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No. 68 2002–03

## Taxation Laws Amendment Bill (No. 7) 2002

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Taxation Laws Amendment Bill (No. 7) 2002

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# Taxation Laws Amendment Bill (No. 7) 2002

**Date Introduced:** 23 October 2002

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The majority of the Bill commences on Royal Assent. However, the various measures have effect from different dates as detailed below.

## Purpose

To:

provide various tax exemptions for 'temporary residents';

exempt from income tax compensation payments for the loss of defence remuneration, where such remuneration is itself tax-exempt;

allow retrospective adjustment of earlier tax assessments where some of the original income has to be repaid in later years;

increase the threshold for the medical expenses tax offset from \$1,250 to \$1,500 per annum; and

provide an income tax exemption for the Commonwealth Games Federation for the 2006 Melbourne Commonwealth Games.

## Background

As there is no central theme to the Bill the background to the various measures will be described below.

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## Main Provisions

### Temporary Residents

The provisions in the current Bill regarding the taxation treatment of foreign expatriates — or ‘temporary residents’ — were debated by the Parliament as part of *Taxation Laws Amendment Act (No. 4) 2002*. On 27 June the Senate amended the Bill to that Act by deleting the provisions relating to temporary residents.<sup>1</sup> The House of Representatives agreed to the Senate amendment later the same day.

With the exception of minor changes, the provisions in the current Bill relating to temporary residents are identical to those in *Taxation Laws Amendment Bill (No. 4) 2002* (see [Bills Digest No. 179 2001-02](#) for earlier commentary).

The current Bill:

*provides* a tax exemption to ‘temporary residents’<sup>2</sup> for a maximum period of 4 years for all foreign source income and capital gains not associated with Australian employment or service;

*gives* temporary residents an exemption for a similar period from interest withholding tax obligations,<sup>3</sup> and

*removes* the current time limit of 4 years on exemptions from Foreign Investment Fund (FIF) rules<sup>4</sup> for all holders of temporary visas.<sup>5</sup>

The explanatory memorandum to the Bill states that the ‘exemption for temporary residents measure’:

seeks to attract internationally skilled mobile labour to Australia. It also seeks to assist in the promotion of Australia as a business location, by reducing the costs to Australian business of bringing skilled expatriates to work in Australia.<sup>6</sup>

In a related step, the Government amended the *Superannuation Industry (Supervision) Regulations* and the *Retirement Savings Account Regulations* in May 2002 to allow temporary residents to access their Australian superannuation on permanent departure from this country.

As noted in *Bills Digest No. 179 2001–02*, income tax relief for people working in Australia on temporary entry visas was recommended in the 1999 *Review of Business Taxation — A Tax System Redesigned* (Ralph Report). The Ralph Report observed that a new Australian Tax Office ruling:

...may have led to more foreign expatriates, such as executives, becoming residents for tax purposes. As many employers agree to pay tax on expatriates behalf, the ruling may result in higher costs to businesses wishing to employ expatriates.<sup>7</sup>

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The Ralph Report recommendation that tax exemptions for expatriates only apply in relation to pre-residence assets and liabilities has been extended by the Government to apply to foreign source income and interest withholding tax obligations regardless of whether the relevant asset or liability was acquired before or after the expatriate took up residency in Australia. As the explanatory memorandum notes, this will enable expatriates to add to or change their overseas sources of income while resident in this country without incurring Australian income tax:

The extension to the Ralph recommendations avoids locking temporary residents into pre-residence investments or financial arrangements for the period of the 4 year exemption.<sup>8</sup>

Following the exclusion of tax exemptions for temporary residents from Taxation Laws Amendment Bill (No. 4) 2002, the Chief Executive of the Business Council of Australia, Ms Katie Lahey, said that Australia's present international tax arrangements were constraining our participation in the international economy:

They distort commercial decisions, they are arbitrary and unnecessarily complex. In the face of a contemporary wave of rapid change in international tax regimes around the world, Australia's international tax arrangements are becoming even less competitive.<sup>9</sup>

On 22 August 2002, the Treasurer released the consultation paper *Review of International Taxation Arrangements*, the first major review of Australia's international tax regime since the early 1990s.<sup>10</sup> The consultation paper is available at the Tax Board's [website](#).<sup>11</sup>

Chapter 5 of the consultation paper — 'Improving Australia's tax treatment of foreign expatriates' - refers to the measures in the current Bill to reduce taxation for expatriates, arguing that they 'are consistent with approaches other countries take'.<sup>12</sup> It then proposes a number of additional measures to further ease the Australian tax burden on such people.<sup>13</sup> As the Treasurer noted, the thinking behind such reforms is to improve the 'tax treatment of foreign expatriates to enhance Australia's attractiveness to overseas talent'.<sup>14</sup>

The *Review of International Taxation Arrangements* has been criticised, with one commentator noting that the suggested reforms in the consultation paper 'are not placed within a broad theoretical framework; rather they are a grab bag of options'; and that 'there is a focus on short-term change rather than long term policy design'.<sup>15</sup>

The deadline for written submissions in response to the consultation paper was 31 October 2002. The Government has asked the Taxation Board to report on the outcome of the consultation process by the end of 2002. Submissions will not be available publicly until the Board has delivered its report.

According to the Treasurer, 'the Government will consider its position on what reforms might be needed once the Board has reported'.<sup>16</sup>

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In response to the release of the consultation paper, Brian Toohey in the Australian Financial Review commented:

Some of the proposals would seem to violate the general tax principle that income should be treated equally, regardless of the identity of the recipient. If the Government pushes ahead with one change, Australian citizens will be entitled to ask why a foreign executive working in Australia should pay less tax than an Australian counterpart.<sup>17</sup>

The Certified Practising Accountants of Australia reported that in a consultative seminar with the Taxation Board:

On Chapter 5 issues (improving the tax treatment of expatriates), it was suggested that any changes here should ensure equality between permanent and temporary residents, particularly bearing in mind the current political sensitivities on this topic. While not a high priority, some thought to do nothing could send the wrong message to foreign investors... It was also noted that the real problem in this area was Australia's high marginal tax rates.<sup>18</sup>

In contrast, the Business Coalition for Tax Reform reiterated 'its support for measures to minimise the Australian tax levied on non-Australian source income, or gains to non-residents'.<sup>19</sup> Sally Morton from Deloitte Touche Tohmatsu also supported changes to taxation rules affecting foreign expatriates, arguing that temporary residents should pay some tax, but only on an amount that is commensurate with their time in Australia. According to Morton, 'the cost of hiring foreign nationals has been a real impost, particularly in the last two years'.<sup>20</sup>

The explanatory memorandum to the Bill estimates that the measures will cost between \$40 and \$50 million per year.<sup>21</sup>

**Item 2 of Schedule 1** will insert a **new paragraph 128B(3)(i)** into the *Income Tax Assessment Act 1936* (ITAA36) to exempt temporary residents from all interest withholding tax obligations for the duration of the 4 year exemption period.

**Item 4** will replace existing paragraphs 517(2)(b) and (c) of the ITAA36 with a **new paragraph 517(2)(b)** that removes the current 4 year time limit on exemptions from FIF rules for holders of temporary visas.

**Item 9** will insert a **new section 51-52** into the *Income Tax Assessment Act 1997* (ITAA97) to exempt the foreign sourced income of temporary residents from income tax. The exemption will not apply to foreign income earned as a result of employment undertaken or services provided while a temporary resident.

**Item 11** will insert a **new section 118-575** into the ITAA97 to exempt capital gains and losses for temporary residents derived from a source outside Australia and/or from assets lacking the 'necessary connection with Australia'. Gains from land and buildings in Australia, and legal interests in such assets, are outside this exemption, as are other assets

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such as shares in Australian resident private companies. However, shareholdings of less than 10 per cent in Australian public companies, and holdings of less than 10 per cent in resident unit trusts are not classed as having a ‘necessary connection with Australia’ and are therefore within the exemption (see section 136-25 of the ITAA97).

**Application:** The amendment in Item 2 to exclude temporary residents from withholding tax obligations applies to payments of interest made from the date of Royal Assent. The other provisions affecting taxation of temporary residents apply from 1 July 2002 (**item 13**).

### **Comment**

It is not clear why the Bill seeks to pre-empt Government consideration of the Taxation Board’s report on the *Review of International Taxation Arrangements*, nor why it includes some only of the measures relating to taxation treatment of foreign expatriates discussed in the Review’s consultation paper. It would seem sensible for the Government to determine its overall strategy for international taxation – and within this its policy on the appropriate tax burden for foreign expatriates - before presenting individual measures to Parliament. In addition, it would be useful for Parliament in debating this issue to have access to public submissions on the *Review of International Taxation Arrangements*, and to be able to consider as one package the proposed measures regarding expatriate taxation.

### Compensation for Loss of Defence Remuneration

Where a member of the Australian Defence Force (ADF) sustains an injury on warlike operations overseas and is repatriated to Australia, he/she receives compensation for the loss of an overseas deployment allowance. Under current law, the deployment allowance is exempt income for the purposes of taxation but the compensation amount is not.

Similarly, where a member of the Reserve Defence Forces resigns because of injury sustained during Reserve service, he/she receives compensation for loss of Reserve Force income. Under current law, Reserve Force pay and allowances are exempt income for the purposes of taxation but the compensation amount is not.

**Item 4 of Schedule 2** will insert new **sections 51-32 and 51-33** into the ITAA97 to provide an income tax exemption for compensation paid for the loss of the warlike service deployment allowance or Reserve Force pay and allowances.

**Application:** From 1 July 1996 (**Item 5**).

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## Excluding Repaid Amounts From Assessable Income

There is no provision under current taxation law allowing retrospective adjustment of earlier tax assessments where some of the original income amount has to be repaid in later years.

As the explanatory memorandum notes, the ADF, for example, pays retention bonuses to encourage servicemen and women to stay in the armed forces for the whole of an agreed period. If the ADF member resigns before the end of the agreed period, he/she has to repay the retention bonus on a pro-rata basis.<sup>22</sup>

Taxpayers pay income tax on such payments in the year the payments are received. However where taxpayers have to make repayments in later years, they may be required to repay the gross amount — ie including an amount for tax already paid or payable.

**Item 1 of Schedule 3** will insert **new subsection 170(10AB)** into the ITAA36 to allow retrospective amendments of income tax assessments despite the normal time limits (2 or 4 years depending on the class of taxpayer) for such amendments being exceeded.

**Item 4 of Schedule 3** will insert a **new Division 22** into the ITAA97 treating previously assessable income as not assessable if it has to be repaid in later years.

Application: From 1 July 1996 (**Item 7**).

## Medical Expenses

Under the ITAA36, Australian residents can currently claim a tax rebate equal to 20% of net medical expenses above \$1,250 in an income year.

**Item 1 of Schedule 4** will amend paragraph 159P (3A)(b) of the ITAA36 so that taxpayers will need to incur \$1,500 in net medical expenses before the 20% rebate applies.

According to the Government, this change will deliver savings of \$54 million over the next three financial years.<sup>23</sup>

The table below shows the history of tax concessions in Australia for medical expenses.

Application: From 1 July 2002 (**Item 2**).

**Table 1. Tax concessions for health-related expenditures, 1961—2001<sup>24</sup>**

Year	Medical expenses	Health fund contributions
1960-61	Deductible to limit of \$150	Fully deductible
1963-64 to 1974-75	Fully deductible	Fully deductible
1975-76	General rebate of \$540 plus 40 cents in the dollar for eligible expenditure above \$1350	As for medical expenses

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Year	Medical expenses	Health fund contributions
1976-77	General rebate of \$610 plus 40 cents in the dollar for eligible expenditure above \$1525	Not allowable after October 1976
1977-78	Concessional expenditure rebate at 32 cents in the dollar for eligible expenditure in excess of \$1590	Not allowable
1978-79	Concessional expenditure rebate at 33.5 cents in the dollar for eligible expenditure in excess of \$1590	Not allowable
1979-80	Concessional expenditure rebate at 33.07 cents in the dollar for eligible expenditure in excess of \$1590	Not allowable
1980-81	Concessional expenditure rebate at 32 cents in the dollar for eligible expenditure in excess of \$1590	Not allowable
1981-82	Concessional expenditure rebate at 32 cents in the dollar for eligible expenditure in excess of \$1590	Separate rebate at 32 cents in the dollar of eligible expenditure for basic hospital and/or medical insurance only
1982-83	Concessional expenditure rebate at 30.67 cents in the dollar for eligible expenditure in excess of \$1590	As above at 30.67 cents in the dollar
1983-84 and 1984-85	Concessional expenditure rebate at 30 cents in the dollar for eligible expenditure in excess of \$2000	Not allowable
1985-86	Net medical expenses rebate at 30 cents in the dollar for eligible expenditure in excess of \$1000	Not allowable
1986-87 and 1987-88	Net medical expenses rebate at 29.42 cents in the dollar for eligible expenditure in excess of \$1000	Not allowable
1988-89	Net medical expenses rebate at 29 cents in the dollar for eligible expenditure in excess of \$1000	Not allowable
1989-90 to 1996-97	Net medical expenses rebate at 29 cents in the dollar for eligible expenditure in excess of \$1000	Not allowable
1997-98	Net medical expenses rebate at 20 cents in the dollar for eligible expenditure in excess of of \$1250	From July 1997, income-tested rebate up to \$150 (\$250 for a couple; \$450 with dependent child). Medicare levy surcharge exemption for private hospital fund members
1998-99 and onwards	Net medical expenses rebate at 20 cents in the dollar for eligible expenditure in excess of \$1250	From January 1999, 30 per cent rebate for private health insurance. Medicare levy surcharge exemption as above

Sources: AIHW 2000; Butler and Smith 1992.

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## Commonwealth Games Federation

The explanatory memorandum states that the Commonwealth Games Federation – an unincorporated association based in the United Kingdom - will be given a tax exemption for the purpose ‘of organising and promoting the staging of the Commonwealth Games’. It is envisaged that the exemption will apply principally in respect of payments to the Federation from the organising committee for the 2006 Melbourne Commonwealth Games in relation to the sale of television broadcasting rights.<sup>25</sup>

Despite the wording of the explanatory memorandum, **Item 3 of Schedule 5** does not limit the exemption either to income derived by the Federation for the purpose stated in the explanatory memorandum, or to income the Federation receives from the organising committee for the 2006 Games.

**Item 3 of Schedule 5** will amend **section 50-45** of the ITAA 97 to provide an income tax exemption for the Commonwealth Games Federation for the period 1 January 2000 to 30 June 2007.

Application: From 1 January 2000 to 30 June 2007 (**Item 4**).

## Endnotes

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- 1 An ALP amendment to this effect was supported by the Greens and the Democrats. The ALP position, as stated by Senator Conroy, was that ‘we do not believe it is an appropriate use of taxpayers’ funds to give this sort of tax break to foreign executives, particularly given their somewhat colourful and successful regimes that run some of our larger public companies’. (Senate Hansard, 27 June 2002, p. 2982).
- 2 Under item 12 of Schedule 1, to qualify as a ‘temporary resident’ for the purpose of income tax assessment, a person cannot have been a resident of Australia within the last 10 years. If a person stays more than 4 years in Australia, they cease to be a ‘temporary resident’.
- 3 Under section 128B(2) of the *Income Tax Assessment Act 1936*, Australian residents who pay interest to overseas lending institutions are obliged to “withhold” a certain percentage of the interest as tax payable to the Australian Government. The rate depends on the country in which the lending institution is based, but is usually 10 per cent. Under section 255, Australian residents are personally liable for any amounts they fail to withhold.
- 4 Under FIF rules, Australian taxpayers must pay tax on income and gains from non-Australian controlled overseas companies, foreign trusts or foreign life insurance policies with an investment component.
- 5 As the explanatory memorandum notes at p. 20, this measure not only applies to ‘temporary residents’ but also to others who enter Australia under the economic, international and

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social/cultural visa streams, as well as those on student visas and New Zealanders who do not intend to stay permanently in Australia.

- 6 Explanatory memorandum, p. 18.
- 7 *Review of Business Taxation – A Tax System Redesigned*, p. 675.
- 8 Explanatory memorandum, p. 8.
- 9 Business Council of Australia, *Media Release* 4 July 2002.
- 10 Michael Dirkis, “Reviewing an International Tax Review”, *The Tax Specialist*, October 2002, p. 68.
- 11 [http://www.taxboard.gov.au/content/int\\_tax/board\\_plan.asp](http://www.taxboard.gov.au/content/int_tax/board_plan.asp)
- 12 Department of the Treasury, *Review of International Taxation Arrangements*, p. 73.
- 13 These additional measures include:
  - Creating a specialist cell within the Australian Taxation Office to provide administrative support for foreign expatriates and employers;
  - Removing double taxation of employee share options through bilateral treaty negotiations;
  - Not proceeding with the Ralph Report recommendation that departure from Australia triggers taxation previously deferred on discounts for employee shares or rights; and
  - Not proceeding with the Ralph Report recommendation that residents departing Australia provide security for deferred Capital Gains Tax liability.

See *Review of International Taxation Arrangements*, pp 75 – 80.
- 14 Treasurer, *Press Release*, 22 August 2002.
- 15 Dirkis, *op.cit.*, p.78.
- 16 Treasurer, *Press Release*, 22 August 2002.
- 17 Australian Financial Review, 24 August 2002. Whether an Australian executive would pay more tax depends, of course, on whether such a person has overseas investments and other sources of foreign income. The specific terms of Double Taxation Agreements with particular countries may also affect the relative amounts of tax payable.
- 18 CPA Online Information Centre, “[Review of international taxation arrangements](#)”, 1 October 2002  
(at [www.cpaaustralia.com.au/01\\_information\\_centre/24\\_advocacy/1\\_24\\_0\\_0\\_home.asp](http://www.cpaaustralia.com.au/01_information_centre/24_advocacy/1_24_0_0_home.asp)).
- 19 Bernard Kellarman, "Tidying up the tax laws", *CFO* November 2002, at [www.cfoweb.com.au/stories/20021101/16723p.asp](http://www.cfoweb.com.au/stories/20021101/16723p.asp)
- 20 *ibid.*
- 21 Explanatory memorandum, p.22.
- 22 *ibid.*, p. 30.

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- 23 2002-03 Budget Paper No. 2.
- 24 Julie Smith, "Tax expenditures and public health financing in Australia", *The Economic and Labour Relations Review*, December 2001, p. 246.
- 25 Explanatory memorandum, p. 35.

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