

12 Mr Johnston, Submission No.20, p.7.

13 Mr Johnston, Submission No.20, p.9.

14 Mr Johnston, Submission No.20, p.6.

- 5.14 His recommendations for a stricter and clearer system include:
- re-introducing use of the ‘non-resident’ indicator as opposed to self-assessment¹⁵;
 - data matching against DIMA records and Employment Declaration Forms¹⁶;
 - recording of departure date on the ATO system¹⁷; and
 - changes to forms to make requirements clearer¹⁸.
- 5.15 The International Student Advisers Network Australia raised the need for the ATO to ‘print information for students to handout as part of pre-departure and orientation to explain about why TFNs are needed, paying tax in Australia (PAYE), submitting tax returns, etc’¹⁹ and the need for faster processing of tax assessments by the ATO to overcome the current problem where many international students have left Australia before their tax assessments have been processed.

Self assessment

- 5.16 As noted above, the current system of self-assessment of residency status in tax returns opens up the potential for tax evasion.
- 5.17 Mr Deane, a Public Assistance Officer in the ATO, advised the Committee that:

Under present arrangements it is extremely simple for a person holding an appropriate visa to correctly state their status as “non-resident” on their TFN Application and thereby obtain a TFN quite legitimately. They can then change their status to “resident” by simply ticking the appropriate box when they complete their Tax Return. This way such a person need never pay tax at non-resident rates.²⁰

15 Mr Johnston, Submission No.20, p.7.

16 Mr Johnston, Submission No.20, p.7 & Attachment 1&7.

17 Mr Johnston, Submission No.20, Attachment 6.

18 Mr Johnston, Submission No.20, Attachments 1&2.

19 International Student Adviser Network Australia, Submission No.18, p.1.

20 Mr Deane, Submission No.3, p.1.

5.18 The ATO have advised the Committee that they do not consider this issue to be a significant risk. In particular the ATO have noted that:

Prior to bringing residency status into line with the general self assessment regime, follow up of apparent residency status anomalies and related taxpayer objections was a large and unproductive workload. The anomalies and objections were largely caused by system over-rides of returned residency status, reverting taxpayers to the "status" which existed when they first requested their TFN.

... A formal risk assessment was conducted on this work and it was found that the cost and effort of continuing with a non-self assessment policy was not justified.²¹

5.19 The Committee considers that this issue remains a serious problem for the Commonwealth. There is a significant potential risk of revenue leakage and compromising of both the integrity of Commonwealth systems and compliance with Commonwealth law.

5.20 The ATO have advised the Committee that 'risk assessments of residency self-assessment have been conducted twice a year'²², and that this is a standard and ongoing process in the area of self assessment compliance. In undertaking these risk assessments, the ATO must make sure that it makes full use of all available information, including through the input of its front-line staff. In addition, the Committee considers there is a need for the ATO to consider possible systems solutions to this risk.

Recording and matching visa numbers

5.21 DIMA visa data identifies work rights granted to individuals and duration of stay for people entering Australia. Centrelink and the HIC currently use visa data to determine eligibility for income support payments and access to Medicare benefits.

5.22 DIMA visa information is currently available to the ATO, however it is only used on a case by case basis. As noted in Chapter 4, this information could be used to automate TFN registration for people entering Australia, along the lines of the HIC use of visa data to streamline issuing of Medicare cards. While the ATO and DIMA have developed a proposal to do this, a claimed lack of resources in both organisations has meant that the proposal has not been implemented²³.

21 ATO, Submission No.23, pp.4-5.

22 ATO, Submission No.23, pp.4-5.

23 Transcript, p.119 & ATO, Submission No.17, p.23.

- 5.23 In addition to use as part of the TFN registration process, visa data could also provide an effective method of identifying illegal workers. With a systematic exchange of visa issue data from DIMA, the ATO could match the information with its individual income records and identify those individuals that have exhausted their work rights, or have not been granted permission to work in Australia (providing these people are not working for cash in hand).
- 5.24 A key determinant of the success of such an approach would be the quality of the match that can be achieved between ATO and DIMA records. Using the visa number as the key for matching is likely to produce a high quality match, as opposed to matching against name and address.
- 5.25 In this regard, it is of concern that the ATO currently is not recording all visa numbers. The ATO's approach to recording visa numbers appears fairly random. While the TFN application form does include space for recording a visa number, this number is not always recorded, and even when it is, it is not always entered into the ATO's database. This is also a concern for the success of data matching ATO records against DIMA movement records, as outlined in Chapter 3.
- 5.26 Failure by the ATO to make systemic use of visa data adds to the range of DIMA/ATO interface problems. As already noted, the need for improvements to TFN processes for people entering Australia and tax treatment of non-residents is a well-known problem that has been the subject of both ANAO and parliamentary inquiries. The Committee is not confident that DIMA and the ATO will act on these issues.

Recommendation 14

- 5.27 **That the Australian Taxation Office introduce systematic data matching against Department of Immigration and Multicultural Affairs visa data in order to identify illegal workers. As part of this process, the Australian Taxation Office has to improve its data quality and data recording processes.**

Harvest labour

- 5.28 Harvest labour is a particularly problematic area for ensuring correct tax treatment of temporary entrants. The itinerant nature of this work, the large number of workers, including large numbers of working holiday makers, and the short time periods of work in each location, mean that it is difficult to establish work rights, ensure correct taxation and to track down individuals who are defrauding the system. (See also paragraphs 5.62 to 5.67 on *Harvesting Australia: Report of the National Harvest Trail Working Group*).
- 5.29 A concessional tax rate of 15 per cent applies to Australian residents working in the harvest industry. In contrast, non-residents are taxed at 29 per cent for this work. As noted by Mr Thompson MP, a member of the Government's Harvest Trail Working Group, this provides an incentive for working holiday makers to misrepresent their circumstances²⁴.
- 5.30 As detailed below, DIMA have established a process to address the issue of establishing work rights for visitors and temporary resident.
- 5.31 Mr Thompson proposed reducing the tax rate for working holiday makers to 15 per cent for harvest work. The equivalent amount of superannuation required under the Superannuation Guarantee for these workers would be paid as a tax to the government. In addition, an upfront charge could be applied to working holiday visa applications.²⁵
- 5.32 Mr Thompson's proposal would be revenue neutral; would remove the tax differential between Australian residents and working holiday makers, hence removing the incentives for fraud and would improve the image and integrity of the tax system.
- 5.33 The Committee considers that there is an urgent need for reform in this area. DIMA and the ATO must work together to find solutions that improve tax collection while not overly burdening employers in this industry. On these criteria, the Committee considers that Mr Thompson's proposal has significant merit.

24 Mr Thompson MP, Submission No.27, p.3.

25 Mr Thompson MP, Submission No.27, pp.3-4.

Recommendation 15

- 5.34 **That the Department of Immigration and Multicultural Affairs and the Australian Taxation Office investigate options for addressing taxation and work rights issues in relation to harvest labour, including in relation to known areas of fraud and without overly burdening employers in this industry.**

Fraud

- 5.35 The Committee has received information about TFN fraud committed by non-residents or through the use of TFNs issued to non-residents. This information has largely been anecdotal, but has included comments based on field work by the ATO and DIMA. (See also paragraphs 5.64 and 5.65).
- 5.36 DIMA have advised the Committee that:
- Through our field operation we come across lists of tax file numbers that are displayed in youth hostels. We come across people that are working by having quoted the tax file numbers of friends, people that have left, people that no longer have a need, or even having doubly mentioned the tax file number of another person.²⁶
- 5.37 Importantly, there is no mechanism for DIMA to systematically collect this information. DIMA does pass on any information regarding TFNs that it collects during its field work, and does conduct a number of joint operations with the ATO. However, DIMA legislation does not allow specific questioning of illegal workers in relation to TFNs.
- 5.38 Ms Mackenzie, an officer with the ATO, advised of:
- ... some recent work I have been doing in which temporary residents and foreign students are paid to allow their TFN's to be used to set up "shell" companies which are used for money laundering operations. In many cases, it appears that the individuals who supply their TFN's leave the country shortly after supplying their TFN's, but the shell companies continue to trade for some time after they have left²⁷.

26 Transcript, p.120.

27 Ms Mackenzie, Submission No.1, p.1.

- 5.39 In response to these claims, the ATO have advised that
- The ATO is acting upon a practice that has emerged where certain members of the community, with the intent of circumventing ATO reporting systems and income tax obligations, seek to purchase the Tax File Number and identity details of another person;
 - The practice appears confined to fewer than 500 individuals and to certain industries. Strong attention is being placed on persons believed to be promoting the practice; and
 - In a minority of cases, the person from whom the TFN is purchased intends to leave Australia and has little continued need for that TFN. The ATO's compliance programs would be assisted in this area by improved systematic access to the records of individuals permanently leaving the country.²⁸
- 5.40 The ATO needs to identify the extent of TFN fraud committed by non-residents and through the use of TFNs issued to non-residents and to take steps to address known means of fraud. Fraudulent use of TFNs issued to individuals who have left Australia is a particular concern given that these are considered to form a large proportion of the 3.2 million excess TFNs identified by the ANAO.
- 5.41 A number of suggestions have been made to the Committee as potential means for addressing this fraud.
- 5.42 *Movement data:* As noted by the ATO, access to movement data would assist in identifying TFNs that should no longer be in use²⁹. These numbers could then be archived, and any fraudulent activity against the TFNs could be followed up. While this would assist in reducing fraud, it is likely that it would not be timely enough to prevent fraud. For example, in the case of harvest labour, individuals are likely to have moved on prior to the ATO picking up that they have used an expired TFN.
- 5.43 *Recording of departure date:* As noted by Mr Johnston³⁰, the ATO could record the departure date of temporary entrants at the time of issuing a TFN. This would mean adopting a similar process to the HIC, which end-date Medicare cards issued to temporary entrants based on their departure date. It would provide a similar outcome to the use of movement data by allowing identification of TFNs that have been issued to individuals who have left the country. However, it would not allow the certainty of departure as provided by movement records, as there would be the possibility of individuals having left the country prior to the end date of

28 ATO, Submission No.23, p.3.

29 ATO, Submission No.30, p.6.

30 Mr Johnston, Submission No.20.

their visa, or alternatively of having been granted an extension to their original visa.

5.44 *TFN-based identifier*: Mr Johnston also suggested TFNs issued to temporary entrants and non-residents could include an indicator of this status and/or their departure³¹. The Committee notes that such a move would add embedded meaning to the TFN, which may mean that this is not a preferred solution.

5.45 Ms Mackenzie has stated that:

I believe it would be beneficial to introduce a numbering system which would identify that a TFN had been given to a person temporarily – perhaps even incorporate 3 digits within the number to indicate the end date of validity, so that it would be obvious to ATO officers dealing with that TFN that the person to whom it originally related was a temporary resident of some kind.³²

5.46 A similar approach was proposed by Mr Cooper from the Taxation Institute of Australia. Mr Cooper proposed that:

If a TFN, to relate to a permanent resident, had to have two extra digits or something like that at the front, then you would overcome the problem because the TFN would still be used as an identifier for the tax office, but ... could not be used by a worker to have reduced rates of tax deducted; it could not be used by a non-resident to avoid with-holding tax on bank accounts; could not be used by a non-resident to avoid withholding tax on unfranked dividends and so on.³³

31 Mr Johnston, Submission No.20, Attachment 1, p.18.

32 Ms Mackenzie, Submission No.1, p.2.

33 Transcript, p.71.

Recommendation 16

5.47 That the Australian Taxation Office:

- identify the extent of tax fraud being committed by non-residents;
- review potential vulnerabilities with the current tax treatment of non-residents;
- propose ways to address this issue, particularly focussing on options within existing laws; and
- seek to implement these proposals as soon as practicable.

Work rights of non-residents

5.48 The use of TFNs as a means of establishing work rights for non-residents is an issue of particular concern.

5.49 As noted by the Taxation Institute of Australia:

...[an] area of concern is the issue of TFNs to non-resident holiday makers in Australia ... [and] the loss to revenue due to the fact that tax file numbers are commonly viewed by employers as an indication of residency and right to work. In multicultural Australia, questions about work permits, etc are generally not made, employers instead rely on the TFN to withhold tax at the lower resident rates³⁴.

5.50 The current system of establishing work rights for individuals is extremely difficult. For example, DIMA's employer information kit, *Employing Overseas Workers – Doing the Right Thing*, took 33 pages to explain procedures to employers.

5.51 In relation to checking visas in overseas passports, the ATO advised the Committee that:

What would be really helpful is to have something stamped on it which was really obvious such as 'no work rights'. That does not happen at the moment. They have got this numeric system which is a bit complicated for people to try to work through.³⁵

34 TIA, Submission No.14, p.4.

35 Transcript, p.16.

- 5.52 The Committee notes that two recent reports, *Review of Illegal Workers in Australia: Improving immigration compliance in the workplace*³⁶ and *Harvesting Australia: Report of the National Harvest Trail Working Group*³⁷, have both identified the same issues around the fraudulent use of TFNs and illegal work by non-residents. These reports are expanded on below in paragraphs 5.53 to 5.60 and 5.62 to 5.67 respectively.

Review of Illegal Workers in Australia: Improving immigration compliance in the workplace

- 5.53 Of particular relevance when considering establishing work rights and ensuring correct taxation of temporary entrants to Australia is the recent report *Review of Illegal Workers in Australia: Improving immigration compliance in the workplace*³⁸. This report was prepared for DIMA by an external reference group and was presented to the Minister for Immigration and Multicultural Affairs in November 1999.
- 5.54 The report is openly critical of DIMA's procedures in many areas regarding the treatment of illegal entrants and visa issuing processes. The report's recommendations fall into the broad categories of education, procedure and enforcement and deterrents. The recommendations, if implemented, would introduce significant changes to DIMA's procedures and treatment of visitors³⁹ and some will require legislative amendment before they can be put into practice⁴⁰.
- 5.55 DIMA have advised the Committee that this review and its recommendations are its principle vehicle for addressing the issue of illegal workers. DIMA are currently undertaking a consultation process with industry in relation to the report, with the intention of implementing a number of the report recommendations during this calendar year⁴¹.
- 5.56 A number of the recommendations in the report are of particular relevance to the difficulties facing the ATO that have been outlined in this chapter. This is particularly the case with those recommendations aimed

36 Department of Immigration and Multicultural Affairs. 1999. *Review of Illegal Workers in Australia: Improving immigration compliance in the workplace*. Canberra, Department of Immigration and Multicultural Affairs, 142p.

37 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, xvi 118p.

38 Department of Immigration and Multicultural Affairs. 1999. *Review of Illegal Workers in Australia: Improving immigration compliance in the workplace*. Canberra, Department of Immigration and Multicultural Affairs, 142p.

39 Transcript, p.121.

40 Transcript, p.126.

41 Transcript, pp.121&126.

at making identification of visa work rights easier and more recognisable for employers, and those which aim to identify breaches of those rights in a more consistent and timely manner. The report also identifies a need for closer cooperation between agencies, including the ATO and DIMA.

- 5.57 While the Committee has not considered individual recommendations of the *Review of Illegal Workers in Australia* in detail, it strongly supports the direction of the recommendations and the need for reform in this area.
- 5.58 The Committee considers that there is a need for the ATO to be actively involved on this issue. While the ATO has advised that it has had discussions with DIMA regarding the review, and provided a discussion paper to the reference group, the Committee considers there is considerably greater scope for the ATO to be involved in this process.
- 5.59 In particular, DIMA's report considers this issue from the direction of DIMA initiated reforms, and does not include consideration of possible TFN reforms. For example, there are a number of TFN solutions that could provide a means for employers to identify work rights, including those outlined in the report *Harvesting Australia: Report of the National Harvest Trail Working Group*⁴² (see paragraphs 5.62 to 5.67) . This could include a TFN that included an indication of no work rights. Alternatively, it may be possible to develop some means of on-line verification of TFNs that would confirm that a TFN was valid and that the individual had work rights (the Harvest Trail Working Group's report includes a recommendation for on-line verification of TFNs⁴³).
- 5.60 The ATO needs to consider TFN system reforms that could be introduced to support DIMA reform proposals, or provide a more efficient and simpler solution to these issues.

Recommendation 17

- 5.61 That the Australian Taxation Office more actively work with the Department of Immigration and Multicultural Affairs to implement reforms in the area of work rights for non-residents, including full consideration of possible Australian Taxation Office delivered solutions.**

42 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, xvi 118p.

43 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, Recommendation 7.34, p.xii)

Harvesting Australia: Report of the National Harvest Trail Working Group

- 5.62 The issue of establishing work rights and ensuring correct taxation of temporary entrants to Australia in relation to the harvest industry is dealt with in significant detail in the report *Harvesting Australia: Report of the National Harvest Trail Working Group*⁴⁴. The National Harvest Trail Working Group, comprising 'Members of Parliament and Representatives from the horticultural industry including growers'⁴⁵, was established by the Minister for Employment Services in May 1999. The Working Group's report was publicly released by the Minister in August 2000.
- 5.63 The report 'examines ways to increase the take up of work in harvest areas'⁴⁶. It includes a range of recommendations aimed at developing and promoting a national harvest trail in Australia.
- 5.64 In line with this Committee's findings, the report highlights the significant extent of fraudulent use of TFNs in the harvest industry:

The use of false tax file numbers was reported to be common among harvest workers. One contractor said that up to 90% of the tax file numbers he submitted were returned by the ATO as not valid. ATO advice is that of the 51,000 declarations in the industry code that includes fruit picking that they have received since 1 July 1998, nearly 7% contained an invalid tax file number quotation while around another 4% did not quote a tax file number at all.⁴⁷

44 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, xvi 118p.

45 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, p.1.

46 The Hon Tony Abbott MP, Minister for Employment Services. 11 August 2000. *Media Release*. 'Harvesting Australia – Jobs on the Harvest Trail'.

47 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, p.30.

5.65 The working group considered that this high level of TFN fraud was reflective of a high level of tax evasion, social security fraud and illegal work in the industry. As stated in the report:

Casual harvest labourers give false names and tax file numbers because they believe it reduces their tax liability, because they are also on social security allowances or because they are working in Australia illegally.⁴⁸

5.66 Of particular relevance to this inquiry are the working group's recommendations on taxation, non-resident labour and the need for closer cooperation between agencies in addressing illegal practices in the industry (particularly illegal workers).

5.67 While the Committee has not examined the working group's recommendations in detail, it supports the directions of the report and the need for action in this area. In particular, the Committee notes the recommendations in Chapters 7⁴⁹ and 10⁵⁰, aimed at reducing TFN fraud and illegal work without being overly burdensome on employers, which it considers fit well with the findings and recommendations of this report.

48 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, p.30.

49 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, pp.32-33.

50 National Harvest Trail Working Group. 2000. *Harvesting Australia: Report of the National Harvest Trail Working Group*. Canberra, Department of Employment, Workplace Relations and Small Business, p.44.