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The International Taxation Project
Board of Taxation Secretariat
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PARKES ACT 2600

31 October 2002

Dear Sirs

Submission on Review of International Taxation Arrangements

Introduction

PricewaterhouseCoopers welcomes the consultative process in relation to the review of certain aspects of Australia's international tax arrangements. In this submission we respond, briefly, to the options put forward in the Treasury consultation paper "Review of International Taxation Arrangements" released on 22 August 2002.

PricewaterhouseCoopers is the largest professional services firm in Australia and has over 100 partners and over 700 staff in its Australian taxation services business. Our clients range from small and growing enterprises through to the largest multi-nationals. We have specialist groups focussing on international tax matters, the funds management industry, and expatriate taxation (amongst others). The views set out below reflect that expertise and some of the issues we encounter in practice with our clients.

We have commented below on the general framework of the review and specifically issues which we consider ought to be addressed but which are not, as we understand it, within the current scope. We have then addressed each of the chapters in the consultation paper in the order in which they appear. Our comments on the options in the consultation paper are brief where there is focussed debate through various industry bodies.

General Comments on the Review

Whilst the issue of a consultation paper prepared by Treasury is welcome in moving the debate forward on Australia's international tax arrangements, there are important issues at stake which are either not addressed by the paper or which appear to be outside of its scope. Particular issues of concern in relation to these issues, and some of our views on the approach the Board should take in moving forward, are as follows:

- The paper, and therefore the options, tend to focus on short term amendments to the law and short term design change rather than a review of the overall framework which if approached properly would ensure another review of this type would not be needed for some time.

- No reference is made to the important work of the Review of Business Taxation ("RBT") in 1999, for example recommendations in relation to legislation and design principle,s and no recognition is provided of the 50 recommendations that were made by the RBT in relation to international tax issues. We estimate that only 10 of those 50 recommendations have actually been implemented, and 9 of those 10 were all in the area of thin capitalisation. Much of the analysis in the consultation paper, and much of the focus of interested parties in the debate over the last few months, has very much been a repetition of the work that was completed in 1999. We would therefore urge that the Board revisit the RBT framework and recommendations in drawing up its report to Government.

- A number of the options are incompatible, either directly or implicitly, and they would not seem to be able to be implemented with any degree of coherence. In its report to Government, we would urge the Board to provide recommendations that draw together the diverse aspects into a coherent package.

- There is insufficient focus on underlying policy themes that are relevant to this century, and modern business. There is an implicit acceptance that the frameworks of certain parts of our international tax arrangements are, by the mere fact that they are in place, valid. There is no critical assessment of these frameworks, such as the controlled foreign companies regime, to assess whether they are a sound platform upon which to consider change. We strongly urge the Board to consider, perhaps in the context of option 3.9 of the paper, establishing a framework for a coherent review of the CFC and FIF measures over the following 12 months.

- A number of the options presented in the paper are no more than technical amendments to existing law. This, together with the lack of any reference to the problems with the CFC regime that have been acknowledged as between industry, the ATO and Treasury, in our view means that the Board should consider recommending to Government an administrative process that ensures that technical corrections are dealt with on a timely basis. If technical corrections and minor policy issues were dealt with in an appropriate timeframe a review of this nature could rightly focus on long term policy objectives.

Chapter 2: Attracting equity capital for offshore expansion

We note that the paper suggests that it is necessary to further consider the effect on Australian companies of the apparent dividend imputation bias at the shareholder level. We have not addressed this issue in our submission in the knowledge that business groups and companies will be providing detailed analysis and information in relation to this.

Three alternative options are presented for consideration in the paper, options 2.1 A to C.

We concur with the suggestion in the paper that option C provides limited ongoing benefit given the preponderance of investment by Australian companies into businesses in jurisdictions which either do not levy a withholding tax (eg the UK) or in circumstances where withholding tax is likely to be eliminated through a double taxation agreement (eg the USA).

Options A and B, in our view, have merit although their impact would appear to be quite different as between different companies and shareholder groups. Both options would be of benefit to companies, we would expect, in attracting equity capital and therefore ought to be assessed quite closely. Both options A and B should be able to be implemented relatively simply, without disturbing the existing imputation framework.

Given that options A and B would impact on different companies in different ways even a combination of them is only likely to mitigate against any bias at the shareholder level, rather than eliminate it.

An alternate approach would be to pursue some form of extended dividend exemption mechanism in relation to foreign sourced dividends.

In our view the Board should consider a recommendation to Government that a combination of options A and B, or an exemption model and option B be pursued.

Promoting Australia as a location for internationally focussed companies

The controlled foreign companies rules ("CFC")

There is still, some 12 years after this law was introduced, some confusion over whether its purpose is to ensure all income derived by controlled offshore entities is subject to a level of tax comparable with Australia's, or whether the purpose of the regime is more properly described as directed at targeting passive income sheltered in low tax countries in the pursuit of avoiding Australian tax. This fundamental question directs the whole framework of our CFC rules.

CFC rules were introduced when Australia's transfer pricing regime was not as clearly effective as it is today, and when the competitive pressures faced by Australian based multinationals were arguably not as acute as they are today in the global economy. For these two reasons alone the case for a policy driven review of the CFC measures is clear.

The four options presented in the paper in relation to the CFC rules (option 3.1 – 3.4) comprise an uncomfortable package of two proposals targeted at clear inequities in the current system that inhibit business competing effectively offshore, one option seemingly designed to target simplicity and compliance costs, and finally a "catch all" option directed at identifying technical and other remaining policy issues.

Australia's CFC regime is amongst the most complex in the world. Given the challenges that Australian companies face in competing with, for example, US or European based multinationals, the sheer complexity and inequitable outcomes in many areas are a serious disadvantage.

As the Board is aware, professional bodies and the ATO and Treasury have been aware for many years of a range of problems with the CFC rules. These are recorded in a register and have been subject to discussion at the NTLG FSI subcommittee meetings. The fact that many of these issues have been aired as between business and Government for close to ten years is evidence of the desperate need for a sound process of "care and maintenance". To illustrate the issues, option 3.1 which suggests improving rollover relief concessions under the CFC rules, focuses on an issue that was raised some 7 years ago in the FSI subcommittee.

It is our view that whatever the outcome of this review process one recommendation of the Board should be that a clear and reliable process exists for speedy resolution of inequities and technical problems.

Options 3.1 and 3.2, which target improved rollover relief for corporate restructuring and the tainted services income rules are well overdue. Whilst there are many solutions to these two problems, simplicity and equity are key and therefore one approach would be as follows:

1. In relation to rollover relief to simply exempt from the CFC rules any gain arising to a CFC on a disposal of a non-portfolio interest in a non-resident company with underlying active assets in pursuit of a corporate reorganisation, merger or demerger. A blanket exemption could apply to all forms of broad exemption list ("BEL") country rollover.

2. Tainted services income ought to be redefined so that it only applies to services provided by CFCs to related party Australian residents. Transfer pricing mechanisms, and other aspects of the CFC regime, are sufficiently robust to deal with any ancillary revenue leakage this type of approach might present.

The current list of BEL countries is clearly out of date. There are examples of robust tax systems existing in countries that are in effect treated as tax havens under the CFC rules. The approach to be taken in categorising countries as benefiting from some form of broad exemption, such as the BEL list, needs to be developed in light of broader policy objectives. Given that this option (3.3) is, however, put forward in the context of the timetable of the Board to 31 December 2002 we would suggest that new criteria for the exemption process be recommended, pending a broader CFC review. A useful criteria for assessment might be, for example, whether the country concerned taxes business income at no less than 80% or 90% of the Australian rate. This type of approach might well be more agile in determining broadly comparable tax jurisdictions than any other type of arrangement.

Option 3.4 seeks views on whether a process should be established to identify technical and other remaining policies and how they might be resolved. As discussed above, there are a range of issues well known to Government and taxpayers that have caused frustration for years. Given the existence of these, and potentially many others that have not been presented to the FSI subcommittee (which has only met twice in the last two years) it is surely time to seriously consider a broader reform package to see whether there is a CFC framework that can be identified that is not prone to the types of uncertainties and inequities that have subsisted for the last decade.

We would urge the Board to seriously consider a reform process, and recommending to Government a framework including a timeline, the steps that would need to be taken in identifying broad policy settings, establishing alternates and consulting with business and other interested parties.

Modernising Australia's tax treaty network

Treaty policy has long been a mystery to many businesses, and indeed advisers. The proposal for open consultation on this is therefore welcome (option 3.8).

The Board should, in our view, recommend to Government a clear framework for consultation on treaty renegotiation, and should set out for the Government the parameters for a review, and rewrite, of Australia's "model" treaty approach (option 3.7). We do not consider that it is necessarily the case that the recent US protocol should be a blueprint for future negotiations, although a drive towards zero withholding taxes on interest and royalties would be welcome (option 3.5).

The RBT proposal, to apply CGT to interposed non-resident entities should not in our view be implemented (option 3.6). The policy is fundamentally flawed, impracticable to apply and a disincentive for inbound investment.

The treatment of foreign or non-portfolio dividends at the company level

The paper suggests that one option to deal with various compliance and complexity issues would simply be to abolish the "lists" and exempt all non-portfolio dividends received by Australian companies (option 3.9). An initiative along these lines would be a significant change to the underlying international tax framework in that it would result in taxation on overseas activities at the corporate level being limited to overseas taxes (in the absence of attribution under the CFC rules). An initiative such as this is welcome and could result in repatriation of significant profits from offshore. In taking this option forward, however, the Board should in our view fully assess the interaction with other parts of the package.

Improving conduit income arrangements

In our view there is no doubt that whilst the Australian tax system imposes taxation on income or capital gains derived from foreign sources that is in effect passed through to non-residents, Australia will continue to be an unattractive location for holding companies.

This issue must not, however be confused with measures which might attract companies to establish regional headquarters and other similar activities in Australia giving rise to jobs and general wealth creation. Whilst the RHQ matter has been considered a number of times in the past[1] the economy has changed significantly since those earlier reviews and we would suggest the Board initiate a process to revisit the conclusions drawn at that time.

From a policy perspective the paper acknowledges the general policy that tax on conduit income should be avoided, and therefore an extension of the current FDA arrangements to meet with policy goal is sound (option 3.10).

[1] For example, see to NSW Legislative Council Standing Committee on State Development report of October 1996 on Factors Influencing the Relocation of Regional Headquarters of Australian and Overseas Corporations to New South Wales.

The paper sets out a range of difficulties that exist with a conduit holding regime, for example in the context of changing and differing foreign shareholding interests. An alternate approach of a restructure relief is also promoted. We would suggest that this type of approach would introduce unnecessary complexity.

Option 3.11 recites an RBT recommendation concerning foreign income. We support any initiative to implement that recommendation.

Determining the place of residence of companies

The paper usefully canvasses an area of particular concern with the current corporate residency rules. Firstly, companies incorporated outside of Australia can find themselves inappropriately residents of Australia if it is the case that the exercise of central management and control in Australia also amounts to the carrying on of business in Australia. This is clearly inappropriate. Secondly, foreign incorporated subsidiaries of Australian companies have to deal with complex administrative arrangements in order to ensure they are not inappropriately regarded as resident of Australia, for example arranging for board meetings to be held offshore.

We support the suggestion of option 3.12. We consider that option 3.13 requires further consideration.

Promoting Australia as a global financial services centre

We enthusiastically support the stated policy objective of promoting Australia as a global financial services centre.

We note that the consultation paper is somewhat narrowly focused in terms of the issues raised for discussion, concentrating on a number of funds management issues. For example, it makes no mention of the Offshore Banking Unit (OBU) rules, interest withholding taxes or other significant issues raised in the Senate Select Committee report of March 2001 on The Opportunities and Constraints for Australia to Become a Centre for the Provision of Global Financial Services.

In relation to the funds management issues, there are a number of mooted changes to the capital gains tax (CGT) regime which would greatly enhance the attractiveness of Australian managed funds to non-resident investors. The current rules which subject to CGT gains on the disposal of units in an Australian unit trust where a non-resident investor holds 10% or more of the units on issue, while direct investment in the same underlying assets would not be subject to any Australian tax is non-sensical.

Another significant problem for Australian based fund managers is the Foreign Investment Fund regime which is responsible for significant administration and transaction costs which are unnecessary in terms of the overall policy objective. We support the submission of the Investment and Financial Services Association in relation to possible changes to the FIF regime.

Improving Australia's tax treatment of foreign expatriates

The discussion in the Treasury paper concerning the treatment of expatriates is inappropriately brief. Important issues that are not raised for consideration include the following:

The removal of PAYG withholdings for foreign employers.

Most multi-national companies operate comprehensive "tax equalisation" policies when assigning executives and other employees for international duties.

The equalisation policy operates on the basis the assignee is no better or worse off from the home country taxation perspective while living and working overseas. The contractual arrangement effectively places the liability for taxation in respect of the assignee's remuneration upon the employer in the Host Country.

Australian PAYG places an obligation upon the foreign employer to meet the assignee's Australian tax liability at the end of the month in which salary and wages are paid (or earlier), in default of which punitive rules may apply against the foreign employer.

While there are practical ATO jurisdictional and other difficulties in enforcement of the PAYG obligations, it is our experience that multi-national employers abide by the contractual obligations of their tax equalisation policies in any event, and Australian tax liabilities are met in a timely and efficient manner by the employer within the return lodgement system.

The PAYG rules should be reviewed to address the issues faced by multi-national companies doing business in Australia with a view to allowing for the foreign employer to enter into an agreement, consistent with tax equalisation policies, to guarantee payment of the assignee’s Australian tax liabilities in respect of their remuneration and other benefits in lieu of the PAYG obligations. Such an agreement could be entered into, for example, as part of the process for application of a Temporary Residency Work Visa which is ordinarily sponsored by the employer.

Such an agreement would remove the tension which currently exists in multi-national companies through the non-compliance with PAYG obligations.

Taxation of Foreign Pension Transfer to Australia

The recent Senate Report concerning transfer of foreign pension fund monies to Australia recommends, inter alia, that the present deterrent to transferring pension fund monies to Australia be removed (section 27CAA of the Income tax Assessment Act essentially taxes the growth on such monies from the date of arrival of the foreign national into Australia at the top tax rate, and preservation rules largely preclude the individual from accessing those funds to pay the tax liability).

The Report recommends the tax be levied on the recipient Australian superannuation fund (at the contribution tax rate of 15%) and the preservation rules be relaxed to allow the fund to pay the tax.

This recommendation (and others) if legislated, would not only allow the flow of foreign pension fund monies into Australia, it would also assist, in the long term, the permanent relocation of foreign executives and other expatriates who may choose to live and work in Australia.

Option 5.1 raised for reconsideration an RBT recommendation concerning residents departing Australia and security of the deferred CGT liabilities.

At present, resident taxpayers who depart Australia and hold assets 'not having the necessary connection with Australia' ("assets") are deemed to have disposed of these assets at the time they become tax non-residents of Australia. The Capital Gains Tax (CGT) liability is calculated with reference to the market value of the asset(s) on the day residency ceases and the date of acquisition for CGT purposes of the asset. Alternatively, the taxpayer may elect for the deemed disposal not to apply. Where this election is made, CGT is then payable upon future sale of the asset, with reference to the actual sale proceeds.

The recommendation has been made that departing residents provide 'appropriate security' to the ATO in recognition of their potential Australian liability to CGT upon eventual sale of the asset.

As yet, no guidance has been provided on what form 'appropriate security' will take, whether a cash payment, the granting of a right to the ATO over the taxpayer's asset, or other.

If a cash payment were required, the taxpayer would most likely be required to either sell the asset or take out a loan in order to fund the required payment. Either alternative would have negative consequences for the taxpayer reaching beyond the income tax obligations of resident taxpayers. This recommendation would also be a disincentive to expatriates transferring to Australia.

Alternatively, security may be proposed by way of granting of rights over the assets to the ATO. We understand that this is the approach proposed in Canada, to apply only where the estimated CGT liability exceeds $25,000. There are, however, a number of difficulties inherent in this approach, including:

- In many instances the taxpayer will have existing loans against the assets (eg property mortgages, margin lending against a share portfolio), meaning the provision of rights over the asset to the ATO may not always be possible;

- The considerable administrative procedures and cost of legal fees required to facilitate an effective grant of rights, particularly where the asset in question is a foreign asset. Depending upon the jurisdiction in question, rights over the foreign asset may not even be legally enforceable. It is contended the ATO would find it difficult to obtain jurisdiction to enforce its right over many foreign securities;

- Foreign national employees departing Australia after having resided here for longer than five years during the preceding ten year period, would currently be liable to provide the proposed security in respect of assets acquired both before and during their assignment in Australia.

  For departing foreign nationals residing in Australia for less than five years, the proposed security would currently be required for assets acquired during their period of residency. In both cases, it would be expected that the majority of assets subject to the security recommendations would be foreign assets and therefore raise the difficulties as outlined above.

- Further, upon eventual sale of the asset after the expatriate has returned to their home country, it is likely that the home country would also seek to tax the sale (depending on the tax jurisdiction). This will in the case of many expatriates, result in foreign tax credits to offset the CGT liability in Australia arising on the sale of the foreign asset. The work required by the ATO in establishing rights over the taxpayer's foreign assets would not seem time well spent if the only revenue eventually raised, if any, was the difference between the taxpayer's CGT liability in Australia and their related foreign tax credit entitlements.

  Given the new CGT provisions to tax 50% of capital gains would apply at the time of disposal of these assets, it is likely no CGT liability would actually arise in Australia.

- There may be a concern for the administration by the ATO of security provisions. Further on we allude to the continuing existence of section 213 of the Income tax Assessment Act which is a carry-over from the original 1936 Act. We note that provisions in sections 210 and 211 of the 1936 Act which required a "clearance" from the Commissioner prior to departure from Australia were repealed as long ago as 1962.

  In light of all the foregoing, it would seem that there are more reasons now not to introduce such rules than there may have been in 1962.

In our experience, a high percentage of taxpayers breaking Australian tax residency, either for the first time or after an expatriate assignment in Australia, are doing so as a result of undertaking an assignment contract for their employer.

Accordingly, the provision of security will become a corporate issue in accordance with the terms of the employee's assignment contract. If cash security were required, it is likely the employer would have to agree to fund the security payment in order for the assignee to agree to accept the overseas assignment. Alternatively, if security by way of grant of rights is required, it may be viewed by the taxpayer as a considerable disincentive to accepting the proposed assignment.

The negative implications of this proposal for corporations seeking to expand abroad and conduct business internationally should not be overlooked.

There are various alternative proposals. Our preferred approach is:

- Remaining consistent with a globalisation approach, the deemed disposal rule should not apply at all in Australia or if it is to apply, its application should be restricted to Australian assets. Outside of Australia, Canada is the only major economy that has a similar deemed disposal rule. However, developed economies such as in the case of Australia and Canada have encountered practical difficulty in applying these measures and have yet to discover a workable system for these measures. The US, UK, Singapore and Japan do not create tax obligations on unrealised gains.

We recognise that there is an issue of CGT evasion that needs to be addressed particularly in relation to the sale of Australian shares by non-residents. However we believe that withholding tax rules could be used to tax non-residents of Australia at the time of disposal who have made the deemed disposal election and, effectively, elected to have these assets treated as taxable Australian assets. This should be sufficient mechanism to collect Australian tax obligations on Australian based investments. It is noted that the proposed legislation to introduce a category of taxpayer known as "exempt visitors", treats Australian public company shares and units in resident unit trusts held by such exempt visitors, as "assets which have the necessary connection to Australia". This has obvious potential for withholding tax in the future

Other alternative approaches are:

- The UK tax system for CGT. In brief, where a taxpayer is resident for four out of seven years immediately preceding the year of departure and becomes a non-resident for a period of less than five complete tax years, they will be liable for CGT on assets which are sold after their departure, provided the assets were owned prior to departure. Where the sale occurs during a complete year of non-residence, the gain is reported in the first tax return in the repatriation year to the UK. Where the sale occurs during the year of departure, the gain is reported in that year.

- Maintaining the deemed disposal rule for taxpayers departing Australia. However 'exempt visitors,' in accordance with the proposed legislation, should be exempt from the rule in relation to assets 'not having the necessary connection with Australia' which were acquired whilst resident in Australia.

- For those residents for whom the deemed disposal rule applies, the following two rules which are being proposed in Canada might be adopted:

  – A deminimis rule, whereby no security is required to be given if the deemed disposal liability is less than $25,000, though this amount may already be at an unrealistically low level.

- If the departing resident returns to Australia within five years, the security is returned to the taxpayer. It may even be appropriate to extend this rule to a taxpayer who returns to Australia after five years as they will then be in a similar situation to ordinary Australian taxpayers.

- Any changes made due to this recommendation should only be made after all Australia's Double Taxation Agreements have been amended to include consistent and comprehensive Articles to deal with capital gains. At present, many of Australia's Double Tax Agreements were enacted prior to the introduction CGT in Australia and do not adequately deal with relief for double taxation which will often arise on the disposal of assets by individuals who had previously been residents of Australia for tax purposes. Accordingly we would support similar provisions to those recently included in the US/Australia Double Tax Agreement also being negotiated with the other countries with which Australia has an existing Double Tax Agreement.

- Gains in relation to employee share plans and option plans should be specifically exempt from the above rules.

- We make the observation that the Income Tax Assessment Act, as originally enacted in 1936, still contains section 213 which provides for security by "bond or cash" to be provided as a guarantee for payment of tax by persons carrying on a business in Australia for a limited period of time only. We question how effective that provision has been to date (and how relevant it is in a modern society) and how is it administered by the ATO.

Option 5.2 raises the prospect of bilateral treaty negotiation and related changes to domestic law to ameliorate the adverse impact of double taxation on employee share options.

Foreign expatriates may be subject to double taxation on the benefits arising from employee share options. An example is where an employee is issued share options offshore that are conditional on a certain period of service with the employer, part of which occurs offshore and part in Australia. Alternatively, the employee may be issued share options in Australia that are similarly conditional.

In these circumstances, double taxation could arise because countries have different approaches to taxing the benefits arising from these options. Some countries tax the benefit at the time the options is granted, or when the option vests, or when the option is exercised, or when the shares acquired under the option are sold. Some countries may not tax the benefit from the share option separately, but catch it under their capital gains tax provisions. Australia generally treats the benefit or discount on an employee share option as assessable income at the time the option is acquired, although assessment may be deferred for certain 'qualifying' options.

Because of the wide range of approaches that countries have adopted and the need for reciprocity to effectively remove double taxation, it is appropriate to address the double taxation of benefits arising from employee share options on a country-by-country basis through bilateral tax treaty negotiations.

One approach that could be adopted in treaty negotiations is the one the OECD promotes. The OECD approach allocates full residence taxation to the treaty partner in which the share options are exercised. The other treaty partner's taxing right is limited to that proportion of the income or gain on the option which relates to the period(s) between the grant and the exercise of the option during which the individual has worked in the partner country.

This approach is able to deal with residence-source issues where share options are subject to tax in more than one country. However, it does not always appropriately deal with situations where share options are taxed in three or more countries on a residence and source basis. The OECD noted that a solution would be for the competent authorities of each country to agree that each should provide relief on the residence-based tax that the other country levied on that part of the benefit relating to employment exercised while the employee was a resident of the partner country.

In addition to the treaty approach, changes to Australia's domestic tax law treatment of employee share options might also be needed.

Option 5.3 seeks views on whether to proceed with the RBT recommendation to treat ceasing to be an Australian resident as a cessation event for the purposes of Division 13A.

Option 5.3 seeks to subject to tax the value of discounts afforded to an employee (whilst resident) under qualifying employee share schemes in the tax year an employee ceases to be an Australian resident. In effect, this measure intends that ceasing to be an Australian resident for tax purposes should be considered a "cessation time" for the purposes of section 139CB of the Income Tax Assessment Act 1936.

The original recommendation recognises that the implementation of such a measure could cause double taxation and recommends a review of the international taxation issues and the application of Double Tax Agreements (see above).

Temporary Residents of Australia

Employees arriving to work in Australia on a temporary basis ie. for not more than 4 years, often remain in the employee share scheme of the parent company based in the home country. Awards of shares or rights under an employee share scheme may be made for different reasons, depending on the nature of the share scheme in operation. Although the RBT indicates that awards may be made in respect of services rendered in Australia, the RBT ignores that awards are made which are not specifically related to Australian service. Individuals coming to work in Australia often participate in employee share schemes simply by virtue of continuing employment with the parent company in the home country. The foreign parent company may not be able to exclude employees from share plan participation as the company may be required to operate a non-discriminatory scheme. In any event, if an employee participates in a share plan whilst in their home country, he/she usually continues to participate whilst on overseas assignment (which is typically a very brief period of time during the "life" of employment with the home company).

The above recommendation will seek to tax the value of discounts under an employee share scheme in the year of departure regardless of whether the taxpayer can exercise their rights under the scheme. Subsequent to returning to their home country, if and when these individuals exercise their rights, they will also be taxable on the discounts in their home location. This income will often have a home country source which will mean that the taxpayer will not obtain a credit for the Australian taxes paid. Also, it is unlikely that the tax liability will occur in the same year as the Australian liability which may again prevent the taxpayer from receiving a credit in their home country for the Australian taxes paid. The taxpayer will then be faced with double taxation on this income. There is also the added complication that while other countries tax the discount on a source and residency basis, the Australian rules treat the discount as "statutory income which is taxable on a basis other than source" and disregard residency.

Many global companies with international employees operate a tax equalisation policy to protect individuals from adverse tax consequences arising from working outside of their home country. It is likely that under tax equalisation, companies would be obliged to meet the additional tax costs that would arise should the RBT's recommendation be implemented. Further, companies would be obliged to meet Fringe Benefits Tax costs and other associated costs arising from payment of Australian taxes on behalf of employees.

Faced with these significant additional costs of employing a global workforce in Australia, companies may be further disinclined to bring skilled overseas employees to Australia which would reduce those companies' capacity to expand their operations in Australia. This recommendation does not align with the view that foreign employees should be encouraged to work in Australia, to enhance international skill sharing.

Australian Nationals Working Outside Australia

Where an individual accepts an employment assignment outside Australia, it is proposed that any benefits derived from employee share plan participation should be included in the tax return of the year of departure from Australia where the individual ceases to be a tax resident.

As share prices fluctuate unpredictably over time, it is quite possible that tax under this proposed provision may be payable on options that have no value at the time the tax becomes due and payable and/or when the options can be exercised.

It is likely that unreasonable financial constraints will be placed on such individuals who are obliged to pay income tax on options they hold at the time of becoming non resident even though these options are not (and possibly cannot be) exercised at the time that tax is due. Again, under these circumstances, the taxpayer's employer may be obliged to meet the immediate tax costs (plus Fringe Benefits Tax plus associated costs) on behalf of the employee. Under the proposed recommendation, this would occur notwithstanding that the individual has not realised any benefit from employee share plan participation.

Should options then be exercised whilst the individual is offshore, it is likely that there will be foreign tax considerations. At that point, it may be necessary to seek a refund of tax from the ATO which may not be available based on the existing legislation.

In many foreign jurisdictions income tax is imposed at the point of exercise of options. As the Review refers, this will present the potential for double taxation.

We request that you consider our following suggested alternatives:

- It is proposed that for Australian nationals domiciled in Australia who are departing for an employment assignment, an election may be made requiring any discount to be reported at cessation time. Any total benefit derived should then be apportioned for the period the taxpayer held the shares or options and was resident of Australia for tax purposes, and tax should be paid on that portion of the total benefit.

- Temporary residents (resident for a maximum of 4 years who have become resident for the first time) should be exempt from the proposed recommendation if it is to be implemented, provided the individual is participating in a foreign employee share plan of the home country employer.

- It is proposed that this recommendation is held open until the current review of the tax legislation regarding share and options plans is completed.

- Any recommendation should be considered in relation to Australia's DTAs.

- There is one final point that does need to be emphasised. Given the awkward nature of the deemed disposal for CGT purposes and the simple fact that such a taxing event is out of kilter with commercial reality, the introduction of a further "cessation time" on departure from Australia can only exacerbate the present problems. Given also the complexity and the incompatibility of share scheme taxation rules in various other countries, the inclusion of this additional "cessation time" can only add to the amount of work required to renegotiate Double Tax Agreements in this area.

The paper considers whether the ATO should establish a specialist cell to work with employers in relation to foreign expatriate employees (option 5.4). Whilst a co-ordinated approach to dealing with issues would be welcome this must not be at the expense of speed and agility. The terms of reference for such a cell would therefore need to be refined before unequivocal support could be provided.

Should you have any questions in relation to this submission please feel free to contact Ian Farmer on 8266 2802.

Yours faithfully

Ian Farmer
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