TD 2011/1EC - Compendium

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Ruling Compendium – Taxation Determination TD 2011/1

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2010/D1 – Income tax and fringe benefits tax: can a non-resident entity be:

(a) required to withhold amounts from salary and wages paid to an Australian resident employee for work performed overseas under section 12-35 of Schedule 1 to the *Taxation Administration Act 1953*?

(b) subject to obligations under the *Fringe Benefits Tax Assessment Act 1986* in relation to benefits provided to an Australian resident employee in relation to work performed overseas?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	***Employee liability to income tax on benefits previously dealt with under fringe benefits tax*** The key issue that the draft Determination potentially creates (but does not address) is that the non-application of PAYG withholding, and therefore FBT for some non-resident employers, does not mean that benefits received by formerly section 23AG of the *Income Tax Assessment Act 1936* (ITAA 1936) exempt employees remain free from taxation. An example of an inequitable situation – Employees working overseas on a fly-in fly-out basis in the same circumstances will be subject to different income tax consequences depending on whether their employer is non-resident or Australian. The employee of the non-resident employer could be subject to income tax on benefits received whereas the same benefits received by an employee employed by an Australian employer would be subject to FBT.	All these issues have been noted. These issues are outside of the scope of this Taxation Determination. They arise as a result of the position in relation to the application of PAYG withholding as explained in the Determination and the consequential FBT position also explained in the Determination. This Taxation Determination is intended to clarify the tax position of non-resident employers and does not rule on employee liability. Treasury and the ATO are aware of these concerns and the consequential interaction issues which have arisen as a result of the changes to section 23AG of the ITAA 1936. These have also been raised and discussed through the FBT NTLG Subcommittee. These issues remain the subject of ongoing discussions between the ATO and Treasury.

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1. cont	Whether the potential application of section 15-2 of the *Income Tax Assessment Act 1997* (ITAA 1997) applies only to items of ordinary income or whether it extends the legislation to convert non-cash benefits which would not otherwise be ordinary income into statutory income. Substantial valuation difficulties and inequities would arise as exemptions and reductions such as the otherwise deductible rule, applicable under FBT, would not be available where the benefits fall within the scope of individual taxation. A complementary Determination be released to provide certainty on the employee implications where their non-resident employer is not required to withhold. Additional guidance be provided to employees in TaxPack and the ATO website to assist with the completion of income tax returns.	The ATO publications Foreign employment income and section 23AG – employees and Foreign employment income and section 23AG – employers provides guidance on some of these issues. To assist with awareness of this issue, the final Determination will state that benefits may be included in the Australian assessable income of employees.
2	***Meaning of 'sufficient connection' with Australia*** The draft Determination does not provide adequate certainty as to when a non-resident employer would have a 'sufficient connection' with Australia and a further definition of the term is required in order to properly apply the Determination. Many non-resident employers will find it difficult to work through the 'sufficient connection' tests as currently proposed. The subjectivity in which these tests can be applied will lead to greater confusion and an increased risk of non-compliance with employer obligations.	The issue for this Determination is the extra-territorial operation of the PAYG withholding obligation and the consequential fringe benefits tax obligations on employers. This issue turns on the legal principle of 'sufficient connection' with Australia. The draft Determination provides certainty about the ATO view that the principle of 'sufficient connection' applies. The application of the principles in individual situations is a question of fact. Nevertheless, the draft Determination goes further to provide certainty on the ATO view that a physical business presence is Australia is needed. Any subjectivity is a feature of the principle which allows individual circumstances to be correctly dealt with on their merits.

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2. cont	The tests should be simplified and provide greater certainty. The following is proposed: (1) does the non-resident employer have a PE in Australia, or (2) does the local related entity of the non-resident employer carry on the Australian business of the non-resident employer. Many non-residents already consider PE implications associated with doing business in Australia.	The concept of permanent establishment does not properly substitute for the legal principle of sufficient connection. The concept of carrying on the Australian business is also different from the concept of sufficient connection with Australia. It is our view that the circumstances in which a PAYG withholding obligation arises are not limited to circumstances giving rise to a permanent establishment.
3	***Meaning of 'employer' and 'payer' as used in the Determination*** The draft Determination uses the terms 'employer' and payer interchangeably throughout the draft Determination without sufficiently differentiating the PAYG definition of employer from the legal definition of employer. This is likely to lead to confusion amongst non-resident employers. This usage may be due to the fact that the draft Determination is intended to refer to the FBT definition of 'employer' rather than the common law definition. Paragraph 18 states that the obligation to withhold is on the employer. However, paragraph 25 states that where the payment is made by an entity other than the non-resident employer to a person as employee of the foreign employer working overseas, any withholding obligation by that payer entity must be separately considered from the perspective of that payer. Paragraph 18 is inconsistent with section 12-35 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) as it is the payer rather than the employer that must consider whether to withhold tax from a particular payment.	The draft Determination is intended to address and provide a binding ATO view on straightforward employment situations. These are considered to be where the employer and payer are the same entity. In the context of the draft Determination it was considered to be a more appropriate form of plain English communication to refer to the employer. The meaning and intent of the usage will be better explained in the Determination. In light of the feedback, the Determination will refer to 'entity' generally and use more specific terms only where appropriate. Where the circumstances become more complex, the correct application of the law can depend on the individual facts and circumstances involved. Where additional facts are material, the principles identified in the draft Determination may be considered in developing a reasonably arguable position for the particular circumstances. Alternatively, a private ruling should be sought on such circumstances. The draft Determination was developed to deal with situations where the payer is the employer. The way the idea is expressed in the final Determination will be revised to avoid this apparent inconsistency. The term payer has been removed from final Determination.

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	For example, if the non-resident employer was to have a sufficient connection with Australia by virtue of a common law agent relationship with a subsidiary, and the employee was paid by the subsidiary, which entity would have the obligation to withhold? The Determination should provide clarification in relation to the definition of 'employer' and the withholding obligations for both 'employer' and 'payer' What approach will the ATO adopt when considering if the non-resident is the employer of an individual, that is, will the ultimate employer be the employer under employment law or tax law (that is, economic employer)? Clarification is sought where employers are transferred between companies in the same global company (each entity being a separate business unit).	In the example, both the non-resident employer and the Australian subsidiary would be subject to the obligation to withhold from a payment the entity makes. Withholding by the subsidiary on the payment it makes would satisfy the obligation on both entities. The relevant entity for the purposes of the PAYG and FBT provisions is the entity making the payment. This will be clarified in the final Determination. The Determination has been redrafted to refer to entity rather than payer.
4	***Treatment of various payroll scenarios – split payroll arrangement, cost recharge, and payment made on behalf of a non-resident*** In a situation where there is a split payroll arrangement or where there is an Australian subsidiary paying an employee on behalf of the non-resident employer who does not have a sufficient connection with Australia (that is, the payment of salary by the Australian subsidiary does not give rise to a common law agent relationship), it is our understanding that the Australian subsidiary 'payer' would nevertheless be considered the 'employer' for FBT purposes and would, therefore, have an FBT obligation in respect of benefits provided to the employee by the non-resident employer. The Determination should clarify this issue as it has wide application.	We agree that relevant consideration includes whether the act of payment constitutes a common law agency. Questions of agency require consideration of individual circumstances. In general, in the absence of other relevant facts and circumstances, the act of payment does not create a common law agency. We consider that the act of payment would satisfy the employer's liability, but would not be taken to be an act of the employer under the principles of common law agency; nor would the meeting of tax lodgment requirements. Per issue 6 below dealing with the law of agency is beyond the scope of the Determination.

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4. cont	A variation to example 3 in paragraph 8 – An employee is paid in Australia by an Australian subsidiary on behalf of, and with all costs recharged to, the non-resident employer. In this situation, would the non-resident employer have a 'sufficient connection' with Australia to have PAYG withholding and FBT obligations? Considerations include whether the act of payment constitutes a common law agency, and whether BAS and PAYG lodgment on behalf of the non-resident employer constitutes a common law agency. Example – under the terms of a secondment agreement, an individual is seconded to South East Asia. All work is for the benefit of the foreign entity. The individual remains on the Australian payroll, and the Australian entity recharges these costs to the foreign entity. Does the foreign entity or the Australian entity have the PAYG withholding obligation? Example – as above except now paid by the foreign entity. Under the secondment agreement long service leave continues to accrue in accordance with the original Australian employment contract; annual leave is determined in accordance with the secondment agreement.	Both entities are potentially subject to a withholding obligation. The entity which is the 'payer' will be entity with the actual obligation to withhold. In the first example, it appears that the Australian entity is the 'payer' (this assumes that by remaining on the Australian payroll and recharging the cost, it continues to make payment to the individual). In the second example, the foreign entity is the 'payer'. The Determination is intended to provide binding advice in straightforward situations where the 'payer' is the individual's employer. More complex situations may depend on the individual facts and circumstances. Such circumstances should be the subject of a private ruling.
5	***FBT consequences of having made prior year payments*** Extending example 3 in paragraph 8 – If an employee receives a bonus payment from an Australian subsidiary in relation to previous work in Australia, would that payment expose the subsidiary to FBT on benefits provided by the non-resident employer. The Australian subsidiary has a PAYG withholding obligation and it follows that it is an employer for FBT purposes. Would the associate rules to apply FBT or would it be considered to relate to different employment?	No. In cases where there are two 'associated' employers of one employee, sections 138 and 138B of the *Fringe Benefits Tax Assessment Act 1986* apply to prevent the double counting of fringe benefits and ensure that the liability for fringe benefits tax is with the employer in respect of that employment to which the benefit relates.

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6	***Common law agency*** It is not clear from the draft Determination when a common law agent relationship would arise. Multinational companies in Australia undertake many activities on behalf of the wider group, for example, payroll, HR, legal and treasury. Many non-resident companies will not be familiar with the concept of common law agent, and the Determination should provide guidance about types of activities that may constitute a common law agent relationship. The Determination should distinguish a common law agent relationship from other types of agency relationships to provide greater certainty about the use of group functions in different physical locations.	Dealing with the law of agency generally is beyond the scope of the Determination. The focus of the final Determination will be on the entity making the payment. The identity of the payer is a question of fact to be determined in each case.
7	***Previously PAYG withholding registered employers*** Automatic inclusion of entities that have previously registered prior to the release of the Determination would unfairly disadvantage entities which do not otherwise have a sufficient connection with Australia. Entities should have an opportunity to deregister.	The issue is whether an entity has a sufficient connection with Australia. The fact of registration by itself is not sufficient to create a connection with Australia, and this paragraph will be deleted from the final Determination.

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8	***Status of employees seconded to Australia*** The Determination should clarify the treatment of employees of foreign employers seconded to work in Australia for the Australian subsidiary of their foreign employer. It is presumed that the foreign employer will not have a sufficient connection with Australia raising personal income tax and FBT issues.	This is outside the intended scope of the Determination. This priority issues arose as part of the implementation of recent amendments to the tax law where Australian residents work overseas. To effectively manage the issue, the circumstances being considered are confined to Australian residents working overseas. Non-resident employees working in Australia are likely to be earning Australian source income. This factor should be considered together with the remaining factors identified in paragraph 17 of the Determination, that is, the entity making the payment, the employment relationship and the payment itself, to determine if PAYGW can apply in each case.