International Tax

Tuesday 29th May 2012

The Manager
Philanthropy and Exemptions Unit
Indirect Tax Division
The Treasury
Langton Crescent
PARKES
ACT 2600

Dear Sir or Madam

Fringe Benefits Tax Reform – Living Away From Home Allowances and Benefits
Exposure Draft of Legislation – Treasury Consultation of May 2012
Wood Group Kenny and Activpayroll International Tax – Joint Submission

We are responding to the Fringe Benefits Tax "Reform of the Living-Away-From-Home Allowance and Benefit Rules" public consultation of May 2012. This is a joint submission by Wood Group Kenny and our specialist expatriate tax advisors, Activpayroll Pty Ltd ("Activpayroll International Tax").

We made a previous joint submission for the 4 February 2012 public consultation on the LAFHA changes, in which we stated our strong objections to the proposed taxation of LAFHA for foreign nationals who reside and work in Australia on 457 work visas and who constitute a substantial proportion of our employees. Our submission is publicly available on the Treasury website.

Wood Group Kenny is a leading global provider of engineering design services to the offshore oil and gas industry. The main focus of the Wood Group Kenny companies is to provide a seamless service for the engineering design and project management of subsea facilities, pipelines, risers and marine renewable energy developments worldwide.

The Wood Group Kenny companies in Australia employ substantial numbers of foreign nationals on 457 work visas to work in Australia. We note that these workers benefit the Australian economy, both by their services and by the money they spend in this country. Many of these 457 visa employees are currently eligible to receive a tax-free Living Away From Home Allowance ("LAFHA").

Activpayroll International Tax is a specialist, boutique provider of expatriate tax advice and services to the oil and gas industry, based in Perth WA and headquartered in Aberdeen, UK. Activpayroll International Tax has a wide variety of clients across Australia and around the globe who are substantially affected by the draft LAFHA legislation.

Without repeating any aspects of our first LAFHA submission, we would like to point out the overriding implications of Australia's Double Taxation Agreements ("DTA's" or tax treaties) on this draft legislation. In our opinion, the draft legislation is in breach of at least seven of Australia's DTA's.

1. Double Taxation Agreement Implications – Non-Discrimination Articles

The *eligibility* for a 2-year exemption from having to maintain two Australian homes in order for one's LAFHA to be tax-free in the 2-year transitional period is the issue we object to in the draft legislation. This transitional LAFHA eligibility criterion clearly discriminates against one group of individuals in Australia on the basis of their nationality alone.

In the draft legislation, the "transitional period" is defined as a maximum 2-year period from 1 July 2012 during which an employee, who already had a tax-free LAFHA arrangement in place as at the 8 May 2012 Budget date, can continue to receive his or her LAFHA tax-free.

The draft legislation states (for insertion into the *Taxation Administration Act 1953*) that (emphasis added in bold) :

> "(1) During the transitional period, you can disregard paragraphs **25-115(1)(b) and (e)** of the *Income Tax Assessment Act 1997* if :
>
> (a) You are **neither a temporary resident nor a foreign resident**; and
> (b) During the entire period :
> (i) starting at the Budget time; and
> (ii) ending on 30 June 2012;
> your employment was covered by an eligible employment arrangement that was not varied or renewed."

In other words, an Australian Permanent Resident or Australian citizen who is tax resident in Australia can ignore **both** sub-paragraphs 25-115(1)(b) and 25-115(1)(e) during the transitional period.

However, a foreign national on a 457 work visa who is tax resident in Australia (and a New Zealand national who is a temporary resident of Australia although not requiring a 457 visa to work here) is not granted the same beneficial treatment as an Australian national. The draft legislation states (again for insertion into the *Taxation Administration Act 1953*) that (emphasis added in bold) :

> "(1) During the transitional period, you can disregard paragraphs **25-115(1)(e)** of the *Income Tax Assessment Act 1997* if :
>
> (c) You are **a temporary resident or a foreign resident**; and
> (d) During the entire period :
> (iii) starting at the Budget time; and
> (iv) ending on 30 June 2012;
> your employment was covered by an eligible employment arrangement that was not varied or renewed."

In other words, while the draft legislation allows an Australian national (Permanent Resident or citizen) to ignore paragraph 25-115(1)(b) during the 2-year transitional period, it does not allow a foreign national living in Australia (a temporary resident) to do the same.

The draft paragraph 25-115(1)(b) of the *Income Tax Assessment Act 1997* states that (emphasis added in bold) :

> "(1) You can deduct an amount for an accommodation, food or drink expense you incur if :

(a) you incur the expense because your employer requires you to live away from your usual place of residence for the purposes of your employment; and

(b) that residence:

(i) is a dwelling in Australia in which you or your spouse have an ownership interest; and

(ii) **continues to be available for your use and enjoyment during the period you are required to live away from it;** and

(c) …

(d) …

(e) …"

The draft legislation therefore discriminates during the entire transitional period against a foreign national as opposed to an Australian national, even though both individuals are tax resident of Australia.

We understand from various Treasury announcements and, for example, paragraph 2.31 of the Explanatory Materials to the draft legislation that, for either a temporary resident (i.e. foreign national) or a Permanent Resident (i.e. Australian national) to be entitled to claim a LAFHA deduction (and hence ensure their LAFH allowance is tax-free from 1 July 2012 onwards), they must maintain and pay for *two Australian* homes – one say in Perth WA that is their "usual place of residence" and the other say in Brisbane where they are temporarily living for work purposes for up to 12 months. They cannot merely be living away from say a UK home while in Perth WA as the UK home is not an Australian home.

However, the transitional rules in the draft legislation make an exception to this requirement for the duration of the transitional period. But, as noted above, the exception is heavily weighted in favour of an Australian national. An Australian national under the transitional rules is exempt from the requirement to maintain two Australian homes during the 2-year transitional period from 1 July 2012 to 30 June 2014. But the foreign national who is a temporary resident (or even a non-resident) is not exempt from that onerous requirement.

As a result, where two otherwise identical employees of a company currently receive LAFHA (and both had a LAFHA arrangement in place as at the 8 May 2012 Budget date for LAFHA transitional rule purposes), but one employee is a *foreign national* living in Australia on a four-year 457 work visa and the other employee is an *Australian national* living in Australia doing the identical job, the foreign national employee will not be eligible – by virtue *solely* of his or her nationality – for continuing tax-free LAFHA for the next two years during the transitional period. But the Australian national will.

The *eligibility* for a 2-year exemption from having to maintain two Australian homes in order for one's LAFHA to be tax-free in the 2-year transitional period is the issue we object to in this draft legislation. This eligibility criterion clearly discriminates against one group of individuals in Australia on the basis of their nationality alone and carries a substantial, punitive tax and financial cost to the foreign national and/or to their employer (but not to the Australian national in identical circumstances). This cost arises only as a result of this discrimination by the Australian Government against the foreign national employee on the basis of their nationality.

Most of our 457 visa employees who live and work in Australia are skilled oil and gas workers from the United Kingdom. They are tax residents of Australia, are temporary residents of Australia and are also almost all UK nationals. We note that the Australian Government has signed a Double Taxation

Agreement or DTA with the UK (the *2003 United Kingdom Convention* in Schedule 1 of the *International Tax Agreements Act 1953*). Hereafter called the "UK DTA".

Article 3(1)(l) of the UK DTA states that :

> "(l) the term "national" means :
>
> (i) in relation to the United Kingdom, any British citizen, or any British subject not possessing the citizenship of any other Commonwealth country or territory, provided that individual has the right of abode in the United Kingdom; and any company deriving its status as such from the law in force in the United Kingdom;
>
> (ii) in relation to Australia, an Australian citizen or an individual not possessing citizenship who has been granted permanent residency status; and any company deriving its status as such from the law in force in Australia;"

Article 25 (Non-discrimination) of the UK DTA states that (emphasis added in bold) :

> "1 **Nationals** of a Contracting State shall not be subjected in the other Contracting State to any taxation or other requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which **nationals** of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.
>
> …
>
> 5 Nothing contained in this Article shall be construed as obliging a Contracting State to grant to individuals who are **residents** of the other Contracting State any of the personal allowances, reliefs and reductions for tax purposes which are granted to individuals so resident.
>
> 6 This Article shall not apply to any provision of the laws of a Contracting State which :
>
> (a) is designed to prevent the avoidance or evasion of taxes; …
>
> 7 The provisions of this Article shall apply to the taxes which are the subject of this Convention."

We observe that the Notes to the UK DTA in relation to Article 25 (i.e. tax rebates and credits in relation to dividends) do not affect any of the above terms.

Article 25(1) of the UK DTA means that **a UK national** (i.e. any British citizen, even if they are tax resident and "treaty resident" in Australia and non-resident of the UK) **may not be subjected in Australia to any taxation** or other requirement connected with tax **that is different from or more burdensome than** the tax and related requirements that **an Australian national** in the same circumstances may be subjected.

Article 25(5) of the UK DTA does not impact or reduce this DTA protection for UK nationals from Australian tax discrimination. This is because almost all UK nationals working in Australia on a 457 visa as temporary residents – and who are being discriminated against under the transitional LAFHA rules – will be *Australian tax residents* and not UK tax residents. For DTA purposes, they will almost

all be Australian tax residents and also "Australian treaty residents" under the Article 4(3)(a) Residence Tie-Breaker rules. Article 25(5) of the UK DTA is therefore not relevant to them as they are not UK resident nor UK treaty resident. So Article 25(5) of the UK DTA cannot be used to ignore or override the non-discrimination requirement of Article 25(1). In addition, the reference to "personal allowances" in Article 25(5) is to the UK's tax-free Personal Allowance (which is currently £8,105 pa and is equivalent in concept to Australia's current $6,000 pa tax-free threshold), and not to a LAFH Allowance or other income allowances.

We note that a DTA will in principle (almost always) override Australian domestic taxation law (except where there is Part IVA anti-avoidance and a few other remote reasons that are not relevant to this issue of LAFHA discrimination). However, **Article 25(6)** of the UK DTA (i.e. allowable discrimination where there is avoidance or evasion of Australian tax) is not relevant to this LAFHA discrimination situation. This is because the proposed ineligibility of a UK national to receive tax-free transitional LAFHA under the draft legislation is not designed to prevent the avoidance or evasion of Australian taxes. It is simply discriminatory, apparently only in order to raise substantial additional tax revenue for the Australian Treasury from foreign national employees working in Australia while not taxing their Australian national colleagues working in the same circumstances.

We note that Article 2(1)(b) of the UK DTA includes both Australian income tax and Fringe Benefits Tax as taxes to which the UK DTA applies. Therefore **Article 25(7)** of the UK DTA covers both Australian income tax and Fringe Benefits Tax (both of which are relevant to the proposed taxation of LAFHA and LAFH benefits) and therefore protects UK nationals from discriminatory Australian income tax and FBT treatment, such as is proposed under the draft transitional LAFHA legislation.

As a result, in our opinion the Treasury's draft legislation regarding LAFHA – and, in particular, the blanket ineligibility of any UK national working in Australia on a 457 work visa (as a temporary resident or as a non-resident) to claim tax-free LAFHA during the 2-year transitional period as compared with any Australian national in the same circumstances – is discrimination on the basis of nationality alone. This appears to be an illegal breach of Australia's Double Taxation Agreement with the United Kingdom. If so, we understand this fact will make the relevant sections of the draft legislation unenforceable under Australian law.

We would be interested to see how the Treasury concluded that its draft *transitional LAFHA* legislation was not discriminatory against foreign nationals, particularly given the Treasury's obligations under international law with the UK and other DTA countries.

We note that this draft legislation's discrimination against foreign nationals' eligibility for the 2-year LAFHA transitional rules is also a breach of Australia's Non-Discrimination Articles in the DTA's with the **United States** (Article 23(1)(a) Non-discrimination), **South Africa** (Article 23A(1) Non-discrimination), **India** (Article 24A(1) Non-discrimination of the 16 December 2011 Protocol to the 1991 DTA, the Protocol and its Article 24A(1) will come into force shortly), **Norway** (Article 24(1) Non-discrimination), **Finland** (Article 23(1) Non-discrimination) and **New Zealand** (Article 24(1)). The principle we applied above to the UK DTA applies equally to each of these DTA's.

If the draft legislation is enacted in relation to transitional LAFHA, it is our opinion that any UK national, US national, South African national, Indian national, Norwegian national, Finnish national or New Zealand national who is a temporary resident (or non-resident) of Australia can rely on the Australian DTA with their respective country of *nationality* in order to override Australia's domestic tax laws (the draft legislation) and thereby claim continuing tax-free LAFHA for up to two-years during the transitional period (as long as they had a LAFHA arrangement in place at the 8 May 2012 Budget date).

In addition, any *company* that employs a foreign national who is a national of one of these seven DTA countries, and who has a LAFHA arrangement in place at the 8 May 2012 Budget date, will itself be entitled to ignore any PAYG withholding, Fringe Benefits Tax, State Payroll Tax and Superannuation Guarantee that purports to arise on their LAFHA or LAFH benefits during the 2-year transitional period. Where a DTA exempts the transitional LAFH income or benefit from Australian income tax or FBT, then PAYG, FBT, State Payroll Tax and Super Guarantee cannot arise as a DTA overrides domestic taxation law.

2. New Zealand Double Taxation Agreement – "Fringe Benefits" Definition

Finally, the draft legislation also causes a discrepancy under the New Zealand DTA's Article 15 (Fringe benefits). Where a fringe benefit is taxable in both countries, Article 15 will allocate the taxing right to one country alone (i.e. the country that has the primary taxing right over the employee's salary).

We note that the equivalent Article 15 (Fringe benefits) of the UK DTA states that a "fringe benefit" *for the UK DTA's purposes* is defined as the meaning it has under Australia's Fringe Benefits Tax Assessment Act 1986. Under current Australian FBT legislation, an *excessive* cash LAFHA is a "fringe benefit", is hence subject to FBT and therefore falls under Article 15 to avoid double taxation by both jurisdictions. From 1 July 2012, the definition of "fringe benefit" in the FBTAA 1986 will change so that a cash LAFHA (and an excessive cash LAFHA) no longer falls under the FBT regime but falls back under income tax instead. A LAFHA will no longer be a "fringe benefit" or a "benefit" under domestic FBT law. This definition change will flow through to the UK DTA and therefore does not cause any DTA problems.

However, the New Zealand DTA's definition of "fringe benefit" does *not* follow the Australian domestic FBT definition of "fringe benefit". Article 15(2)(a) of the New Zealand DTA states that (emphasis added in bold) :

> "2. For the purposes of this Article:
>
> **'fringe benefit'** includes a benefit provided to an employee or to an associate of an employee by:
>
> (i) an employer;
> (ii) an associate of an employer; or
> (iii) a person under an arrangement between that person and the employer, associate of an employer or another person in respect of the employment of that employee,
>
> and **includes an accommodation allowance** or housing benefit so provided …"

As a result, the New Zealand DTA's definition of "fringe benefit" will still include any amount of a cash LAFHA (whether excessive or not), even though the Australian domestic law FBT definition will no longer include a cash LAFHA as a "fringe benefit" from 1 July 2012.

Therefore where the New Zealand DTA applies (e.g. an Australian is sent to New Zealand to work but remains Australian tax resident), and he or she is provided with a cash LAFHA after 1 July 2012, and New Zealand has the first right to tax the salary under the DTA, then Australia cannot tax that cash LAFHA *at all* because Articles 15(1) and (2) of the New Zealand DTA define it to be a "fringe benefit" and only New Zealand may tax that "fringe benefit" cash LAFHA.

This discrepancy under the New Zealand DTA may be an oversight or it may be an intended outcome by Treasury. We raise it for awareness and discussion.

3. Our Recommendation

We have already recommended in our February 2012 submission to Treasury that LAFHA should not be taxable for any foreign nationals working in Australia on a 457 work visa. Our position has not changed in that regard.

We now **strongly recommend** that the draft LAFHA legislation be amended so that all foreign nationals who are temporary residents (or non-residents) of Australia be eligible under equal terms for the 2-year LAFHA transitional rules, allowing those foreign nationals who had a tax-free LAFHA arrangement at the 8 May 2012 Budget date to continue to be eligible for tax-free LAFHA for up to 2 years, exactly as the draft legislation provides to Australian nationals in the same circumstances. To act otherwise is to discriminate against foreign nationals and this appears to be an unenforceable breach of Australia's DTA's with seven countries.

We **also recommend** that this transitional LAFHA eligibility is extended not merely to nationals of the above seven DTA countries whose DTA Non-discrimination Articles will override the draft legislation (UK, USA, South Africa, India [when the Indian Protocol comes into force], Norway, Finland and New Zealand) but also, as a principle of equity and fairness, to all foreign nationals.

We look forward to your consideration of the facts and the law.

Yours faithfully

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