

**8 JUNE 2009**

**SUBMISSION TO THE SENATE COMMITTEE INQUIRY**

**TAX LAW AMENDMENT (2009 BUDGET MEASURE NO.1) BILL 2009**

**SCHEDULE 1 SECTION 23AG OF THE INCOME ASSESSMENT ACT 1936**

**RE: TAX AMENDMENTS RE FOREIGN INCOME DERIVED BY  
AUSTRALIAN RESIDENTS WORKING OVERSEAS**

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## OPENING STATEMENT

I, Richard McDonald, am the Managing Director of RMS Engineering & Construction Pty Ltd.

RMS Engineering & Construction Pty Ltd (RMS) is owned by the Richard McDonald Family. I am the fourth generation of McDonalds to be involved in civil construction and building.

RMS has offices in Townsville, Darwin and East Timor. Head Office is located in Townsville. The company currently employs approximately 34 skilled and experienced full time staff throughout Australia and East Timor. RMS is an Australian company proud to be an exporter of services and goods to East Timor and is proud of its role in the development and future of East Timor and Northern Australia.

The East Timor operations were established by Richard Sippel and me in 1999. Management and staff in East Timor are comprised of 15 Australian and Philippine expats and 65 nationals. RMS is the largest Australian civil construction and building company in East Timor.

RMS is the preferred supplier to the Australian Defence Force and United Peacekeeping Force in providing a diverse range of construction and engineering projects.

The company's East Timor policy is to employ Australians in key management and project positions and thereby provide good and proper training for East Timorese in all aspects of civil construction and building. Given the previous shortage of skilled Australian workers, especially ones willing to work in East Timor, I have had to employ Philippine expats to fill vacancies.

I had been hopeful that as new skilled positions became available, I would be able to recruit Australians to fill the roles.

**I believe that the proposed Tax Amendments to the Income Tax of Australian Residents working overseas and the application of FBT to airfares to fly them to and from Australia will have serious unintended adverse consequences for**

## **the continued employment of Australian Residents in East Timor and Australia's overall future business interests in East Timor.**

I will forward this submission to the Committee Secretary by email. For the Senators who wish to obtain a greater understanding of RMS and its operations in East Timor, I will also attach to the email (i) a short profile of the company and (ii) Certificate of Appreciation from Lieutenant Colonel S. Ferndale Commanding Officer Defence Cooperation Program –East Timor.

RMS has also been nominated for a CCF Earth Award for the Specialist Training Wing Project at Metinaro that Lieutenant Colonel S. Ferndale refers to in his Certificate of Appreciation.

## **SUBMISSION**

Australian businesses that export goods and services to countries such as East Timor through their own overseas based offices will suffer severe disadvantages under the proposed tax amendments. **These disadvantages will prejudice both the employment of Australian Residents and the continuation of the businesses.**

The major competitors to the Australian companies in countries such as East Timor are not other Australian companies. The major competitors are from Indonesia, Philippines, China, Singapore, etc. Operations from these companies currently enjoy a significant cost advantage.

Under the proposed Tax Amendments, Australian businesses would be further and significantly disadvantaged.

It must be also noted that an Australian business such as RMS has significantly higher standards as to OH&S and Environment Management than the operations from the competitor countries. Whilst this is a further cost disadvantage, it also distinguishes RMS from its competitors. In other words, RMS believes that the East Timor government, East Timor businesses and East

Timorese employed by RMS benefit by being exposed to a good standard of OH&S and Environmental Management. RMS can maintain this advantage only by employing skilled and experienced Australian Residents in East Timor who understand and can successfully implement these standards.

**The unintended adverse outcomes and consequences that would be experienced by businesses such as RMS under the proposed Tax Amendments include:**

**Outcomes:**

1. The cost of employing Australian Residents overseas will substantially increase.
2. Australian Residents, especially skilled employees, will require their current after-tax income level to be maintained. The employer will need to gross up their remuneration packages to cover the proposed tax imposts. This would increase the cost of employing Australian Residents by 30% to 40%.
3. The Australian Residents employment packages include regular flights home to Australia. The impost of the FBT on these flight costs will also add substantially to the employer's employment costs.
4. Australian workers, especially skilled and experienced workers, accept overseas roles to gain a financial benefit. Currently the base overseas remuneration packages are higher, but not significantly higher, than that which would be earned within Australia. The current major advantage is via the Income Tax exemption. The higher net income is required as a reward for working in remote and difficult sites, working away from families and working in an environment with underlying risks. The loss of the Tax Exemption will prejudice the existing positions and the recruitment of future Australian Residents for overseas positions.

*I must emphasise that whilst RMS's Australian employees require a tangible benefit from working in East Timor, and rightly so, they proudly represent Australia and positively contribute to Australia's standing with the East Timorese people and to the development of the country. They take pride in being Australians and in their overall contribution to life in East Timor.*

5. The additional costs to the Australian businesses, created by the loss of the employee's Tax Exemptions will mean considerable less profit, which consequently, will mean less business tax revenue for the ATO.

**Consequences:**

- Australian Businesses exporting goods and services to overseas countries through their own overseas offices may have to:
  - Close the overseas operation / office.
  - Employ more skilled workers from other countries (Philippines, Indonesia, etc). Currently there are no skilled or experienced East Timorese engineering or construction workers.
  - The Australian businesses will lose their critical skill base and their key sustainable point of difference over foreign competitors.
  - The grass roots interaction of Australians with the local work force will cease.
  - The growing respect for Australia and Australians will be limited to government aid and development projects. It would be a terrible outcome for Australian infrastructure projects to be undertaken by other than Australian businesses and Australians. Australian businesses, without permanent in-country bases, could undertake

development projects on a project by project basis. This arrangement by its very nature would require the Australian contractors to employ and utilise overseas suppliers that have established bases in the country.

Once the project is completed, the Australians leave and the desired continuity is lost.

- Australian businesses that employ more foreign workers will suffer the loss of the Australian skills and the loss of contracts / business that are won due to those skill levels. The wages for the foreign workers will not provide any income for the ATO. Even if the Australian businesses maintained their work levels and profits, the ATO will not receive any additional tax income.
- Lost opportunities for skilled Australian workers to gain experience working overseas will result in fewer future Australian businesses setting up to undertake overseas work and export goods and services.

### **Unintended unfair discrimination against overseas employees of the private sector:**

The proposed Tax Amendments provide exemptions for Australian Resident individuals engaged in approved:

- ✓ Relief Projects
- ✓ Development Projects
- ✓ Australian Government Aid Programs
- ✓ Disaster Relief
- ✓ AusAid
- ✓ Members of Defence Forces, Peace Keeping Forces and Police Forces.

These roles would obviously be in Third World Countries and Developing Countries. Most of these would be in the Pacific and Asian Regions. These exemptions are warranted and justified.

However, the existence of Australian businesses in the country receiving the aid, Australian businesses employing Australians in the key roles, adds real and significant value to this aid. There is real value and synergy that continues past the completion of the project. This is not achieved by utilising non Australian businesses and/or using Australian businesses on a fly in project basis.

The intention of the aid provided by the Australian Government is to facilitate the development of the recipient country. The existence of a permanently based Australian business contributes significantly to achieving this outcome.

Australian Resident employees of Australian businesses with a permanent business operation in a country receiving Australian Government Aid and support must be viewed as directly contributing to the Australian Government's overall aims for the recipient country. Even if the Australian business does not directly undertake an aid project, its presence contributes to the development of the recipient country.

**Therefore it would be unjust for these Australian Residents, as employees of Australian private industry, not to be granted the same tax exemptions as other Australians who assist in the development of countries that receive Australian Government Aid.**

## **PROPOSED REGULATION IMPACT**

The 'General Outline & Financial Impact Assessment' in the Explanatory Memorandum (Pages 7 & 8) states that the impact is 'Low' and that forward revenue estimates are only \$675M (\$169M annually).

The unintended serious consequences previously highlighted will have an adverse impact on these revenue projections.

- a) Fewer Australian residents will be employed overseas.
- b) Workers from other countries will be employed.
- c) The ATO will receive no additional revenue.
- d) Australian businesses operating overseas, through their own offices, employing skilled Australian Residents, may close or scale back their overseas operations. This will result in reduced business tax revenue for the ATO.
- e) Australian businesses undertaking Australian funded Aid Projects on a project-by-project basis, fly-in / fly-out, will be at higher costs to the Australian Government.
- f) Australian Staff employed on a project-by-project basis will be exempt from paying tax in Australia.
- g) An Australian business with a permanent overseas business base generates income and profits from other non Australian funded sources. This provides additional business profits and thereby tax revenue for the ATO. This will be lost if the business withdraws its overseas base.

**The basis on which the additional Tax Revenues have been calculated appears to be flawed. It does not take into account that the revenue base will be substantially decreased and thereby the potential Tax Revenues will decrease.**

**Furthermore, even if the ATO could achieve its project revenues, it would not justify the adverse cost impacts on the government's aid programs and the loss of Australian private industry and Australian Resident workers contributing directly to the development of the recipient countries.**



## **RECOMMENDATIONS**

My recommendations are based on and consistent with my preceding comments.

The proposed Tax Amendments should be reviewed and amended to better target the tax avoidance and the tax minimisation schemes without having the serious adverse unintended consequences for genuine Australian businesses operating in overseas countries on a permanent basis.

### **My recommendations are based on:**

- Country Approved for Exemptions
- Australian Business Guidelines
- Australian Resident employed overseas exemption criteria

### **COUNTRY APPROVED FOR POSSIBLE EXEMPTIONS:**

Countries to be exempted to be listed by the ATO. An Australian Resident working in private industry cannot be approved for exemption unless he / she is employed by an Australian business and is working full time in a country on the Exemption List.

### **Criteria for approving a country for exemption:**

- I. Developing and Third world countries that receive Australian aid &/or support via AusAid, Relief Aid, presence of Australian Defence Forces or Australian Police Forces.
- II. It is in Australia's mutual interest to support the development of the country, including the development of its economy.

- III. Hardship test: Countries listed would generally be ones where infrastructure and living standards are such that Australian Residents working in that country would not be reasonably expected to take their families. The families remain living in Australia.

The circumstances that would reasonably prevent the family relocating from Australia would include – lack of reasonable housing, lack of English schooling, general safety and security concerns and limited community facilities.

**Given that the employees' families must reasonably remain in Australia, it would be unreasonable and punitive to charge FBT on the airfares to and from Australia for the employees to return home on a regular basis.**

*(East Timor is an example. Australian Resident employees live in a secure company compound. Guards are employed and the employees are housed in 'Dongas'. There is very limited facilities and infrastructure. It would be unreasonable to expect Australian Residents to take their families to East Timor and for them not to return home on a regular basis)*

**Once a country is listed as a country for exemption, the Australian business that operates in such a country has to make an application to the ATO to have its Australian Resident employees approved for Tax Exemption and for their Air Fares to be exempt from FBT.**

Such countries would be:

- East Timor
- Tonga
- Solomon Islands
- PNG, etc

**Australian Residents working in an 'Exempt Country' for an approved Australian employer obtain exemption from Australian income tax on income earned in that country by the Australian employer applying to the ATO for an overall exemption for its Australian Resident employees.**

**The criteria for the Australian Business to be approved:**

- I. An Australian 'Pty Ltd' company, partnership or sole trader. *(I do not propose to make recommendations as to a criteria for Australian Public Companies)*
- II. Business registered for GST.
- III. If a company, no shares are owned, directly or indirectly, by a public company, non Australian resident or any entity that is involved in Tax based schemes.
- IV. The same criteria as in 'III' would apply for partnership and sole traders.
- V. The Australian business entity is reasonably assessed as being a genuine commercial venture, trading for profit and commercially viable and sustainable.
- VI. The business is of general benefit to Australia and the exempt country. *(e.g. An Australian business exporting and selling say alcohol or cigarettes in East Timor would not met this general benefit criteria)*
- VII. The business has a permanent office / base in the exempt country. This would be evidenced by address, phone numbers, email, leased premises etc.

**The Criteria for the Businesses' Australian Resident Employees qualifying for the tax exemption granted via the Australian employers would be:**

1. The employee must be an Australian Resident;
2. Employed full time in the exempt country by an approved Australian business for a period in excess of 90 days;
3. Holds an Australian TFN.

## **SUMMARY**

I believe that this submission outline is fair and balanced. It supports the goals of the Australian Government to assist developing countries whilst not impeding the prospects for Australian businesses to be successful with their overseas operations.

It will also allow the Government to best target arrangements that unreasonably minimise or avoid tax in Australia.

The Australian Government's efforts to fully participate in the Asian and Pacific Regions can be enhanced by Australian businesses establishing successful business operations that employ skilled Australian residents in those businesses.

If you wish to contact me to clarify any parts of this submission, please do so.

Thank you for reading and considering my submission.

Richard McDonald

Managing Director

RMS Engineering & Construction Pty Ltd.

## **RMS Engineering and Construction**

Att: Mr Richard Sipple

### **CERTIFICATE OF APPRECIATION**

Dear Richard,

On behalf of the Australian Defence Cooperation Program - East Timor, I would like to take this opportunity to express my gratitude to you for the manner in which your company delivered the Specialist Training Wing Project at Metinaro.

From the start, this particular task was a very high profile and important project for not only the Australian government, however, more importantly the Democratic Republic of Timor Leste and the Timor Leste Department of Defence.

Your Company's commitment to the delivery of this project ensured that the highest possible quality product was delivered in an extremely tight timeframe without compromise. The professionalism and skills of your staff ensured that all client and stakeholder expectations were met and, in fact, were well exceeded with the final functionality of the facility. In addition, your staffs approachable and proficient manner fostered an exceptionally good working relationship between all parties involved.

On a professional and personal level, I trust that this level of working commitment will be maintained and extended to all other project undertaken between the Defence Cooperation Program - East Timor and RMS.

**S. FERNDALE**

Lieutenant Colonel

Commanding Officer

Defence Cooperation Program-East Timor

18 May 2009