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

Email: fbt@treasury.gov.au

29 May 2012

Dear Sir,

Submission on the Exposure Draft of the Tax Laws Amendment (2012 Measures No. 3) Bill 2012: Deducting expenses for living away from home

PwC welcomes the opportunity to make a submission in relation to the Exposure Draft legislation (ED) of the Tax Laws Amendment (2012 Measures No. 3) Bill 2012: deducting expenses for living away from home and associated Explanatory Materials (EM).

In this submission, references to "LAFH benefits" are to Living Away from Home (LAFH) accommodation and food allowances and reimbursements.

Our submission is in two sections as follows:

1. Impact on Australian business
2. Submission on the Exposure Draft

PwC would welcome the opportunity to discuss this submission with Treasury. Please contact Jim Lijeski on (02) 8266 8298 or Norah Seddon on (02) 8266 5864 with any queries in relation to the contents of this submission.

Yours sincerely

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1. Impacts on Australian business

We believe the changes in the ED will have a significant negative impact on Australian business and therefore on the Australian economy.

In our submission of 3 February 2012, we detailed these impacts in relation to the removal of LAFH benefits for temporary residents and these impacts still arise under the ED. In summary, the negative impacts include:

1. higher costs to business including higher labour costs for mobile employees along with additional payroll tax, superannuation and workers compensation costs;

2. business needing to address these higher costs through moving contracts and projects offshore, additional costs being passed onto customers (and ultimately consumers) and contracts being terminated because the profits on the contracts have become uncommercial; and

3. a significant negative impact on Australia's competitiveness in the global talent war resulting in current employees leaving Australia because of the removal of the LAFH benefits and creating difficulties in attracting talent and key skills to Australia because of the high cost of living (including tax rates) as compared to other countries.

Subject to certain transitional rules, the changes in the ED now place limitations on LAFH benefits for non-temporary ("permanent") residents. Where a permanent resident is living away from home, LAFH benefits will only be available for a maximum 12 month period for where the employee lives away from and maintains an Australian home for their use and enjoyment.

We believe that the impacts outlined above in paragraphs 1. and 2. will also arise in relation to the proposed changes in relation to permanent residents. In addition, we believe that the proposed changes in relation to permanent residents will inhibit employee mobility within Australia. This mobility should be encouraged in light of the skills shortage in many areas and industries within Australia. The limitations on LAFH benefits will mean that there will often be little incentive for employees to offset the disincentives of being mobile (for example, relocating families and lives, getting used to a new location and working environment, making new friends, the costs associated with maintaining family links in the home location).

In relation to the transitional rules in the ED, we welcome the transitional rules for permanent residents but are disappointed that there were no transitional rules introduced for temporary residents (other than temporary residents who were living away from an Australian home at 7.30pm on 8 May 2012).

These temporary residents made good faith decisions to come to Australia based on LAFH benefits that have been in place since 1945 and they are here currently contributing to the Australian economy. Temporary residents have been given 53 days (from Budget Night to 30 June 2012) to make arrangements and decisions in relation to the changes in the ED. These arrangements and decisions are having a significant impact on temporary residents, their families and their employers. We believe that temporary residents will consider returning home as a result of the changes in the ED and their employers are also considering the impact on their business in deciding the employer's response to the changes.

While temporary resident employees have been aware since 29 November 2011 that there would be future changes in relation to LAFH benefits they were receiving, they and their employers hoped that there would be transitional rules for a period of time after the final form of the changes was available.

The Australian economy needs employee mobility both domestically and internationally in order to meet the needs that arise as a result of the skills shortage in certain areas and industries. The changes in the ED remove a key incentive for employees to be mobile and will therefore have a significant impact on Australian business and the economy. The absence of transitional rules for temporary residents is disappointing and is also likely to have a significant negative impact on Australian business and the economy.

2. Submission on the Exposure Draft

2.1 12 month time limit for living away from home deduction

Proposed new subsection 25-115 (1) of the 1997 Act provides that "you can deduct an amount for an accommodation, food or drink expense you incur.....while living away from an Australian home where under new subparagraph 25-115 (1) (e) (i) .....the expense relates to all or part of the first 12 months that you live away from that residence as required by your employer".

While paragraph 2.50 of the Draft Explanatory Materials ('EM'), explains the 12 month period commences the first day the employee begins living away from home and paragraph 2.51 states the 12 month period pauses if the employee temporarily relocates to their usual place of residence, further guidance in the EM would be helpful as to:

- whether the day (or days) of travel to and from the usual place of residence count towards the 12 month period;
- when the 12 month period starts where a permanent resident has commenced an assignment during the period between Budget Night (8 May 2012) and the effective date of the changes in the ED (1 July 2012) – on the actual start date or 1 July 2012; and
- whether commuters (whose usual place of residence is say Sydney, and they work in say Melbourne on week days spending the weekend back home) should count the weekend days as a "pause".

In respect of commuters, the exception to the 12 month rule in subparagraph 25-115 (1) (e) (iii) suggests that commuters as described above may not be subject to the 12 month rule. The EM does state at paragraph 2.10 that the deduction will be limited to a period of 12 months (other than fly-in and fly-out workers). The inclusion of two subparagraphs in 25-115 (1) (e) for fly-in and fly-out workers indicates both remote and non-remote areas are meant to be carved out of the 12 month rule. Subparagraph (iii) is capable of being read so as to include interstate (and other) commuters. We suggest that an example is included in the EM in relation to commuter arrangements and how Treasury intends the changes in the ED to apply to such arrangements.

The EM makes clear that the 12 month period restarts if the employee's work location changes, that is, if the employee is required by their employer to move to another location to perform the duties of

employment and it would be unreasonable for the employer to require their employee to commute to the new location from the earlier location.

What is not clear is whether an employee can claim LAFH again if they are required by the same employer to work temporarily again at that same work location (perhaps many years later). It appears that as long as the employee has resumed living in their usual place of residence, the 12 month period should start again for the second assignment however we suggest that an example of such a situation and how the rules apply should be included in the EM.

Where the employer requires an employee to work at a new location, the EM states that the 12 month period will start again where it would be unreasonable for the employer to require their employee to commute to the new location from the earlier location. We suggest that a rule of thumb in relation to distance or travel time as to when it would be "unreasonable" for the employer to expect the employee to travel should be included in the EM.

We also note that there are genuine situations where employees will travel on business trips to a location and then subsequently start living away from home at that location. We believe that the 12 month rule should apply from the first date that the employee is living away from home however we ask that clarity is provided on this point in the EM. In addition, guidance on the difference between business trips and living away from home (e.g. length, type of accommodation, nature of work) should be provided.

2.2 Transitional provisions

Transitional rules apply to permanent residents who have employment arrangements for LAFH benefits in place at 7.30 pm (AEST) on 8 May 2012.The conditions in the Budget to:

- Maintain a home in Australia; and
- Limit the concessional treatment to a maximum of 12 months;

will not apply to permanent residents until the earlier of 1 July 2014 or the date a new employment arrangement is entered into.

Eligible employment arrangements

While the ED itself makes clear transitional rules apply to an eligible employment arrangement which cannot be varied or renewed, the EM does not actually provide any illustrative examples on what is meant by "your employer or a connected of your employer commits to provide you with an allowance or benefit for your accommodation, food or drink while you are required to live away from your usual place of residence".

In particular, neither the ED nor the EM address the situation where an employer has made an offer of employment to an employee that includes a commitment to provide LAFH benefits prior to 8 May 2012 but the offer is only accepted by the employee after 8 May 2012. Also, neither the ED nor the EM outlines whether an "eligible employment arrangement" includes company policies that commit to providing LAFH benefits to employees that are living away from home prior where both the employee was living away from home and such policies were in place on or prior to 8 May 2012.

Guidance is therefore requested in relation to whether these would qualify as an "eligible employment arrangement".

The ED and EM also do not define the terms "varied" or "renewed" for the purpose of the transitional provisions. As a result, it is unclear whether a change to the amount of rent charged under an existing arrangement or a change in the method that a LAFH benefit is delivered to an employee (i.e. from payment of an allowance to a reimbursement of rental expenses incurred) would effectively vary or renew an eligible employment arrangement for the purpose of the transitional provisions. We assume that such changes would not mean that the transitional rules cease to apply however guidance is requested from Treasury on these points.

When is an employee's "tax status" tested?

Consideration should also be given by Treasury as to when an employee must be a permanent resident for the purpose of the transitional provisions (that is, not a temporary or foreign resident). The transitional rules do not apply to a temporary resident or a foreign resident (and both of these terms are defined).

A foreign resident (being a non-resident taxpayer) can become an Australian tax resident (but not a temporary resident) and a temporary resident can cease to be a temporary resident where they fail the "however" provision in the definition in subsection 995-1 of the 1997 Act. For example a temporary resident who acquires an "Australian spouse" through marriage or a de facto relationship will cease to be a temporary resident from that time.

There is no guidance in the ED or the EM as to when an employee's "tax status" is to be measured. The following are examples of situations where an employee's "tax status" changes and guidance is requested on such situations in relation to the application of the transitional rules where someone becomes a permanent resident.

> Example 1: A temporary resident living away from a foreign home on 8 May 2012, marries an Australian citizen on 1 June 2012, but still maintains their usual place of residence overseas. On 1 July 2012, they are a permanent resident. They should get transitional relief from both the home requirement and the 12 month requirement provided their eligible employment arrangement is not changed or varied prior to 30 June 2012.
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> Example 2: A temporary resident living away from a foreign home on 8 May 2012, marries an Australian citizen on 1 August 2012, but still maintains their usual place of residence overseas. On 1 July 2012, they are a temporary resident. They should get transitional relief from both the home requirement and the 12 month requirement from 1 August 2012 provided their eligible employment arrangement is not changed or varied prior to 30 June 2012.

2.3 Non-discrimination article

An integral part of Australia's taxation laws are Australia's Double Taxation Treaties. Many of these treaties (for example, the United Kingdom and the United States) have non-discrimination articles whereby nationals of the foreign treaty country cannot be worse off under taxation or connected laws than an Australian national in the same circumstances.

The ED will result in an employee being denied deductions for accommodation and food expenses unless the employee maintains a residence for their use and enjoyment in Australia during a period

they are living away from that residence. A temporary resident employee is still required to maintain a residence for their use and enjoyment in Australia before accessing the concessions for LAFH benefits.

The transitional provisions however allow a "permanent resident" employee covered under an eligible employment arrangement at 7:30pm (AEST) on 8 May 2012 to access the concessions for LAFH benefits. Except for temporary residents who were living away from an Australian home at 7.30pm (AEST) on 8 May 2012 covered by an eligible employment arrangement, there are no transitional rules for temporary or foreign resident employees.

In substance rather than perhaps in form, the requirement to maintain an Australian home may be seen to be discriminating against non-Australians as typically temporary and foreign residents claiming LAFH benefits are living away from a foreign home.

The transitional rules however are in clear contradiction to the requirements of the non-discrimination articles in Australia's Double Taxation Treaties.

The OECD model convention article and commentary for the non-discrimination article are shown below.

Paragraph 1 of Article 24 of the OECD Model Convention states that:

> *Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any 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. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.*

Paragraph15 of the OECD commentary for paragraph 1 of Article 24 states the following:

> *Subject to the foregoing observation, the words ". . . shall not be subjected . . . to any taxation or any requirement connected therewith which is other or more burdensome . . ." mean that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form as regards both the basis of charge and the method of assessment, its rate must be the same and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.*

The following countries have a non-discrimination article in their Double Taxation Treaty with Australia:

Chile
Finland
Japan
New Zealand
Norway
South Africa
Turkey
United Kingdom
United States

We submit that Treasury should revise the transitional provisions to apply to both permanent residents and temporary residents with eligible employment arrangements in place at 7.30pm on 8 May 2012 in order to meet the requirements of the non-discrimination articles in Australia's treaties.

We also submit that Treasury should consider whether the requirement to be living away from an Australian home (rather than a home anywhere in the world) could raise issues under the non-discrimination clauses in the above treaties.

Where the ED becomes law, it is likely that nationals from the above list of countries will rely on the non-discrimination article to ensure that they are not faced with a more burdensome taxation requirement than Australian citizens are.

2.4 Other

Other aspects that need further consideration are outlined below.

Ordinary weekly food and drink expenses

Section 25-115(3)(b) of the draft legislation states that the ordinary weekly food and drink expenses for a child aged under 12 during a 7-day period for the 2011-12 income year is $44. However, per paragraphs 2.40, 2.42 and 2.43 of the EM, the ordinary weekly food and drink expenses for a child aged under 12 during a 7-day period for the 2011-12 income year is $55.

We assume that the correct amount is $55 however the ED and the EM should be consistent.

Substantiation that a residence is available for use and enjoyment

The ED and EM state that an employee would only be eligible for LAFH benefits if they live away from an Australian home. We further note that under paragraph 2.28 of the EM, the employee's home has to be available for their use and enjoyment at all times during a period the employee is required to live away from that home.

Documentary evidence will be difficult to produce as the evidence will be "proving a negative fact" rather than "proving a positive fact". Guidance should be provided by Treasury or the Australian Taxation Office (ATO) as to what would constitute appropriate documentary evidence of the employee's home being available for their use and enjoyment.

ATO determinations re: reasonable food allowances

The move from FBT rules to the income tax regime for LAFH allowances does mean the ATO food determinations for year ending 31 March 2013 will not be relevant post 30 June 2012. The ATO will need to publish guidance BEFORE 30 June 2012 as to reasonable food allowances for interstate (and intrastate) temporary transfers for the 12 months to 30 June 2013.

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