



International Tax

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The Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES
ACT 2600

Submission by email to : FBT@treasury.gov.au

Dear Sir or Madam

**Fringe Benefits Tax Reform – Living Away From Home Benefits
Treasury Consultation Paper of November 2011
Wood Group Kenny and Activpayroll International Tax Joint Submission**

We are responding to the Fringe Benefits Tax Reform “Living Away From Home” Benefits Consultation Paper of November 2011. This is a joint submission by Wood Group Kenny and our specialist expatriate tax advisors, Activpayroll Global Employment Solutions Pty Ltd (“Activpayroll International Tax”).

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

As our subsea engineers are all highly specialised workers with a unique skillset, they are greatly sought after around the world by the oil and gas industry and we have to compete with many other countries, projects and competitors to attract these highly skilled workers to come to Australia on 457 work visas.

The Wood Group Kenny companies in Australia employ substantial numbers of foreign nationals on 457 work visas to work in Australia. We note that these workers benefit the Australian economy, both by their services and by the money they spend in this country, and many stay on to become Permanent Residents and citizens of Australia.

Many of these 457 visa employees are currently eligible to receive a tax-free Living Away From Home Allowance (“LAFHA”) under the Fringe Benefits Tax Assessment Act. This LAFHA is to cover their Australian rental and food costs while they are living away from their home country for up to four years. When structured correctly, the LAFHA will also (currently) be exempt from Fringe Benefits Tax (“FBT”).

1. Does a tax problem really exist with excessive LAFHA for temporary residents ?

While we understand from the Consultation Paper that some employers in Australia may be providing excessive LAFHA to a few of their foreign national employees on a 457 visa, the Consultation Paper fails to draw attention to the vital fact that the FBT legislation currently provides an extremely effective remedy against any such “roorting” of the Australian tax system. Namely, that if any employee or executive (whether foreign or Australian) receives excessive LAFHA, their employer currently must (and has always had to) pay FBT on that excessive LAFHA. FBT is a tax on the employer company. While FBT is levied at a notional tax rate of 46.5%, we would point out that FBT is in fact *an effective tax rate of around 87%* as FBT is levied on the *grossed-up* value of the underlying fringe benefit.

For example, where an employee receives a LAFHA of say \$150,000 and let’s assume that say \$100,000 of that LAFHA is excessive or unreasonable, then the employer entity will currently be liable to pay FBT of \$86,920 on that \$100,000 excessive LAFHA. This is an *effective* FBT rate of almost 87% (i.e. $\$86,920 / \$100,000 = 86.92\%$). This has always been the case with an excessive LAFHA.

This effective 87% rate of FBT is an extremely effective mechanism that is currently in place to act against any excessive LAFHA. As a result, we see no need for a blanket cancellation of tax-free LAFHA for foreign national 457 workers as is proposed in the Consultation Paper. The current facts of the FBT system do not warrant such strong action that seems to be strongly prejudiced against foreign nationals and not in the interest of the Australian economy or Australian resource projects.

The remedy to the claimed, anonymous cases of excessive LAFHA is simply for the Australian Taxation Office to audit the relevant companies and levy FBT (plus penalties and interest) on them if those companies have not declared the excessive LAFHA in their annual FBT returns. We are not aware of any companies who pay such excessive LAFHA to their temporary resident employees as shown in the Consultation Paper’s examples. In our experience, and that of our international tax advisors who have assisted us with the preparation of this Treasury submission, such extreme examples of excessive LAFHA do not exist – or if they did, the FBT payable by the employer company will be excessively high so as to eliminate such practice.

2. Will a “level playing field” exist if Treasury’s LAFHA proposals are enacted into law ?

The Consultation Paper states that the Treasury would like to “ensure a level playing field exists between hiring an Australian worker or a temporary resident worker living at home in Australia, in the same place, doing the same job.” (Foreward, p. vii).

However, it appears that Treasury has not considered the many costs that a temporary resident will incur yet that any Australian worker in the same circumstances will not incur. Making LAFHA taxable to the temporary resident will not level any playing field if these other costs are ignored. For example :

- (a) Most foreign national temporary residents working in Australia on a 457 visa are not allowed to use Australia’s Medicare public hospital system or the Pharmaceutical Benefits Scheme. While workers from only nine countries (e.g. workers from Malta and UK nationals who have been living in the UK immediately prior to coming to Australia) are partially entitled to use the Medicare hospital system, we note that most foreigners are not. Workers

from the United States, South Africa, the Philippines, Singapore and almost all other countries around the world cannot use the Medicare system unless they become Permanent Residents or citizens of Australia.

- (b) As a result, without access to the Medicare public health system, most temporary residents working in Australia must therefore obtain private health insurance. This is also a legal requirement under the 457 visa rules. But here again we have no level playing field for the foreigner. An Australian family with two young children will pay around \$150 per month for comprehensive private health insurance with a noted national private health insurer. A foreign family on a 457 work visa but with identical health facts and family ages must pay around \$450 per month for the identical policy at the same insurer. This is three times the insurance premium that an Australian with the same facts must pay. This is a live example using known families.
- (c) A foreign national who is on a 457 work visa must usually pay far higher school fees and university fees for their children than the Australian worker on the same salary who is doing the same job in the office next door to them. This again is not a level playing field and it is prejudiced against the foreigner or temporary resident. School fees and university fees may be twice the cost for the temporary resident than what the Australian next door has to pay.
- (d) A foreign employee on a 457 work visa often needs Foreign Investment Review Board (“FIRB”) approval before they may legally buy a home in Australia. Foreign persons are prohibited by law from acquiring established dwellings for investment purposes – i.e. they cannot use an established dwelling as a rental property and rent it out to others. We note the FIRB website states that “temporary residents can apply to purchase one established [i.e. not new] dwelling to use as their residence in Australia. Approval is usually provided subject to a condition that the temporary resident sells the dwelling when it ceases to be their residence.” We note that no such restriction in buying or selling applies to any Australian worker doing the same job and, in fact, the Australian is allowed to buy multiple, negatively-gated Australian rental properties, offsetting the rental losses against their salary and claiming large tax refunds from the Australian Taxation Office each year. No foreigner is legally allowed to do this. The economic playing field in Australia is clearly stacked against the temporary resident and in favour of Australian workers.
(http://www.firb.gov.au/content/real_estate/residential/developed.asp)
- We note that LAFHA was enacted into Australian law as a tax-free payment for temporary residents for up to four years in order to recognise and reward the fact that temporary residents usually incur great costs and personal discomfort in moving from their home countries to Australia in order to work here for the benefit of the Australian economy. A foreign national and their family on a 457 work visa, such as from the UK, will incur very expensive annual home flight expenses back to the UK in order to see their extended family and friends but an Australian worker will not have to incur these costs. The temporary resident also usually does not know the cheapest places to buy food and the tax-free food component of LAFHA was designed to take this fact into account. The temporary resident sometimes pays to maintain their foreign home while they are here temporarily – the tax-free accommodation component of LAFHA was designed to take this fact into account and to recognise that Australian rental costs are extremely high when compared with rental costs in Europe, the USA and elsewhere.
- Far from being a “rorting” of the Australian tax system, we would point out that the tax-free LAFHA to cover rent and food costs in Australia for foreign workers on a 457 visa was

specifically enacted by the Australian Government. This was enacted into the income tax and FBT legislation in order to attract this valuable pool of skilled foreign workers to Australia by providing a small measure of tax-free remuneration from their employers that offsets some of these high costs and difficulties that these individuals suffer when choosing to come to Australia. We note from our own experience in trying to bring foreign workers to Australia that it is the tax-free status of LAFHA that convinces many of them to accept the role. Many other countries offer similar tax advantages (such as the UK's "detached duty relief" or "temporary workplace rules" for up to 24 months of tax-free food, rental and travel costs) and in our opinion it would be unwise to make Australia less attractive to foreign workers by making LAFHA taxable. There will be a substantial loss to the Australian economy and businesses if many temporary residents leave (by choice or forced by economic necessity) to return to their home countries.

3. Other negative implications to Australian companies if LAFHA becomes taxable

If the Government enacts the legislation to implement Treasury's proposal of taxing temporary residents on their LAFHA, this will have substantial negative cost implications to many Australian businesses, including ours.

For example, a correctly-structured LAFHA is currently exempt from FBT in the hands of the employer company. Any such benefit that is exempt from FBT is also exempt from State Payroll Tax in all eight States and Territories. Where, for example, a temporary resident employee receives say \$60,000 pa as a LAFHA to cover their (and their family's) Australian reasonable rental and additional food costs, this \$60,000 pa LAFHA is not taxable to the employee and is exempt from FBT. As a result, nil State Payroll Tax arises on this LAFHA.

However, from 1 July 2012, when Treasury proposes to tax the temporary resident employee on his or her LAFHA, this will also now trigger State Payroll Tax to arise to the employer company as well. In Western Australia, for example, the rate of Payroll Tax is 5.5%. For this one employee in Perth with just \$60,000 pa LAFHA, their employer will now have to pay an additional \$3,300 pa in WA Payroll Tax. With just 100 temporary resident employees on 457 visas working in Western Australia receiving LAFHA, their employer is now facing an *additional* WA Payroll Tax cost of \$330,000 pa. We estimate this Treasury proposal will cost the average company around \$1 million every three years in additional State Payroll Tax for every 100 employees working on a 457 visa. This is an unnecessary cost burden and will harm Australian companies operating in the resources industry (particularly Western Australia and Queensland) as the Australian resources industry depends crucially on imported, skilled foreign workers on 457 visas - as Australia does not produce enough skilled workers to operate and maintain our vital resources projects.

We also note that many temporary residents on a 457 work visa have been brought to Australia on a *guaranteed net* earnings package. Where the earnings have been contractually guaranteed to the employee (with tax-free LAFHA structured to attract the worker to Australia), and then this LAFHA becomes taxable, the employer must now contractually step in to pay substantially higher salary to the worker to compensate them for their LAFHA becoming taxable. For example, assume a UK national 457 visa employee earns say \$200,000 pa taxable salary plus \$65,000 pa tax-free LAFHA. Using 2012-13 tax rates and bands for ease of comparison, the worker would receive a net pay of \$133,453 pa (after tax and Medicare Levy) plus \$65,000 net LAFHA = \$198,453 pa net cash. If LAFHA becomes taxable to the employee from 1 July 2012 then, in order to meet the company's contractual obligation to that employee (i.e. guaranteed net earnings after-tax of \$198,453 pa), the company will now have to pay that worker a gross salary of \$321,496. The company's direct

remuneration costs will increase from 1 July 2012 from \$265,000 pa to \$321,496 pa. This is an increase in company costs of \$56,496 pa just to cover his \$65,000 pa LAFHA becoming taxable to him. Again, the effective increase in salary costs alone is 86.92% (i.e. \$56,496 required additional gross salary / \$65,000 former LAFHA = 86.92%).

In addition, the company will have to pay extra WA Payroll Tax of \$65,000 pa x 5.5% = \$3,575 pa. This brings the total additional employer cost to 92.4% of his current LAFHA (i.e. \$56,496 pa additional salary plus \$3,575 pa additional WA Payroll Tax = \$60,071 pa total additional costs / \$65,000 LAFHA = 92.4%). Over this employee's four-year assignment to Australia, this taxation of a reasonable \$65,000 pa LAFHA will cost the employer company around \$240,284 in additional unbudgeted costs that cannot be passed on to the company's project client.

4. Actual examples of LAFHA from our own temporary resident employees

If the Treasury proposal is enacted, all expatriates working in Australia on a 457 work visa who receive LAFHA will have a substantially higher tax burden from 1 July 2012 onwards. We note that particularly those on a lower remuneration (\$100,000 pa or less) will struggle to pay their bills as a result. We know that many lower-paid employees at many companies around Australia will leave Australia as a result of their LAFHA becoming taxable as they will simply not be able to afford to live here any longer. We know this from having spoken to many such individuals :

- (a) As our first "live" example, consider a UK-national named Lisa working in Perth, Western Australia on a 457 work visa. She is married with young children and she is the main breadwinner in her family. Her friends and extended family live in the UK and she has no support network in Australia. Lisa's remuneration is \$100,000 pa, which is currently structured efficiently (in line with the Australian Taxation Office guidelines for salary sacrifice) into \$60,000 pa taxable salary plus \$40,000 pa tax-free LAFHA for her Perth rent and food. Currently she will pay \$12,500 pa in Australian income tax (using 2011-12 tax rates and bands, including the 1.5% Medicare Levy and the Temporary Flood Levy).

However, when Lisa's tax-free LAFHA changes back into taxable salary on 1 July 2012 under the Treasury proposal, she will now pay \$26,447 pa in tax (using 2012-13 tax rates). **Her Australian income tax burden has more than doubled**, from \$1,041 pm tax to \$2,204 pm tax, costing her an extra \$1,163 per month in tax. She is not a high-paid executive and she is not "rorting" the Australian tax system by receiving tax-free LAFHA. At her relatively low income level of \$100,000 pa, and being the main breadwinner, the cancellation of her tax-free LAFHA from 1 July 2012 will be a disaster to her and her family. She has said she will not be able to remain in Australia because of the high cost of living coupled with this doubling of her tax burden. She will be forced to leave the country for economic reasons.

- (b) As our second "live" example, consider another UK-national named Phil also working in Perth, Western Australia on a 457 visa. He is married with young children and is also the main breadwinner in his family. His friends and extended family also live in the UK. Phil's remuneration is \$248,000 pa, which is currently structured efficiently (in line with the Australian Taxation Office guidelines for salary sacrifice) into \$180,000 pa taxable salary plus \$68,000 pa tax-free LAFHA for his Perth rent (\$1,000 per week) and food. Currently he pays \$58,300 pa in Australian income tax (using 2011-12 tax rates and bands, including the 1.5% Medicare Levy and the Temporary Flood Levy).

However, when Phil's tax-free LAFHA changes back into taxable salary on 1 July 2012 under the Treasury proposal, he will now pay \$88,867 pa in tax (using 2012-13 tax rates). **His Australian income tax burden has increased by 52%**, from \$4,858 pm tax to \$7,405 pm tax, costing him an extra \$2,547 per month in tax (i.e. \$2,547 additional tax / \$4,858 current tax = 52.4% increase in his tax). He is a reasonably high-paid executive but he is not "rotting" the Australian tax system by receiving tax-free LAFHA for himself and his family.

It is clear from these two examples that this Treasury proposal to tax LAFHA will hit hardest against the lower-paid employees from overseas who can least afford this (and whose tax on average will increase by 100% as a result), not the high-paid executives who are the apparent target of the proposal (and whose tax will generally increase on average only by around 50%).

5. Our recommendations

We recommend that this Treasury proposal to tax the LAFHA of temporary residents is not enacted into legislation as we believe it is counter-productive, will be extremely costly for Australian business, will harm the Australian economy by forcing lower-paid skilled workers back overseas, will hit lower-paid temporary residents hardest (especially those earning under \$100,000 pa whose tax liability will double overnight), and will not deliver its stated policy intent.

Alternately, if it is so enacted, **we recommend** the proposal be amended so that a *de minimis* threshold of tax-free rental LAFHA be provided in order not to penalise lower-paid 457 workers. For example, a rental LAFHA ceiling could be enacted at say \$30,000 pa so that temporary resident workers receiving more than this \$30,000 pa rental cap would be personally taxed only on the excess rental LAFHA above \$30,000 pa. That excess would be taxed to them as taxable salary and would be subject to PAYG withholding. A ceiling of \$30,000 pa equates to \$2,500 per month (or \$577 per week) of rental costs, which is reasonable for the Australian rental market and is not at all excessive. Executives with higher rental LAFHA would have to pay PAYG and income tax on the excess above \$30,000 pa.

The tax-free amount of food LAFHA (based on accompanying family numbers and ages) is already set by the Australian Taxation Office each year and operates as an effective limit of any excessive food LAFHA. There need be no change to this current practice.

This recommendation would enable Australian businesses to attract the necessary skilled foreign workers to come to Australia on 457 work visas while offering them remuneration that is still internationally competitive but at a minimised employer cost and is still reasonable for tax purposes.

6. Conclusion

We respectfully request that you strongly consider these negative implications of taxing the LAFHA of temporary residents on 457 work visas and our reasonable recommendations. There appears to be no need to implement this Treasury proposal when the FBT rules already act to stop any rotting of the LAFHA system. All that is required is more ATO audits of companies that provide LAFHA – this in itself will generate substantial tax, penalties and interest and will ensure that all companies in Australia operate on a level playing field – but without penalising the foreign workers on whom our businesses and economy greatly depend.

Yours faithfully

Robyn Stobbs
Human Resources Manager
For and on behalf of :
JP Kenny Pty Ltd
432 Murray Street
Perth
WA 6000
Email : robyn.stobbs@jpkenny.com.au
Tel. : 08-6314 2900

Andy Carmichael
Senior Manager - International Tax
For and on behalf of :
Activpayroll Global Employment Solutions Pty Ltd
Level 9, 68 St George's Terrace
Perth WA 6000
Email : andy.carmichael@activpayroll.com
Tel. : 08-9488 7400