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Urgent

Secretary
Senate Economics Committee
PO Box 6100 Parliament House
CANBERRA ACT 2600

By email economics.sen@aph.gov.au

9 June 2009

Dear Sir/Madam

Senate committee inquiry into Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009

PricewaterhouseCoopers welcomes the opportunity to comment on the budget announcement on 12 May 2009 in relation to section 23AG of the Income Tax Assessment Act 1936 on the perceived unfair advantages that workers who earn income overseas have over workers who earn income and pay tax in Australia.

Is there anything wrong with the system as it stands?

Our overarching comment would be that the system appears to be working as it stands. It is simple for employers to understand and self-assess if their employees are in a position to be exempt from income tax. Where the employees do not suffer foreign tax, Australian tax remains payable which is a fair position.

However, if the Government seeks to increase revenue by removing the exemption, the following economic and administrative impacts will likely occur.

i) Australian business will be less competitive on the global stage

Many Australian engineering, construction and services companies are currently undertaking large scale projects in overseas countries. These contracts are highly competitive, with Australian firms competing against firms from other countries with substantially lower labour costs. For many Australian companies, a competitive advantage is the use of highly skilled Australian labour for more senior and critical roles.

Companies which are currently undertaking foreign projects are largely doing so under fixed-price contracts. For example, companies involved in the engineering and construction sector tender for projects well in advance and the contracts can then take

more than one year to execute. Most contracts do not allow for an increase in contract price merely due to tax changes in Australia.

And let's be clear, for existing contracts, this change will in most cases have to be borne by the employer, increasing costs for business and reducing profitability.

The proposed changes contain very little by way of transitional rules. They were amended after the initial announcement to add a pre- and post-1 July 2009 service period rule but we would argue that it is inadequate for long term projects currently under way.

Further, Australian companies using Australian labour will be less competitive when bidding for future tenders due to the increase in costs of assignments. This will be the case as the employer will have to provide similar incentives to entice the Australian employees to work in remote foreign locations. Australian employees will continue to focus on their net income, not gross income.

For example, an employee working on a rotational assignment (eg 3 weeks on, 2 weeks off) in China earning A$150,000 per annum, will increase costs for the employer by A$200,000 per annum If the employer wants to provide the same after tax income to the employee. The costs that will increase to employers include:

- Income tax of employees met by employers
- Fringe benefits tax on Australian income tax payments, benefits in kind, foreign tax payments, flights, loans to employees to meet duplicate tax costs
- PAYG duplication in two jurisdictions and having payroll teams in both countries able to understand the laws
- External providers such as payroll bureaus where there is no corporate presence in the foreign location
- Administration costs of getting the details to enable compliance such as benefits and income paid within the tax years of both Australia and the foreign country (which are rarely the same given Australia's year end).

To remain an attractive employer of skilled labour, employers are likely to have to meet these costs out of the profit margin of a contract.

ii) Australian and foreign business will shy away from hiring Australian residents

Due to the increased costs outlined above, Australian and foreign employers with overseas projects will likely look for a non-Australian workforce to deliver the projects. This will reduce employment opportunities for highly skilled Australians.

If employers are forced to hire less qualified workers to win contracts, this could result in poor quality results and loss of international reputation.

iii) Australian residents may relocate out of Australia for the long term

The proposed new rules apply to Australians who remain tax residents of Australia for the duration of their overseas work. If the changes are enacted, some Australians may be driven to move overseas for the long term, thereby breaking Australian tax residency. This is not ideal for Australian families where the overseas location is unsafe, a remote mine site etc.

iv) Administrative headache

If employers of Australian residents are now required to deduct the normal amount of PAYG withholding tax, there will be significant cash flow issues for the employees. Employers will in nearly all cases already have to withhold tax in the foreign location. In extreme cases, the employee could have marginal tax withholding of up to 85% of their income. This will lead to families being unable to meet even the most basic of living expenses.

The administration of the collection of Australian tax from employers where they are also withholding tax in a foreign location where the employee is actually working must be amended prior to the changes becoming law.

A possibility is to exempt employers from Australian PAYG withholding and simply have employees pay the Australian tax, after foreign tax credit offset, when they lodge their Australian tax returns.

v) Foreign businesses are unable to satisfy their Australian tax obligations

Currently the proposed law change means that foreign employers who employ Australian residents must register with the Australian Taxation Office and withhold PAYG as well as being subject to other employment taxes such as FBT, payroll tax etc. It will be very difficult for the ATO to enforce this requirement. Clarity is sought on this issue and whether it was the intention of the law.

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Our suggestions

For the reasons above, our suggestions would be as follows:

1. Leave the law as it is
2. Alternatively, defer the law change for 12 months to allow a suitable transition time for Australian companies currently employing Australian labour on existing overseas projects
3. Extend the fringe benefit tax exemptions for necessarily incurred benefits such as travel to and from site, vehicles and accommodation on, or close to, sites, expenses of preparing foreign tax returns, etc
4. Allow s23AF exemption to be extended to projects which take place in taxable jurisdictions which are in developing nations and hardship localities
5. Either exempt Australian and foreign employers from having to withhold double tax from wages or at least allow them to self-assess for PAYG variations to reduce PAYG withholding down to the amount that is not paid overseas

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Our colleague John Fauvet will be interviewed at 11am on 10 June 2009 but please contact me on (08) 9238 5116 if you have any queries in the meantime.

Yours faithfully

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