



HUMAN CAPITAL TAXES UPDATE - NOVEMBER 2007

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Executives Working Overseas

Increasingly, the workforce is global, and many individuals will spend part of their working life in countries other than their country of birth or citizenship.

In contrast, almost all superannuation and pension systems around the world are established and maintained on a national basis, and movement of superannuation entitlements across national boundaries can cause difficulties.

For this reason, employees invariably ask questions about their superannuation entitlements when they move from one country to another.

Common queries from your outbound and inbound employees are likely to be as follows.

OUTBOUND EMPLOYEES

Will you continue to make contributions to my Australian super fund whilst I am overseas?

All employers are required to make contributions to an Australian superannuation fund of 9% on ordinary times earnings.

There is an exemption from this requirement for employees working outside Australia, if:

- The employee has become non-resident of Australia for tax purposes; or
- The employer entity is a non-resident of Australia for tax purposes.

However, if the employee remains a resident of Australia for income tax purposes, and an Australian entity continues to employ him or her, that entity is required to continue to make contributions.

In addition contributions may continue to be required pursuant to:

- Certain awards, Enterprise Agreements or Australian Workplace Agreements; or
- Individual employee contracts.

Deductibility of employer contributions to Australian super funds

Typically, an Australian employer will not be entitled to a deduction for contributions unless:

- the employee is engaged in producing assessable income for the Australian employer; or
- The employee is an Australian resident for income tax purposes and is engaged in the business of the Australian employer.

The first of these tests is difficult to satisfy if the employee is located in a foreign country, especially if he or she is primarily assisting a foreign subsidiary or other foreign related company of the Australian employer.

The second test cannot be used for any employee who is non-resident of Australia for income tax purposes in the year in which the contribution is made.

In practice, if the Australian employer is not entitled to a deduction for the contribution, this issue may still be manageable, if a related company of the Australian employer in the foreign country makes the contribution instead.

Will employer contributions count towards my taxable income in the foreign country?

Some foreign countries tax employer contributions made to an Australian superannuation fund equivalently to salary, that is, the employee is required to include the contributions in his or her income tax return in the foreign jurisdiction in the same way as salary (For eg, the United States).

As a result of this treatment, it can be more tax efficient in such instances for the employer to pay additional salary to the employee, and for the employer to then make after-tax (member) contributions to the Australian fund if he or she so chooses.

Are you required to make contributions to a fund in the foreign country?

A number of countries have mandatory requirements for employers to make superannuation contributions for employees to make contributions. These can include social security type contributions (as in the United States), or pension fund systems (as in Singapore or Hong Kong).

In many countries, exemptions apply to exclude temporary employees or non-citizens from such requirements. Rarely if ever will contributions made to Australian superannuation funds count toward any local obligations in the foreign jurisdiction.

However, some countries have signed Bilateral superannuation agreements with Australia, that may exempt an Australian expatriate in these countries from superannuation obligations, on the basis that Australia will provide equivalent exemption from our SGAA requirements for expatriates from such countries.

Some of the countries for which Bilateral superannuation agreements have been signed with Australia include the United States, Croatia, Chile, the Netherlands, Portugal and Belgium.

Broadly, the exemption only applies if the Australian expatriate continues to be subject to the SGAA requirements whilst he or she is in the particular foreign country. As the SGAA excludes most persons working outside Australia from its requirements, the agreements may have limited effect on outbound employees.

Do I need to do anything with my SMSF?

It is critical that all employees who are members of SMSFs seek specific advice in relation to their SMSF before moving overseas for any length of time.

Clearly, if a person has a SMSF in Australia, and then transfers employment or otherwise transfers residency outside Australia for a period of longer than two years, there is a risk that the SMSF may no longer qualify as an "Australian super fund", which results in severe tax penalties.

INBOUND EMPLOYEES

Will my employer continue to make contributions to my foreign super fund whilst I am in Australia?

There are no requirements within Australia for employers to continue to make contributions to an employee's foreign super fund whilst he or she is in Australia.

Depending on the country of origin of the employee, there may be legislative requirements in the foreign jurisdiction to continue to make such contributions.

If contributions are paid, an important issue in Australia is whether the contributions are paid by the original employer of the person (for example, head office), or by an Australian entity (for example, the local subsidiary).

Where the local Australian entity pays the contributions, no deduction will be available.

In addition, any such contributions will be subject to Fringe Benefits Tax ("FBT") in Australia, unless the employee is a "temporary resident".

A "temporary resident" is defined as someone:

- Who is presently the holder of a temporary visa; and
- Who themselves, and whose spouse, is not an Australian resident within the meaning of the Social Security Act 1991.

Will any part of my foreign superannuation arrangements count towards my taxable income in Australia?

For "temporary residents", no part of any contributions made personally or by an employer to a foreign superannuation fund for a person will count towards the Australian assessable income for the employee.

For persons who are not "temporary residents", however:

1. Employer contributions will be subject to FBT;
2. Part or all of the annual growth in the value of the foreign super entitlement may be included in the employee's assessable income pursuant to the Foreign Investment Fund rules; and/or
3. Part or all of the overall growth in the value of the foreign super entitlement since the employee first became resident of Australia for income tax purposes may be included in the employee's assessable income, if and when in the year in which the employee transfers the entitlement to Australia. If the employee transfers the foreign superannuation entitlement to an Australian super fund, he or she is entitled to elect that the taxable portion is taxed within the Australian fund at 15% rather than taxed personally to the individual at marginal rates.

Is my employer required to make contributions to a fund in Australia whilst I am here?

The employer of an inbound employee, whether an Australian company or not, is likely to be required to make the compulsory 9% contributions for that person.

The principal exclusions are:

1. If there is a Bilateral superannuation agreement between Australia and the country of origin of the employee, provided that the employee holds a "Certificate of Coverage" attesting that he or she is subject to some equivalent arrangement for compulsory contributions in that country; or
- Certain senior executives in Australia on particular types of visas (typically CEO, CFO, CIO, etc).

For the rest of the workforce, the compulsory Australian superannuation contributions need to form part of the overall negotiation between an employer and the employee in relation to the remuneration package to be paid whilst in Australia.

Can I get the money out of the Australian fund when I leave Australia?

An employee is entitled to withdraw his or her entitlements from an Australian superannuation fund upon departure from Australia, if he or she meets certain conditions.

These conditions require that:

- The person was the holder of a temporary resident visa during his or her period of employment in Australia, and that visa has expired or been cancelled; and
- The person has permanently departed from Australia.

For entitlements less than \$5,000, these conditions may be satisfied by forwarding the trustee of the Australian fund a copy of the visa, showing its type and that it has expired or been cancelled, and a copy of his or her passport showing departure from Australia.

For entitlements of \$5,000 or more, the employee must forward the trustee of the Australian fund a written statement from the Department of Immigration and Multicultural and Indigenous Affairs, which states that the two conditions have been satisfied.

A withholding tax applies on any withdrawals generally equal to 30% of the taxable component of the payment.

Can I transfer my foreign superannuation entitlements to an Australian superannuation fund?

It will usually make sense for individuals to accrue their superannuation entitlements primarily in the country in which they intend to retire.

For temporary residents, this will usually mean that it is not appropriate to transfer any entitlements that they may have in foreign superannuation funds to an Australian superannuation fund.

The new non-concessional contribution caps may also impede the ability of an individual to transfer significant amounts from a foreign superannuation fund.

These caps broadly have effect that any amount not taxed within the Australian fund is limited to no more than \$150,000 or to \$450,000 if the individual makes no other non-concessional contributions in the same year or in either of the two following years.

If the non-taxable part of the foreign superannuation entitlements exceeds \$450,000, the impact of the 46.5% tax in Australia on the transfer of any excess may be substantial.

Some foreign jurisdictions, or particular foreign funds, impose restrictions on transfers to Australia. A common example of legislative restriction is the United Kingdom, and its rules relating to Qualifying Recognised Overseas Pension Schemes ("QROPS").

The UK imposes a tax penalty on the member, generally at 40%, on any transfer from a UK fund to a foreign fund, for example, if the Australian fund is not a QROPS. A number of larger Australian funds have obtained QROPS status in the UK.

Is there any benefit in me establishing an SMSF in Australia?

The advantages and disadvantages associated with the establishment of an SMSF are typically similar for the inbound employee as for other individuals. Accordingly, it is more likely that inbound employees will inquire as to whether or not to establish an SMSF, after they have already made the decision to become permanent residents, or indeed after they have already obtained permanent residency and are approaching retirement.

Cooper Partners provide taxation related services to employers. For more information on any aspect of your human capital taxation related requirements please contact Michelle Saunders on (08) 6311 6911 or Marissa Behta on (08) 6311 6933.

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