

Overseas based expats, PAYG and FBT

The Tax Office has issued Draft Tax Determination TD 2010/D1.

It states non-resident employers who employ Australian resident individuals overseas (the individuals provide their services outside Australia) will not have PAYG or FBT liabilities in Australia unless they (the non-resident employer) have a sufficient connection with Australia or they have registered for PAYG.

Is there a sufficient connection with Australia?

A non-resident employer will have a sufficient connection with Australia if it:

- ▶ carries on enterprise or income producing activities in Australia; and
- ▶ has a physical business presence in Australia - may include having an office, business operation, trading presence and employees in Australia.

In these circumstances, the non-resident employer is obliged to withhold PAYG from salary and wages paid to an Australian resident employee for work performed overseas.

The non-resident employer will also have an Australian FBT liability in respect of fringe benefits provided to the employee.

The Tax Office has stated that a parent company, a subsidiary or an associated entity of a non-resident employer may provide the non-resident employer with the requisite physical presence in Australia if the entity in Australia:

- ▶ carries on the Australian business of the non-resident employer; or
- ▶ is an agent of the non-resident employer.

However, a non-resident employer will not have a physical presence in Australia if it:

- ▶ merely has Australian clients without any office or employees located in Australia; or
- ▶ only owns real estate or other investments in Australia.

In these circumstances, the non-resident employer will not be obliged to withhold PAYG, nor will it have an Australian FBT liability.

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Employee's tax consequences

The income tax implications for Australian resident employees will differ depending on whether the non-resident employer has a physical presence in Australia.

If a non-resident employer has a physical presence in Australia, the employee will be taxed in Australia on their foreign sourced salary and wages, and the employer will be required to withhold PAYG (which the employee can claim as a credit in their income tax return) and pay FBT on any taxable benefits provided.

Importantly, in calculating the FBT liability, the employer will be entitled to FBT concessions for benefits such as living away from home allowances, relocation expenses etc.

Where the non-resident employer does not have a physical presence in Australia, no PAYG will be withheld which means the employee will not have any credits to claim when they lodge their income tax (although the income will be assessed in Australia). As the non-resident employer will not have paid FBT on the benefits provided to the employee, the Tax Office is of the view that the employee should include the value of all benefits received (which would otherwise have been subject to FBT) in their income tax return and pay income tax on these amounts at their prevailing marginal rate.

Of greater concern in this regard, the Tax Office has also indicated that, in calculating the value of benefits to be included in the employee's income tax return, FBT concessions and exemptions should be ignored which would otherwise reduce the taxable value of fringe benefits.

This means, for instance, that an employee of a non-resident employer who is subject to FBT could receive a living away from home allowance free of income tax and FBT (as the living away from home allowance is generally exempt from FBT).

However, the employee of the non-resident employer who is not subject to FBT would be personally subject to Australian income tax on that same living away from home allowance.

This is an important issue, as poor structuring may result in expatriate Australian employees being significantly out of pocket on overseas assignments.

Ref: Tax determination TD 2010/D1

Taxation of unpaid present entitlements

The Tax Office has released its final position on the taxation of unpaid present entitlements in the form of PS LA 2010/4.

The final practice statement departs from the initial draft in a number of significant ways:

- ▶ small business entities can correct honest mistakes in their accounts where both the company and the trust disclose the UPE as a loan (limited relief – subject to conditions);
- ▶ trusts which have converted UPEs to loans and which have not correctly treated these under Division 7A, may take corrective action to rectify this error. One of the conditions for this includes the requirement for the trust to make a payment to the company equal to the annual repayments that should otherwise have been paid;

- ▶ there are three options provided by the Tax Office for the trustee to calculate the returns payable to the company via the sub-trust:
 - a 7-year interest-only loan;
 - a 10-year interest-only loan; and
 - an investment in a specific asset;
- ▶ in all three options, the company must actually be paid the interest/rent on the UPE invested. It is not sufficient to simply credit a loan account (unless the company owes an amount to the trust); and
- ▶ in the loan options, the company must be paid the principal by the end of the loan period. In the investment option, the proceeds of the disposal of the investment must be paid to the company.

In practical terms, it appears the 10-year loan may provide the best option for trusts.

Ref: Tax Ruling TR 2010/3 - Division 7A loans: trust entitlements;
Draft PS LA 3362 - Division 7A: Trust Entitlements;

Franked dividends payable from loss companies

Dividend traps released

Changes in the Corporations Act could provide companies that have accumulated losses with the opportunity to pay dividends in excess of any accounting profits that the company may generate.

Prior to these amendments (which apply from 28 June 2010), it was difficult for loss companies to make a distribution to free up franking credits that may have been trapped in the company.

New requirements for paying dividends

The new rules remove the restriction that permitted companies to only pay dividends where they had profits. The amendments introduce a new solvency test which will allow a company to pay dividends if:

- ▶ the company's assets exceed its liabilities immediately before the dividend is declared, and the excess is sufficient for payment of a dividend;
- ▶ it is fair and reasonable to shareholders; and
- ▶ it does not materially prejudice the company's ability to pay its creditors.

A director's duty against insolvent trading still applies.

Income tax changes

A corresponding change allows dividends paid out of amounts other than profits to be treated as dividends paid out of profits for tax purposes. However, this does not address a number of issues from an income tax perspective.

Warning on paying dividends

Are distributions from share capital a dividend?

The definition of "dividend" contained in Section 6(1) of the 1936 Act has not been amended. This means that distributions from share capital accounts (which may occur under the amendments to the Corporations Act) may not be dividends for income tax purposes.

There is an exception where amounts are credited to a company's share capital account under an arrangement, and the company subsequently makes a distribution from its share capital of that amount. However, this may only occur in rare circumstances.

Are all distributions frankable?

Another issue is whether dividends paid out of amounts other than profits will be frankable dividends for tax purposes. The Explanatory Memorandum to the Corporations Act amendments indicates these distributions will be frankable, subject to imputation integrity rules. However, a distribution may not be frankable if the distribution is not considered a dividend under section 6(1) and section 960-120 of the 1997 Act.

Furthermore, companies should be aware that a distribution sourced from its share capital account may not be frankable (section 202-45(e) of the 1997 Act).

Ref: Corporations Amendment (Corporate Reporting Reform) Act 2010

Should you require assistance additional information, **contact your PKF tax adviser** or:

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