

A photograph of a lighthouse with a black base, a red middle section, and a white top section, situated on a rocky outcrop overlooking the ocean under a blue sky with scattered clouds.

# Viewpoint

Taxation advice and consulting

*Expatriate executives provide the country's businesses with much needed skills and knowledge.*

## **Australia as an attractive destination for expatriates**

*Nick Gangemi, National Tax Director, BDO Kendalls*

### **Challenge area**

There are many countries that are attractive jurisdictions for expatriates, for both executives who move temporarily within an international corporate group, and for high net wealth individuals who move to that country to retire. For instance, the UK provides a tax deferral for foreign sourced income of temporary residents and non-domiciles, until such time as the income is brought on-shore, while Hong Kong is a source country jurisdiction.

Countries like to attract expatriates. Expatriate executives provide the country's businesses with much needed skills and knowledge. High net wealth individuals who come to a country to live are new consumers, assisting both the country's businesses and, due to the collection of GST or similar taxes, the government of the country. In order to attract expatriates, a country will need to provide various concessions:

- In relation to expatriate executives, deductions for expenses that were incurred by the individual in order to come to Australia, or exemptions for allowances paid to cover such expenses.
- The ability to keep the income from offshore assets out of the country's tax net, either during the term of any assignment (for executive expatriates) or until such time as the expatriate decides to live in the country.
- For executive expatriates, the removal from any exit tax on leaving the country at the completion of an international assignment.

*This Act provides an exemption from Australian taxation for foreign income and capital gains earned by temporary residents.*

- When an expatriate does decide to move permanently to the country, providing a “step up” in the cost base of any assets, so that the expatriate does not get taxed on gains accruing prior to becoming a permanent resident.
- For high wealth individuals to move to a country—not having any death duties or inheritance taxes.

For executive expatriates, in many cases the expatriate’s contract usually has a tax-equalisation agreement, shifting the tax burden to the local employer. Therefore, any tax saved by an expatriate executive is a real cost saving to the local employer.

## New perspectives

**What’s happened in the past (status quo) and what has changed?**

In April 2006, the Tax Laws Amendment (2006 Measures No. 1) Act 2006 was enacted. This Act provides an exemption from Australian taxation for foreign income and capital gains earned by temporary residents.

Prior to this exemption being enacted, an expatriate in Australia temporarily was taxed in the same way as an Australian resident, which required the expatriate to include its worldwide income in its assessable income. It was not possible for the expatriate to “park” income within a foreign trust or company, as Australia’s strict foreign accruals rules tax Australian residents in respect of the income of these foreign trusts. The accruals rules are:

- the controlled foreign companies rules, in relation to foreign companies controlled by Australians;
- the foreign investment fund rules, in relation to interests in foreign companies (except for controlled foreign companies) and foreign trusts; and
- the transferor trust rules, in relation to foreign trusts to which a resident has transferred property, irrespective of any ownership interest or (except in some minor cases) control of the trust.

As residents are taxed on their worldwide income, much will depend on when (and if) an expatriate becomes a resident. Except for very short-term stays, an expatriate would become a resident, usually at the time the expatriate arrives in Australia.

Additionally, Australia has a capital gains “exit tax”, which deems that any person leaving Australia has a CGT event with market value consideration. An individual can elect out of this event, but with the cost that all assets owned at that time, whether Australian and foreign, remain in the Australian tax net. There are exemptions for short-term stays.

*..the temporary resident gets the best of both worlds...*

Australia has not completely been anti-expatriates. For instance, there are many exemptions from Australia's fringe benefits tax rules that allow an expatriate to package a number of items, including:

- a living away from home allowance (LAFHA) to cover excess rental and food expenses;
- children's school fees;
- home leave expenses (a partial exemption); and
- relocation costs.

Additionally, Australia's capital gains tax rules provide a step up in the cost base of assets for a person becoming an Australian resident, ensuring that any pre-residency capital appreciation is tax free. For high wealth individuals in particular, Australia does not have any death duties or inheritance taxes.

The new temporary residents' exemption provides further advantages for expatriates. If a person is classified as a temporary resident, then the following advantages are available:

- Foreign source income is not subject to tax in Australia (there is no "remittance taxation", as would occur in the UK). However, this does not apply to employment income – there is another exemption, available to all residents, for foreign source employment income, with has a number of conditions that need to be fulfilled.
- Capital gains tax would only apply on assets that are "taxable Australian property". With the new amendments to the Australian capital gains tax rules, this will mean that shares in Australian companies (except for land-rich companies) would fall outside the Australian capital gains tax net.
- The controlled foreign companies, foreign investment fund and transferor trust rules would not apply.
- The capital gains tax "step up" event will occur when a temporary resident ceases to become a temporary resident, not when first arising in Australia.
- There will be no withholding tax payable by temporary residents. Currently, if an expatriate pays interest to a non-resident (for instance, interest on a home loan in the expatriate's home country), the expatriate should withhold tax at 10%.
- Special rules apply to shares and options received under employee share schemes, to tax that part of the share scheme which relates to the Australian employment.

Notwithstanding the above, the temporary resident is still classed as a "resident" for some purposes of the income tax law, notably when looking at tax rates. Therefore, the temporary resident gets the best of both worlds—the lower resident tax rates with the exemption for foreign income and gains.

A "temporary resident" is defined as a resident:

- who holds a temporary visa granted under the Australia's immigration law; and
- who is not an Australian resident under Australia's social security law; and
- whose spouse is not an Australian resident under Australia's social security law; and
- has not, at any time since the commencement of the temporary resident rules, been a resident of Australia and failed any of the above three conditions.



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Note that, while it was initially proposed that this would be a four-year exemption only, there is actually no time limit.

## The way forward

The new temporary residents' exemption dramatically changes the taxation of Australian expatriates. In relation to expatriate executives, it makes Australia a more attractive location for expatriates, enables Australian businesses to attract skilled persons and decreases the costs to the Australian employer.

In relation to other expatriates, it increases the attractiveness of Australia by allowing such persons to move to Australia and, so long as they maintain their current visa status, to keep their offshore assets offshore. If they decide to move permanently to Australia, they will obtain a step-up in cost base when they finalise that decision.

However, it all depends on the immigration and social security status of the expatriate. Therefore, expatriates will need to carefully monitor this status to ensure that they do not change their tax status. Additionally, before making any choice about their immigration or citizenship, they would need to carefully consider the tax implications.

There are two other issues that also arise. First, an expatriate will not be a temporary resident if the expatriate's spouse (married or de facto) is an Australian resident under Australia's social security law. Therefore, the expatriate's personal relationships could have serious tax consequences. Could this lead to decrease in romances between Australians and expatriates?

Second, if an expatriate ever failed the tests, the expatriate cannot ever be a temporary resident. Therefore, an expatriate returning for a second time to Australia, depending on their visa status in the first assignment, not be able to avail himself or herself of this concession.



## About the author

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Nick is the National Tax Counsel of BDO. Nick has had extensive experience in advising on corporate tax, international tax and other tax areas. In particular, Nick has worked on inbound and outbound M&A transactions, and on cross-border structuring for individuals and corporations. Nick's specialties are Corporate Tax and Expatriate Taxation.

Nick's areas of experience include conducting corporate tax risk assessments, corporate financing transactions, cross-border investments, corporate reorganisations and transfer pricing. In the expatriate taxation area, Nick advises expatriate executives and other high net wealth expatriates on their complicated arrangements on entering Australia.

## For more information

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