

IAS Global Watch

pwc

*What would
you like to grow?*

Australian resident employees working overseas may be subject to income tax on non-cash benefits for the 2010 tax year

In Brief

Australian residents working overseas from 1 July 2009 can no longer qualify, in most cases for the s23AG employment exemption (which has operated since 1986 and also permitted Australian employers an exemption from both PAYG withholding rules and Fringe Benefits Tax on fringe benefits). Such employees of foreign companies who remain Australian residents are subject to an archaic rule (which remained hidden since 1986) which treats their fringe benefits as taxable employment income. This is because non-Australian employers are not (usually) subject to Australian PAYG withholding rules and consequentially, no Fringe Benefit Tax (FBT) liability arises. Because there is no FBT liability, the employees become exposed to personal tax on their benefits. Fringe benefits are eligible for a number of valuation concessions which are not available under income tax rules and this compounds the problem.

While this “new tax” is archaic, and allowances and reimbursements are taxable, it does have a design flaw in that only the “value to the taxpayer” is taxable. Australian and foreign employers need to understand this “new tax” in structuring employment contracts to ensure costs are not blown out and employees are properly recompensed without excessive personal tax liability.

Section 23AG exemption

Historically, section 23AG provided an exemption from Australian income tax to Australian resident employees engaged in foreign service for a continuous period of not less than 91 days. With effect from 1 July 2009 the section was amended to limit the exemption to only those Australian residents engaged in foreign service directly attributable to, amongst other things, the delivery of Australian official development assistance by the person's employer and deployment outside Australia as a member of a disciplined force.

The removal of the section 23AG exemption also impacts the employer who becomes subject to PAYG withholding obligations and Fringe Benefits Tax (FBT) in respect of taxable fringe benefits provided to such employees and their associates (e.g, the spouse and family members etc). Under income tax law, a fringe benefit is exempt from income tax in order to avoid double taxation.

ATO view – Foreign Employers

Where the employer is a foreign employer, the view of the Australian Taxation Office (ATO) as outlined in a draft ruling is that the foreign employer will only be subject to PAYG withholding where the employer has a physical business presence in Australia.

It is also the ATO's view that if a foreign employer is not subject to Australia's PAYG withholding regime they will not be subject to our FBT regime either. As a result, if a foreign employer gives an employee a non-cash benefit in respect of their offshore employment, the employee **needs to include the value of that benefit in their assessable income.**

To be a correct statement of law, the ATO should have said “the value to the employee of the benefit” needs to be included in the employee's assessable income.

What employees need to know

If you are employed by a foreign employer and you are engaged in foreign service but have remained an Australian tax resident:

- First, allowances will be taxable;
- Secondly, any benefits reimbursed will be taxable;
- Thirdly, any other benefits (which cannot be converted to cash) will be taxable, but the amount depends entirely upon what is the “value to you” of that benefit.
- Finally, none of the FBT concessions relating to the value of benefits including housing, home leave, relocation, education costs etc will apply.

Any non-cash benefits to associates, for example family members, will not be taxable to the recipient but will be taxable to the employee.

Pension contributions to Australian or foreign funds will not be taxable.

What employers need to know

The consequences depend on whether the employer is:

- A purely foreign employer (with no connection to Australia and does not have, for example, an Australian Business Number (ABN)); or
- An Australian company for whom an Australian resident employee works on assignment (or secondment) to an offshore affiliate.

Foreign employers

Foreign employers usually provide benefits in a form which is compatible with host country tax laws, particularly expatriate concessions. Where the employee is subject to Australian income tax on the benefits, while they may claim a “foreign income tax offset” (FITO) for foreign tax paid by the employee on such benefits against their Australia tax liability, it may be that there is little or no foreign tax on host country benefits due to host country expatriate concessions. This can result in additional tax costs for the employee or the employer (if the employee is tax equalised) in relation to the income tax payable on the benefits.

Australian companies with offshore affiliates

The issue here concerns double taxation of benefits.

First, where the Australian resident employee is remunerated on a “split payroll” and/or the Australian company continues to provide fringe benefits, then FBT rules will still apply. There will be double taxation because the employee will be taxed on benefits by the foreign Government (subject to host country expat concessions) and the Australian company will retain its FBT liability, albeit subject to FBT expat concessions).

Secondly, where the Australian company ceases the split payroll arrangements (such that no PAYG obligation arises and therefore no FBT liability arises) and the host country employer pays all the remuneration and benefits, the employee will be subject to Australian income tax on both salary and wages and all non-cash benefits. While the employee will be able to claim a FITO for foreign tax payments, there will be no “expat-related” concessions in relation to the valuation of the benefits. The problem ultimately will be that the assessable value of benefits depends entirely upon what is the “value to the employee”. This will vary from employee to employee and there is no guidance from the Australian Tax Office on this aspect.

Clearly, there must be a reasonable approach to determining value, but once one separates benefits into the dual categories of “private benefits” (which may have a value to the employee and pertain to “otherwise spent” benefits, i.e. those the employee would have paid for regardless of whether the employer provided it) and those benefits which only arise because of the foreign assignment (for example, relocation, housing, cultural training and benefits without which an employee may well not accept a transfer offshore), there will be divergence of opinion on the value of such benefits to the employee.

These are all examples of “blowflies”, for that is what our Taxation Tribunal once held in relation to a test case on the value of benefits to foreign nationals when they come to Australia. The Tribunal stated that foreign nationals coming to Australia must accept all that comes with it including our taxation system and the blowflies of summer.

The Bottom Line

Employers of Australian residents working offshore need to be aware of the implications of the removal of section 23AG on non-cash benefits provided to the employee when the employer is packaging expatriate benefits to ensure both host country concessions are availed of and the assessable value of non-cash benefits for Australian tax purposes are kept in perspective.

The Australian Tax Office will focus on this issue and we are aware they are talking directly to Treasury to address this issue.

To have a deeper discussion about what the above means for your business, please contact your usual PwC contact or:

Lisa Hando
Partner
Phone (618) 9238 5776
Email: lisa.hando@au.pwc.com

Blythe McMahan
Senior Manager
Phone: (618) 9238 5231
Email: blythe.mcmahan@au.pwc.com

Justin Smith
Manager
Phone: (618) 9238 3428
Email: justin.r.smith@au.pwc.com

Dee-May Ong
Manager
Phone: (618) 9238 5217
Email: dee-may.ong@au.pwc.com