AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS

ABN 11 008 484 197

Professionalism in Directorship

Submission

To

Board of Taxation

On

International Taxation Arrangements

31 October 2002

Contents

Australian Institute of Company Directors

Australian Institute of Company Directors (AICD) is the peak organisation representing the interests of company directors in Australia. Current membership is over 16,600, drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors. Membership is on an individual, as opposed to a corporate basis.

AICD is a federation of seven State divisions, each of which is represented on a National Council. Overall governance of the AICD is in the hands of its National Council which is comprised of the seven division Presidents, plus a National President, two National Vice-Presidents and a National Treasurer. AICD has several national policy committees, focusing on issues such as law, accounting and finance, sustainability, taxation and economics, superannuation, and national education, along with task forces to handle matters such as corporate governance.

The key functions of AICD are:

- to promote excellence in director's performance through education and professional development
- to initiate research and formulate policies that facilitate improved director performance
- to represent the views and interests of directors to Government, regulatory bodies and the community
- to provide timely, relevant and targeted information and support services to members and, where appropriate, Government and the community
- to maintain a member's code of professional and ethical conduct
- to uphold the free enterprise system
- to develop strategic alliances with relevant organisations domestically and internationally to further the objectives of the AICD.

1.Executive Summary

The AICD welcomes the opportunity to provide a response to consultation paper on the Government's review of International Taxation Arrangements.

The focus of the AICD submission is on those areas of most importance to Australian Company Directors, it is not intended to be a comprehensive response to every issue raised in the consultative paper. Our submission addresses the particular areas of concern within the noted chapters of the consultative paper. Our views are premised on the reforms meeting the following key objectives:

Objectives

- Ease the compliance burden;
- Ensure that the Australian international tax system is sufficiently competitive to attract levels of foreign investment commensurate with desired rates of economic growth.
- Minimise the impact of taxation on investment decisions; and
- Allow maximum integration of Australian and global financial markets.

A review of the international tax system will not be satisfactory if it only attempts to align the Australian system with changes that have occurred in other countries in recent years. Instead, the review process needs to look at Australia's overall objectives and the nature of the Australian economy to arrive at a set of reforms, which is sensitive to those factors.

Summary of recommendations

In the view of the AICD, this represents a once in a decade opportunity to improve the Australian international tax system so as to achieve the objectives to which we as a small open economy should strive. We are not convinced that the options set out in the consultative paper adequately address the problems that need to be resolved. As a result, we believe that further review and analysis is required in a number of key areas and that the deficiencies of the existing system will not be overcome by a collection of ad hoc amendments.

In summary, our recommendations are as follows:

- The bias against foreign source income imposed by the imputation system be removed either by a systemic review of the operation of the imputation system or by the provision of notional credits for dividends paid out of foreign source income;

- Along with the provision of notional credits, virtually all restrictions on dividend streaming be removed, both to simplify the law and to allow all shareholders to receive maximum tax credits wherever they are resident;

- A major review and rewrite of the CFC provisions be conducted based on an underlying policy that the CFC measures should be anti avoidance in nature and narrow in scope. Specifically, the definitions of tainted services and tainted sales income should be narrowed considerably leaving the focus of the CFC measures being on narrowly defined passive income. Simplification in this area would be greatly assisted if all dividends, not just those from broad exemption list countries could be returned to Australia free of company tax;

- Features of the Australian international tax system which act against conduit income should be reviewed and modified. This includes the operation of the CGT provisions where an Australian holding company with majority foreign ownership disposes of a foreign subsidiary (so called participation exemption), restrictions on dividend streaming, operation of our double taxation agreements, and simplification of the CFC provisions. These changes need to be considered as a whole since conduit investment is extremely sensitive to any adverse feature of the tax system. Because such investments are very mobile, Australia will be unlikely to achieve a roll as a major centre for regional service companies if it does not conduct a comprehensive review in this area;

- Modify the law in relation to the place of residence of companies, so as to limit the importance of the central management and control test. The present law in this area provides considerable uncertainty and imposes constraints which are not consistent with modern means of communications;

- Changes be made to the treatment of expatriates taking up specialised positions in Australia so as to reduce the cost and compliance burden associated with employing overseas personnel. The law in this area should be modified to treat expatriates working in Australia as Living Away From Home and extend to them exemptions from Superannuation Contributions, health levies and CGT consequences for assets held offshore.

2. Chapter 2:Attracting Equity Capital for Off Shore Expansion

Imputation

The introduction of imputation in the late 1980s simultaneously removed double taxation of domestic corporate earnings for resident shareholders and drove a wedge between the taxation of domestic versus foreign income of corporations. The result has been a desire to stream imputation credits to those most able to use them, essentially resident investors. However, increasingly complex tax measures have been adopted to prevent almost all forms of streaming of credits. The policy behind these restrictions on streaming has often not been well thought out or explained, at times to the detriment of domestic investors with offshore investments and foreign investors with interests in Australian multinationals.

Current Law and its Problems

The current law is designed to apply a single layer of Australian tax to all income received by resident individual shareholders. This means that a shareholder on the top marginal rate of 47 percent (ignoring the Medicare levy) will pay tax at the rate of 47 percent either at the company level or in the hands of the individual shareholder. Where the income has been earned by a foreign company, no credit is received for the foreign tax paid so the individual will pay a total of foreign and Australian taxes well in excess of 47 percent. If the foreign tax rate is 30 percent and there are no withholding taxes, the total amount of tax will be 63 percent. For non-residents, the total amount of Australian tax can vary. For a dividend out of fully taxed domestic income, the maximum amount of tax is 30 percent. For unfranked dividends, the maximum is 15 percent, payable as a withholding tax. However, if the dividend is from foreign sourced dividends paid through a so called Foreign Dividend Account (FDA), the rate of Australian tax can be zero.

The operation of the franking account and the FDA are such that dividends cannot be streamed to resident or non-resident shareholders in a favourable manner from these accounts. The result is that as an Australian company increasingly receives income from offshore, this increases the overall level of taxation on resident shareholders, although it may not have any significant impact on foreign shareholders. It is possible to implement schemes, known as stapled stock arrangements, whereby foreign shareholders take their dividends from a non-resident company. While this provides benefits to the foreign shareholder albeit with considerable complexity, it still does not assist the resident shareholder as a debit is still made to the franking account.

The problem with the current law results from this uneven taxation treatment. Because resident shareholders face a higher rate of tax by investing in Australian based multinationals, they are more likely to direct their investments towards other assets, most notably companies with less reliance on foreign source income, conveniently referred to here as domestic companies. Some would argue that there is nothing detrimental about such an arrangement as it encourages Australians to invest domestically and create Australian jobs, leaving non-residents to fund the offshore expansion of Australian companies. However, such an attitude ignores the fact that because of the small size of the Australian market, compounded by competition policy considerations, Australian companies with particular expertise can only fully exploit that expertise by expanding offshore. If Australian investors are dissuaded for tax reasons from investing in Australian companies expanding offshore, these companies will eventually have a preponderance of offshore investors and it will be inevitable that they will cease to be resident in Australia. This must eventually be contrary to Australia's longer term best interests, politically, culturally and economically.

What solutions should be considered?

The problem can be resolved in a number of ways, but it is important to understand the nature of any solution. The problem amounts to excessive taxation of foreign source income to Australian residents. In the broadest possible terms, the problem can be overcome by reducing the rate of taxation on such income. This can be achieved in a number of possible ways:

1. Reduce the personal taxation rate applying to all dividend income but not necessarily to labour income. Such a dual rate system has become common in other countries and reflects the fact that capital is more mobile and investors are likely to respond to high rates of taxation by moving the capital to other jurisdictions;
2. Remove imputation and move to a dual rate system similar to that in place in the UK. Despite the apparent opposition to this approach in the Consultation Paper, it can actually be designed in such a way that it delivers many of the favourable features of the existing imputation system;
3. Provide notional credits for dividends paid out of foreign source income, along the lines of Option 2.1 A in the Consultation Paper but at a higher rate than one ninth; or
4. As a much less preferred option, provide imputation credits for foreign dividend withholding tax paid (Option 2.1 C of the Consultative Paper).

None of the possible options, if adopted, should preclude also applying Option 2.1 B for reasons discussed further below.

The first option directly addresses the problem of high taxation of the income from capital by proposing reductions in the tax rate on all dividends. This may appear to be outside the scope of this review but it points to the fact that the domestic and international tax systems are closely interrelated. Many countries have now moved in this direction even where it has been impossible to lower the top marginal rate on other income. It is an option that should be seriously considered in the Australian context.

Of course, reduction of the tax rate on all dividends will not remove the bias with the imputation system unless the rate of tax on dividends is reduced to zero. This may not be feasible with current budgetary constraints and hence we consider other options below to assist with the bias problem.

The second option involves substituting the imputation system with a dual rate system, which involves lower tax rates on dividends and the provision of notional credits on all dividends. This would be similar to the UK system, which was introduced in the late 1990s to address the same issues currently facing Australia. The result would be a maximum tax rate on all dividend income no higher than the rate of 47 percent delivered by the existing imputation system. Taxpayers on lower marginal rates would not pay any additional tax on dividends and could receive credits to offset against other income (but without refunds). Thus, the system would not involve "double taxation" in the sense that was usually implied before imputation was introduced. It would achieve this result in a way that would be far simpler than under the existing imputation system. While we do not believe that a review of imputation can be achieved in the time available for consideration of international tax reform, we encourage further debate on whether imputation continues to be the best system for taxing income earned through corporate investments.

The first option that could realistically be considered in the time available is Option 3 above. This is very similar to Option 2.1 A in the Consultative Paper but with a higher notional credit than one-ninth. This option is in the right direction for removing the bias between the taxation of domestic and foreign source income. However, a higher rate of credit is required to remove the bias. The credit would need to be in the range one-quarter to three-sevenths (equivalent to 20 percent to 30 percent of the grossed up dividend) to achieve the desired result.

A credit of 30 percent may be seen as high when compared to the franking credits available under the imputation system. While the maximum franking rate is currently 30 percent, companies will often generate some tax preferred income which, if distributed, could not be franked. This is likely to be of less significance going forward since allowable rates of depreciation for plant and equipment have been brought closer to economic depreciation. Thus, while a credit rate of less than 30 percent may be defensible, it should not be much less.

The final option is not a realistic solution to the problem. At best, it is a partial solution but it is of less importance as withholding tax rates are likely to fall in our double tax treaties following the success with the US treaty. Moreover, some countries do not levy withholding tax and hence this option will be of no benefit.

What evidence is there of the problem?

It is very difficult to find hard evidence of how the problem is affecting Australian companies and investors. Some of the problems that would be expected to arise include the following:

- A tendency for Australian shareholders to divest interests in Australian multinationals and invest instead in domestic companies;
- A tendency for Australian companies to move offshore;
- An increase in the cost of capital at least for the newly emerging Australian multinationals.

There is a certain amount of anecdotal evidence on each of these points but not a lot that might be seen as definitive. A paper by Hathaway and Officer (a copy can be provided) did point to a tendency for Australian investors to lean towards holding equities in Australian domestic companies. Results published by a number of researchers have pointed to the fact that imputation credits increase the value of equities, a result that would not be consistent with a view that the cost of capital in a small open economy is determined by global capital markets rather than by Australian investors. The reason for this outcome is that there are information asymmetries in financial markets which means that residents and non-residents will value Australian companies differently. As a result, Australian companies will find their cost of equity rising as the extent of their investment offshore increases.

The view of analysts is that imputation does influence portfolio decisions of investors and the value that they place on equities. This, combined with the body of research literature on the issue, seems to provide enough evidence for the matter to be a concern for policy makers. Policy makers in many other countries have been convinced that high and uneven taxation of income from capital causes economic problems, despite the conclusions that may be drawn from purely theoretical models.

How does the problem/solution relate to other options in the consultation paper?

There is a close relationship between some of the issues associated with conduit investments and the issues discussed here. The existing treatment of conduit income flows when there are also Australian shareholders increases the taxation rate of resident investors in Australian multinationals. Thus, Option 2.1 B in the Consultation Paper is related to this problem.
If any of the options outlined above are adopted, the issue of streaming will become far less important. Resident shareholders will be less concerned with whether they receive a franked dividend or a dividend from foreign sources so there will not be the same incentive to stream franked dividends to resident shareholders. As a result, it would be possible to remove many of the current restrictions on streaming, resulting in considerable simplification of the law.

Companies may still elect to do some streaming, particularly to direct the benefits of foreign tax systems to foreign shareholders. Thus, stapled stock arrangements may continue to be favoured by corporations. It is important that all restrictions that currently make stapled stock arrangements unattractive be removed. This would ensure that if such arrangements are seen as attractive to foreign shareholders, then the Australian company would be in a position to deliver the benefit to those shareholders. It should be possible for this to occur without detriment to the Australian shareholders. The current treatment, whereby the payment of a dividend from a foreign company would still give rise to a debit to the franking account as though a dividend had been paid from the parent company, has little justification and only serves to increase the level of taxation for both resident and non-resident shareholders in a way which can only be detrimental to Australian multi-nationals.

What priority should be given to resolving the problem?

The AICD is of the view that removal of the bias and the reduction in the overall taxation of income from capital represents the prime issue to be addressed in the reform of the international tax system. If this matter is not addressed, it will continue to fuel debate over the extent to which the tax system is discouraging investment in Australian based multi-nationals. Most European and Asian jurisdictions have dealt with this dual problem either by lowering the taxation of dividends or eliminating imputation or a combination of both. Ultimately, we believe that Australia will have to address it in this way as well. It is important that as part of this review, substantial progress be made on resolving the problem.

3. Chapter 3: promoting Australia as a location for internationally focused companies

Controlled foreign company (CFC) rules

Current law and its problems

A number of developed countries have anti avoidance rules designed to prevent resident taxpayers from hiding income in lower taxed foreign jurisdictions. Australia has a number of these measures and they are generally referred to as the "Anti-Tax Deferral Rules".

The anti –tax deferral Rules are made up of the Controlled Foreign Companies (CFCs) measures, which also cover trusts and partnerships, Foreign Investment Fund measures (FIFs), transferor trust and other related trust measures.

The purpose of these measures is to prevent Australian taxpayers avoiding Australian tax on income accumulating in foreign companies or trusts in low tax foreign jurisdictions. They achieve this by attributing back to Australian taxpayers, accrued profits in such entities, where the profits have arisen from passive or other prescribed activities and have not been distributed to Australian shareholders. The attributable taxpayers would include shareholders of an Australian company with a foreign subsidiary or Australian beneficiaries of a foreign trust.

These measures were originally enacted more than a decade ago at a time where there was little understanding at the policy level of the extent to which such measures were desirable. They are well overdue for a major review based on a decade of experience. Over the last ten years Australia' transfer pricing compliance program has vastly improved leading to some overlap in the policy objectives of both measures. The measures are overly complex, designed in a different business era and are consequently out of step with modern business practices. The tainted services income rule is a specific example of legislation measure vastly out of step with advances in the way global organisations now conduct their business activities and the growth of service income with the expansion of outsourcing of services.

A partial review of the CFC rules was undertaken in 1997, but this gave rise to further complexity in their application and increased the compliance burden on business. The CFC, FIF and Transferor Trust regimes overlap and lack symmetry in the way they are applied These rules are applied indiscriminately to both large and small Australian based investors with scant regard for the disproportionate compliance costs for small business.

What Evidence is there of the problems?

Our understanding is that there is already a fairly extensive list complied, identifying the issues in this area by the National Tax Liaison Group Foreign Source Income Sub-Committee[1].

A priority for our members, a large proportion of which are Directors of small Businesses, is to simplify these measures. It is already widely acknowledged that they are overly complex and this is also admitted in the consultative document[2]. Our members would be more inclined to commence or expand their international dealings, if the taxation arrangements under which they must operate were easier to comprehend and less costly to comply with.

How does the problem/solution relate to other options in the consultation paper?

Option 3.9 in the consultative paper provides for an exemption for foreign non-portfolio dividends Australia companies receive and for limited foreign branch profits. This would enable a major simplification of CFC legislation. This measure would mean Companies would not need to maintain records of exempting receipts or attribution accounts. sSection 47A, a very complex provision, could also be abolished. This initiative would contribute to enhancing Australia as a location for conduit investments.

Solutions and Priority

The list of measures requiring review in the CFC area is long and complex. The provisions were drafted in the late 1980s at a time when the underlying policy was in a state of considerable flux. Changes since then have done nothing to improve the clarity of the drafting. Both the underlying policy and the drafting need to be revisited in order to arrive at a set of provisions that achieve the policy goals that Australia should have in this area. Thus, we believe that high priority should be given to option 3.4 but with the emphasis being on a major rewrite of the provisions.

This rewrite would need to take into account a number of matters;

- It should be acknowledged at the policy level that the CFC and FIF measures are anti-avoidance measures and not general taxation measures. This will help ensure that the measures are designed to meet their specific policy intention;

- If option 3.9 is adopted, considerable simplification of the underlying policy could be achieved, thereby providing a further basis for a major redrafting of the provisions;

- Priority should also be given to amending the tainted service income rules (option 3.2). At present, there is a considerable bias against services compared with goods in

[1] Michael Dirkis-Taxation Institute-International Masterclass 14 October 2002
[2] Page 34 Australia as a location for Internationally focused companies

the CFC rules. The only justification for this uneven treatment was that the transfer pricing rules were inadequately enforced in the late 1980s and it was thought that companies could more easily shift income off shore by the use of intercompany services. This argument is no longer valid;

- As a further extension of the previous point, consideration should be given to at total review of the tainted services and tainted sales definitions so as to narrow the scope of this provisions considerably;

- The broad exemption country list could be expanded beyond the present list of seven countries. The only common characteristic of these countries is that their tax systems have a certain level of integrity. The same would apply to a considerably longer list of countries, particularly those countries with which Australia has double tax agreements;

- Consideration should also be given to exempting from attribution income earned in any of the broad exemption countries.

As noted above, there is an extensive list of other issues that require review in the CFC area. We believe that if a significant number of these issues were addressed, a total review of the legislation would be justified. It is inevitable that when changes are made to an existing piece of legislation, the drafting becomes even more convoluted. The existing CFC provisions are already complex and would be verging on unintelligible if changes were made to the provisions without going to the underlying problem, namely one of legislative design.

Conduit Income Arrangements

Current law and its problems

A key area for reform relates to the issue of conduit investment, whereby foreign investors through an Australian resident company, undertake offshore activities. Currently the tax system attempts to deal with these cases by the use of foreign dividend accounts. These aim to provide partial relief from the multiple layers of taxation that can apply to foreign source income. However, they only do this where the dividend being paid to a non-resident would be unfranked. As soon as the dividend is partly franked, the measure does not work effectively. Thus, the measure may work where a resident conduit entity is 100% foreign owned and has a 100% non-resident subsidiary. However, where the resident also earns domestic income and has Australian shareholders, the measure breaks down.
Attention also needs to be given to the so-called triangulation cases, essentially with New Zealand. Australia and New Zealand have similar tax systems but Australian companies are not able to provide franking credits to Australian shareholders for income tax paid in New Zealand. The same also applies in reverse. New Zealand has been keen to develop a solution to this for several years and Treasury officials of both countries have developed a draft paper on the issue. The matter now needs to be resolved in the context of the Review of International Taxation to remove an impediment to the smooth flow of investments between Australia and New Zealand.

Australia seems to lack the ability to attract and retain International holding companies, or regional headquarters, despite Australia's apparent attributes in terms of lifestyle and political stability. Whilst Australia has a headline 30 % company tax rate its effective rate is not so competitive due to adverse capital allowances (depreciation rates). The scope of our taxing provisions and their complexity for a small country is of major concern.

Australia's CGT treatment also discourages the use of Australian based subsidiaries as regional holding companies and this also limits the attractiveness of Australia as the base for regional headquarters. The application of Australia's capital gains tax rules in these cases needs to be reviewed as they act as a direct impediment to any international company from locating here.
Non residential subsidiaries of such holding companies will be subject to Australian CGT on disposal, even when there may be a majority of shares held by foreign shareholders in the holding company. The treatment of capital gains in these circumstances varies considerably around the world and in many countries inbound investors are not subject to capital gains on business assets. Many countries such as the Netherlands, Belgium, Germany and the UK have introduced special measures called "participation exemptions" where the disposal of shares in a subsidiary where the foreign investor has a substantive interest are exempt from CGT either partly or fully

Other aspects of the Australian tax system also act as a disincentive, including the operation of the CFC provisions, the lack of certainty in what is required under the transfer pricing rules, high rates of withholding tax under many of Australia's DTAs and the overall complexity of the tax system.

What evidence is there of the problems?

Professional advisors would generally recommend to foreign multinationals that they not structure investments so that foreign subsidiaries are held by an Australian holding company. The operation of Australia's CGT provisions in these circumstances could add substantially to the taxation burden of such a structure. The result is that Australia misses many opportunities to locate a regional headquarter or holding company. In a significant proportion of cases, this probably means that it misses out on being the location for regional management or back office activities.
The problem with conduit income flows where there are both resident and non-resident investors has been discussed above in Section 2. The operation of the foreign dividend account, the imputation system and the anti-dividend streaming rules result in complexity, higher taxation for resident investors and possible higher taxation for non-residents. The evidence for this is similar to that discussed in Section 2.

Solutions and Priority

The solutions to these problems are apparent from the above discussions. The solutions are interrelated in that if one part of the problem is resolved but another left untouched, there will be no increase in conduit investment in Australia. In particular, if the CFC rules are corrected but no changes are made to the CGT provisions, the overall impact will be close to zero.

With this provision in mind, the AICD recommends the following changes:

- Australia thoroughly review the impediments caused by our current tax system to conduit investment, particularly in relation to regional headquarters. This review should include the operation of the FDAs, CGT provisions and CFC rules

- in particular, aspects of the CGT provisions be reviewed to limit their operation in the case of foreign investors where the investments are in business activities and where there is majority foreign ownership

- develop workable arrangements for triangular cases whereby imputation credits originating in Australia and New Zealand can be recognised by the tax system of the other country

- Australia continue to renegotiate its DTAs as rapidly as possible to achieve substantial reduction in the taxation of cross border transactions

- changes be made to some aspects of the system of capital allowances and amortisation of goodwill to provide greater encouragement to inbound investment

Determining the place of residence of companies

Current law and its problems

At present the Australian tax law contains two tests of residence for corporations, one relating to place of incorporation and the other to place of central management and control. The latter gives rise to difficulties where corporations are operating as part of a global business whereby foreign operating or holding companies may have Australian based management participation. Because central management and control is a common law test its scope is very broad and imposes a limitation on companies, which are genuinely carrying on business outside Australia.

With the use of modern technology eg video conferencing, e-mail, Internet, it is increasingly possible to participate in management from anywhere in the world. It is unreasonable to expect that the use of these technologies alone would give rise to CM&C problems. Australia should legislatively limit the scope of the central management and control test to avoid the most common problems encountered. The mere participation of a board member in Australia via video conferencing may trigger a central management and control issue and give rise to all of the foreign company's income being taxed in Australia.. Australia would not be endangering its taxing rights over what is genuinely Australian source income by this change as there are other key aspects of the tax system which cover this, including source rules, CGT, CFCs, FIFs and transfer pricing.

What Evidence is there of the problems?

This issue is of major concern for many substantial Companies with subsidiaries or interests in entities situated offshore. Professional advice has been given that they run the risk of their overseas operations been deemed to be based in Australia, by virtue of the Australian Chairman and/or a significant number of Australian Directors participating in overseas convened board meetings, via a medium such as video conferencing, whilst physically in Australia.

Solutions and Priority

The central management and control test should be legislatively limited to avoid the common problems currently encountered as outlined particularly through the use of modern technology. AICD view this issue as a major priority.

4.Chapter 5: Improving Australia's Tax Treatment Of Foreign Expatriates

Current law and its problems

It has been recognised that the Australian tax system imposes significant impediments to Australia becoming truly competitive internationally, without reforming the way expatriates are taxed when working temporarily in Australia. The Government in its White Paper "Securing Australia's Prosperity" has acknowledged these difficulties. In this paper, they proposed to enhance the tax exemption available for foreign income and capital gains and losses of assets not having the necessary connection with Australia, other than portfolio interests in Australian publicly listed companies. The exemption was also planned to extend to the "FIF" rules.

Changes to the expatriate tax rules were initially introduced into Parliament as part of Taxation Laws Amendment Bill (No. 4) 2002 ("TLAB 4"), and were intended to apply from1 July 2002. However, the Senate rejected the amendments. Some of these changes have now been reintroduced into Parliament as part of T Taxation Laws Amendment Bill (No. 7) of 2002 ("TLAB 7"). However, it appears that some of these measures will again be rejected by the opposition parties in the Senate.

The rejected provisions aimed to exempt expatriates on Australian assignments of up to four years of being taxed on:

- foreign sourced income
- discounts on shares and options in an employee share scheme
- capital gains and losses from sales of assets that do not have the necessary connection with Australia

Other changes included allowing temporary residents to access their superannuation entitlements provided they have permanently departed Australia, but the payment were to be subject to a 30% withholding tax.

Although the above mentioned proposals went a fair way towards eliminating some the hurdles, the proposals did not go far enough, in that they do not address the non-deductibility of payments made by the Australian employer, to the overseas employer's superannuation/retirement funds, and also did not address the issue of payments to offshore health insurance.

The area of expatriates returning to Australia and allowing their overseas superannuation entitlements to be repatriated is also overly complicated and inequitable. This area also requires review and simplification.

What Evidence is there of the problems?

Impact on Australian Employer

Residency of Expatriate

Apart from the adverse tax impacts on the visiting executives, the Australian Tax system also significantly adds to the cost and compliance associated with employing overseas personnel.

One of the main concerns involves correctly identifying how the incoming executive will be treated for Australian taxation purposes, as this will also determine the level of taxation to be applied to the various benefits provided to the overseas executive. The question of determining residency and hence the appropriate tax consequences of the various payments is not clear and is made more difficult by the Australian Taxation Office's ("ATO") attitude in protecting the revenue at all costs. The test should be factual and simple to apply.

Taxation of Benefits

Typically, an overseas executive receives the following types of benefits:

- Housing
- Cost of living assistance
- Tax equalisation
- Home leave
- Children's education
- Spouse/Partner assistance

The above benefits would involve an annual cost, per expatriate, in excess of $110,000, excluding relocation costs for the expatriate and their family. Fringe benefits Tax, or additional tax equalisation payments would add approximately 50% to the cost if the executive were considered to be Living Away From Home, otherwise the additional tax would effectively double that annual cost to the Australian employer.

In addition to the above, health insurance and compulsory superannuation contributions, are also met by the Australian employer. Although the issue with compulsory superannuation contributions appears to have been addressed by recent bilateral agreements with a few counties, including the United States, it is not clear when these arrangements will be extended to other OECD and trading partner countries. Further, it is not clear what criteria will be used by the ATO to determine the eligibility of the superannuation contribution exemption.

In order to ensure that Australia attracts the appropriate overseas talent in the scientific and commercial fields, it is important that due consideration is given to reducing the tax burden on the expatriate and the local entity employing such persons. Further, it is necessary to ensure that the tax rules are clear and flexible so as to ensure maximum benefit is obtained from attracting overseas expertise at the lowest possible cost

Solutions and Priority

The AICD believes the following options not put forward in Chapter 5 should be adopted :

- the re-introduction and adoption by Parliament of the expatriate rules included in TLAB 4 of 2002 and TLAB 7 of 2002. ***(No.7) 2002***.
- simplification of the taxation rules relating to expatriates, including the treatment of all expatriates as Living Away From Home, for assignments of four years or less. Rules;
- allowing Australian employers to deduct expenses in respect of payments made to eligible overseas pension or retirement funds operated by the overseas employer
- an exemption for expatriates from the Superannuation Surcharge
- an exemption for expatriates from the Health Insurance levy, or alternatively it should be creditable
- a fairer and simpler approach to addressing returning expatriates overseas superannuation entitlements is required.