Exfin Briefing Paper

Changes to Section 23AG : The Impact on Australians Working Overseas

The sections below provide an early review of the impact of changes to s23AG and the taxation of Australian residents who earn employment income offshore. The changes were brought in with very little consultation and as a result there continue to be question marks about how the changes will apply in practice, as you will see reading this paper. This paper is very general in nature and is not intended to constitute tax advice in any circumstances – individual situations differ very markedly and you are strongly advised to seek professional tax advice before making any decisions regarding the impact of s23AG.

Outline of Changes

Prior to 1 July 2009, section 23AG granted an exemption for foreign employment income derived by an Australian tax resident in respect of overseas work assignments that were at least 91 continuous days in duration in a location that ordinarily imposed income tax on that income.

The new section 23AG restricts the general exemption provided to Australians working overseas to aid, charitable and certain government workers (for example, defence and police force personnel deployed overseas) from 1 July 2009.

This means that for all other Australian **residents** working overseas, foreign employment income will be **fully taxable in Australia at resident tax rates**.

Obviously, this will have a considerable impact on many Australians overseas who had accepted employment or other contracts on the premise that Australian tax would not apply – and this is compounded by the fact that the Government provided no warning of the impending changes This paper summaries the impact of the changes and some ways in which the impact might be reduced.

Issues to Consider

1. Becoming a Foreign Resident for Australian Tax purposes

Tax foreign residents are only assessed on their Australian sourced income. If it is arguable that your position may be classified as a **foreign resident** for tax purposes, then any foreign employment earnings **will not be subject to tax in Australia**.

The key question to consider is whether you can establish a “permanent place of abode outside of Australia” and thus sever your Australian tax residency.

The ATO state that relevant factors to be considered are:

- The intended and actual length of your stay overseas;

- Whether you intend to stay in the country only temporarily and then move to another country or to return to Australia at some definite point in time;
- Whether you have established a home outside Australia;
- The duration and continuity of your association in the overseas country;
- the “durability of association” that you have with a particular place in Australia (e.g. maintaining bank accounts here, informing Government departments of your departure etc.)

In other words, by reducing and having a limited social and economic association with Australia, it is more likely that you will be considered as a foreign resident for tax purposes. The nature of your continuing connection with Australia matters however; for example, leaving your family in Australia while you are on an overseas assignment or retaining your accommodation in Australia may indicate that you have not broken your residency and have retained a strong connection with Australia.

In some circumstances it may be as simple as not returning to Australia regularly. However, if a pattern can be established which involves you taking trips back to Australia on a regular and planned basis, for example, returning to Australia every 6 weeks for 1 week, this may tip the scale in favour of Australian tax residency rather than foreign residency, as there is a regular continuity with Australia evidenced through your travel plans.

By having a clearly worded employment contract that has a term exceeding 2 years and setting up a home in a foreign location, it can be argued that a person will be classified as a tax foreign resident.

Issues of tax residence issues are often extremely complicated, and determined on the facts of each case and you should presume that the ATO will be taking a close look at all expatriates who change their residence status from ‘tax resident’ to ‘foreign resident’ due to the change in law.

2. PAYG Variations

Technically, as your foreign employment income is not exempt from Australian tax, it is also now not exempt from Australian withholding tax obligations. Ludicrous as this may seem, it means that your overseas employer should be withholding income tax and remitting it to the ATO!

Due to the possibility of double withholding, because your employer may be withholding local income tax, the ATO will allow a variation to the PAYG withholding requirements where tax is already paid in a foreign location. The main purpose of varying your PAYG withholding is to ensure that the amounts withheld during the income year closely match your tax liability at the end of the income year.

As you are entitled to a foreign income tax offset for tax paid in a foreign location and this may result in a large offset against your Australian tax liability at the end of the income year, it is advisable to obtain this variation certificate. The variation must be applied for through the ATO at the beginning of each year and submitted to your employer each year.

Legally your employer must withhold tax from your salary until you provide them with the variation certificate from the ATO. In principle, this includes overseas employers, as well as Australian employers, but it is difficult to imagine them being too concerned at

meeting the reporting requirements of the ATO. In practice, the emphasis for individuals with overseas employers will be on meeting their Australian tax obligations at the end of each year.

3. Company Policy – Impact on Tax Equalisation

Tax equalisation is designed to ensure than an internal company assignee is indifferent between accepting an assignment in a high tax versus low tax country. This means that the assignee will pay no more or no less tax than they would have paid had they stayed in their home location.

As such the section 23AG changes still enable foreign employment earnings to be tax equalised and ultimately, it should have no effect on your personal bottom line. We suggest that you speak to your company for further information regarding your company's policy on tax equalisation.

4. Other Payments - Superannuation

You may be able to salary sacrifice certain payments to make them more tax effective from an Australian perspective. Although an allowance may not be subject to tax in Australia, it may still be subject to tax in the foreign jurisdiction, so you should seek independent advice.

Superannuation paid from your employer on a prospective salary sacrifice arrangement can lower your taxable salary in Australia and therefore be tax effective. The contributions must be made prospectively, by your employer, and into an Australian complying fund.

5. Living Away From Home Allowance (LAFHA)

Depending on individual circumstances, a LAFHA may be available to compensate an employee for being required to live away from home in order to perform his/her employment duties. This has the ability to reduce your assessable income, as it is provided as an exempt fringe benefit which means that neither your employer or yourself is required to pay tax on the allowances given in Australia.

There may be situation where LAFHA would not be useful, for example, if your career structure requires you to accept regular transfers from one location to another or if your employer either deems you not to be LAFHA or is not willing to offer LAFHA payments

We suggest that you obtain professional tax advice on whether you will might be eligible for a LAFHA benefit and discuss the payment of this with your employer because although the benefit may be tax free in Australia, it still may be subject to tax in the foreign location.

6. Fringe benefits tax (FBT)

As your foreign employment income is no longer not exempt from Australian tax and subject to PAYG withholding, you may be eligible for the taxation of fringe benefits in respect of benefits provided to you overseas. There may be a myriad of fringe benefits that could be available to you, depending on your circumstances. These may include:

- Housing fringe benefits;
- Car fringe benefits;

- Relocation expenses;
- Holiday travel expenses back to Australia for yourself and your family.

It is recommended that you seek professional tax advice to ascertain the fringe benefits that may be applicable in your circumstances and the possible tax consequences of these.

7. Completing your Australian Tax Return

Due to the added complexity involved with these new laws, there will be added complexities to completing your Australian tax return. The ATO has not yet provided clarification in regards to what procedures they will accept for calculating foreign income – however this can be done using a spot rate exchange for the day that income was paid to you or a monthly average rate from the ATO exchange site.