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Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

9 June 2009

Dear Sir/Madam,

Re: Proposed changes to Section 23AG and requests for submissions

Deloitte welcomes the opportunity to comment on the proposed amendment to Section 23AG of the *Income Tax Assessment Act 1936 (1936 Act)* as outlined in Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009.

The proposed amendment is to address Treasury concerns that the Section 23AG exemption can apply in circumstances where little foreign tax has been paid. This can produce non-neutral outcomes between individuals working in different countries with different tax rates and between individuals working overseas and individuals working in Australia.

However the proposed measure is likely to have adverse impacts on many Australian companies with overseas operations.

Preference in using Australian workers overseas

Many Australian companies with operations in foreign countries are faced with the challenge of resourcing their overseas projects. They can send Australian workers or they can solely use foreign workers sourced from either the country where they are operating or from elsewhere in the world.

It is usually the preference of Australian companies to use Australian workers wherever feasible. In doing so, the company typically guarantees that the Australian worker will receive the same net after tax salary they would have received had they stayed in Australia. This ensures that the total employment cost of employing the Australian worker is relatively on par with employing a foreign worker.

Currently, from an employer's perspective, Section 23AG ensures that the amount of tax payable in respect of the foreign remuneration is the same as it would be if the employer had used a foreign worker. If however the proposed changes are enacted, the total cost of employing an Australian worker in a foreign country will be greater than employing a foreign worker. Consequently, the proposed changes have the effect of dramatically reducing the attractiveness of using Australian workers in preference to foreign workers. This is clearly not a desirable outcome given that the aim in the current economic environment should be to preserve Australian jobs.

PAYG withholding issues

Practically speaking, most employers do not know what an employee's residency status will be while they are offshore and therefore whether they need to withhold PAYG from earnings. Therefore, the question to be asked is whether the onus will be on the employee to determine their residency status, thereby exonerating the employer from PAYG requirements? Will the onus then be on the employee to seek their own variation of PAYG to take into account a potential foreign tax offset that will eventuate? This exercise will be both costly and complex and in particular it will be very difficult for employees to estimate the potential foreign tax offset if applying for a PAYG variation.

One suggestion to alleviate this problem would be to adopt an approach similar to the approach adopted in the United States where an employee completes a form for the reduced withholding tax and provides the form to the employer. This takes into account the fact that as an employee files their own return the employee, not the employer, determines their residency or non-residency status and whether they can satisfy requirements to claim treaty exemption. Given these matters are based on personal facts and circumstances an employer should not be required to determine the correct PAYG withholding tax rates.

We would also like to note that if an employer advances funds to an employee to meet the overseas withholding requirements this advance will of itself trigger either additional income or a fringe benefit for the employee and therefore further increase the cost of the overseas employment.

Cash flow issues

If an Australian employer is required to withhold both Australian PAYG and foreign tax and the employee has not obtained a PAYG variation before departure there will be a significant cash flow impact for the employee. The adverse cash flow impact will not be corrected until such time as the employee completes their Australian and foreign income tax returns and the appropriate foreign tax offset has been claimed. Once again, this reduces the attractiveness of working overseas and imposes additional costs on the employee.

Alternatively, if an Australian employer is required to bear both the Australian PAYG and foreign tax on behalf of the employee, and seeks to be reimbursed by the employee when they receive a refund of the overpaid tax, this will create an adverse cash flow impact for the employer at a time when they are looking to manage cash flow tightly, as well as a potential risk that the employee will not reimburse the employer when the employee receives the Australian tax refund.

Fringe Benefits Tax – double taxation

Another adverse outcome of the proposed changes is that fringe benefits will be subject to double taxation. Fringe benefits are currently exempt when provided to employees on foreign assignments who are exempt under Section 23AG. If Section 23AG no longer applies fringe benefits are potentially subject to tax in both the foreign country and in Australia under our Fringe Benefits Tax system. As there is no mechanism under the Fringe Benefits Tax Assessment Act 1986 to claim a foreign tax offset the benefits will be double taxed. Presumably this is an unintended consequence however there has been no mention of how double taxation relief would apply in these circumstances.

If the measures are enacted as proposed then we would suggest that the Fringe Benefits Tax Assessment Act 1986 be amended to ensure that fringe benefits continue to be exempt from tax where they are provided to Australians working overseas. This will ensure that double taxation does not occur.

Requirement that foreign tax is paid

Paragraph 1.5 of the explanatory memorandum for Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009 provides the reasons for the amendments by stating *"Section 23AG provides a mechanism for the relief of double taxation but it does not contain a requirement that foreign tax is paid in order for the exemption to apply"*.

We would like to draw attention to the current wording of subsection 23AG(2) which clearly states that foreign earnings derived in a foreign country are not exempt from tax in Australia if the earnings are exempt from tax in the foreign country. Therefore, Section 23AG already contains a condition which requires that foreign earnings are subject to foreign tax before the exemption can apply.

Administrative Issues

We also note that the requirement for employers to remit PAYG and FBT in respect of remuneration given to employees will create a number of practical administrative issues which have not been clarified. For example, if an Australian employee is employed overseas by a non-resident employer the employer will face a number of administrative obstacles in complying with PAYG and FBT obligations. The employer will not be registered as either a taxpayer or an employer in Australia and will be required to comply with obligations in two countries at the same time.

Another common example is where an Australian employee who had ceased to be a resident of Australia (to work overseas) returns home and shortly thereafter receives a bonus relating to the overseas employment. As a result of the proposed changes the bonus will now be taxable in Australia and in the foreign country. Once again there will be an obligation on the foreign employer to comply with PAYG withholding requirements even though they have no connection to Australia.

These administrative issues will create a significant compliance burden on the employer and a situation where the employer is more likely to employ a foreign resident employee rather than an Australian employee as it will be administratively easier and more economical to do so.

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We would welcome the opportunity to comment further. If you wish to discuss any aspect of our submission, please contact me on +61 (0) 8 9365 7112.

Yours sincerely,

George Kyriakacis
Director, Deloitte Touche Tohmatsu Ltd