CHAPTER 7

OTHER CONCERNS OF EXPATRIATES

7.1 This chapter examines some of the other concerns of Australian expatriates including:

- taxation issues;
- superannuation;
- issues relating to driver's licences;
- medical insurance issues;
- social security agreements;
- working holiday arrangements; and
- issues relating to tourist visas.

7.2 Each of these issues will be considered below.

Taxation issues

7.3 A number of submissions commented on taxation. The most significant areas of concern were:

- income tax rates;
- withholding tax for non-residents;[1]
- lack of a tax-free threshold for expatriates on superannuation pensions;
- section 23AF of the *Income Tax Assessment Act 1936* (expatriates working in countries with no personal income tax); and
- the need to make information on tax issues more available to expatriates.

Income tax rates

7.4 A substantial number of submissions raised income tax rates as an issue, generally to argue that they are too high. Some submitters, such as Mr Ray Thaller, claimed income tax as a factor 'driving them out' of Australia:

> As a potential emigrant (I will be emigrating shortly to the US), I can say that one of the reasons Australians are leaving home is not just to make a splash in a bigger pond as some suggest, but because our tax rates are not

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1 In tax law, expatriates are referred to as 'non-residents'. In this section 'non-residents' will be used where appropriate to maintain consistency with the legislation, and 'expatriates' will be used in a more general sense. For the purposes of this report, the two terms have identical meanings.

> internationally competitive. Much smaller countries like Singapore recognize that they will always be a small pond, hence make it attractive through low income tax rates. Taxes have to be internationally competitive to lure expatriates back and to reduce incentive for Australians wanting to go overseas.[2]

7.5 Other submissions described (allegedly) high rates of income tax as a factor which may prevent or delay repatriation. For example, the SCG stated that:

> The relatively high level of income taxes in Australia compared with the much lower levels applying in many of the countries in which [expatriates] live, is identified as one of the major reasons not to repatriate to a country where job prospects commensurate with their experience and qualifications are limited and a large part of their earnings is taken in tax.[3]

7.6 Most submissions argued that the solution was for Australia to institute a lower personal income taxation regime, though some submitters sought specific tax concessions in order to entice expatriates to return. For example:

> What about some kind of tax "forgiveness" for the first five years of returning Australians? What about low-cost housing loans? A lower mortgage? Subsidised housing? Maybe a $200 fare for returning Australians?[4]

7.7 The Committee does not support tax 'forgiveness' or other tax concessions for returning expatriates. Such a system may in fact have the perverse effect of forcing more Australians overseas in order to qualify for concessional taxation when they return.

7.8 Concern about the level of personal income tax is not confined to expatriates, but rather is a regular feature of Australian public debate on tax policy. The Committee supports one underlying argument in these submissions: that Australia should have an internationally competitive taxation regime. However, in the Committee's view it is somewhat simplistic to examine personal income tax in isolation. Rather, income tax should be considered in the context of the taxation system *as a whole*, and also in terms of the services which are provided by government. Other nations may indeed have smaller levels of income tax, but may compensate for this either by having other forms of taxation, or by providing lower levels of government service. One submitter, Ms Emma Cuttler, took a more sophisticated view of personal income taxation and found that she preferred a nation with relatively high levels of personal income tax:

> I am currently paying 40% income tax in Denmark, which is at the low end of the scale. However I am entitled to free medical cover, I attend free Danish language classes each week, I have access to the libraries and if I

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2 *Submission 208*, p. 1.

3 *Submission 665*, p. 117.

4 Mr Louis Cooper, *Submission 167*, p. 3.

> am living here after 2 years I will be entitled to free education with study payments from the government each month.[5]

7.9 The Committee noted that some submissions on personal income tax appeared confused about what the actual level of personal income taxation is. For instance, Dr George Botha stated:

> Fifty percent tax in Australia is an appalling tax on reward, hence people in Australia don't work hard. This is one of the reasons why many Asian countries have growth rates of about 8-10%, whereas in Australia we struggle tor each half that growth rate.[6]

7.10 Statements such as this one give the impression that resident high income earners are paying 47 per cent income tax on every dollar they earn. This is simply not the case. Personal income tax rates in Australia are *marginal* tax rates. That is, 47 per cent taxation is only applied to every dollar earned over $70,000 (in 2004/05). Even for high income earners, their first $6000 in income is untaxed; their income between $6001 and $21,600 is taxed at 17 per cent; between $21,601 and $58,000 at 30 per cent; and between $58,001 and $70,000 at 42 per cent. Only their income above this amount attracts 47 per cent taxation.

7.11 This system of progressive taxation is a cornerstone of Australian taxation, because it places the greater tax responsibilities on those with the greatest capacity to pay, and seeks a lesser contribution from those with a lesser capacity to pay. While the precise levels of marginal taxation, and the income thresholds at which they should apply, are likely to continue to be matters of political debate, the system of progressive income taxation itself is unlikely to be changed in order to reduce perceived barriers to expatriates returning to Australia.

Withholding tax for expatriates

7.12 Non-resident Australians who earn Australian income in the form of interest, dividends and royalties will have some of those earnings withheld under the pay as you go (PAYG) withholding tax system. The withholding tax on interest is 10 per cent, and the withholding tax on the unfranked portion of dividends and royalties is 30 per cent, unless Australia has a tax agreement with the non-resident's country of residence (in which case the rate is generally lower). This is a *final* withholding tax; that is, once the withholding tax has been paid, the taxpayer's tax liability is fully discharged.

7.13 Some submissions argued that this withholding tax is unfair. Australian Chamber of Commerce, Singapore (AustCham Singapore) suggested that the withholding tax on interest should be waived.[7] Mr Quentin Waddell argued that

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5 *Submission 500*, p. 1.

6 *Submission 415*, p. 2.

7 *Submission 369*, p. 9.

instead of paying the withholding tax, expatriates should be able to enter dividend reinvestment programs, not pay tax on the re-invested income, then pay personal income tax once they return to Australia and realise the income.

7.14 This suggestion would be problematic. Currently, tax law treats wealth acquired through dividend reinvestment schemes as income, and taxes it as such, in the year it is earned. Allowing expatriates to reinvest their dividends, thus delaying their tax liability, would result in that reinvestment wealth occupying an ambiguous position where it is neither income (or else it would be taxed in the current year) nor exempt income (because a tax liability for that wealth remains).

7.15 This suggestion may also increase the complexity of the taxpayer's tax liabilities in their country of residence. Under the double taxation agreements Australia has with a substantial number of nations, Australian nationals may have their Australian tax credited against their tax liability (on their Australian income) in their country of residence. If the tax liability was deferred and not paid, and if the dividend reinvestment was regarded as income by their resident country, this may in fact result in the expatriate being taxed twice for that wealth: once by their country of residence in the year it is earned, and once when the gain was realised on return to Australia.

7.16 The Committee notes the concerns of expatriates regarding withholding tax, but acknowledges that this issue is part of the broader tax debate, and beyond the scope of this inquiry.

Lack of a tax-free threshold for expatriates on superannuation pensions

7.17 Another specific concern that was raised related to the fact that expatriates living on self-funded retirement pensions are not granted a tax-free threshold and as a result are required to pay tax on their entire pension:

> Australian expatriate superannuation pensioners are not entitled to any Australian government financial assistance in their medical care simply because they do not live in Australia. Most such pensioners are also not entitiled to the social security pension (the old age pension) because the means test disqualifies them. They are therefore not a financial burden whatsoever on the Australian government. They must look after themselves. Yet an unfair anomoly exists because any superannuation pension generated in Australia is fully taxed. There is NO tax threshold whatsoever. Out of the net pension they are then required to provide their own offshore medical insurance cover and to pay the costs of hospital outpatient treatment and associated medication.[8]

7.18 This issue is not restricted to superannuees. As a matter of policy, non-residents are not entitled to the tax-free threshold with respect to *any* personal income, instead paying a 29 per cent marginal tax rate on their first $21,600 of Australian

8 Mr Barry Petersen, *Submission 190*, p. 1.

sourced income. Income in excess of $21,600 is taxed at the same marginal tax rates as for Australian residents. Application of this policy to income from superannuation schemes results in the concern identified above. Any suggestion that tax-free thresholds should be implemented for superannuation pensions, by extension, would suggest the implementation of the tax-free threshold for all Australian-sourced income derived by non-residents.

Section 23AF of the Income Tax Assessment Act 1936 (expatriates working in countries with no personal income tax)

7.19 Another concern raised was the application of section 23AF of the *Income Tax Assessment Act 1936*, which relates to income tax exemptions for income derived by Australian residents whilst working on approved overseas projects.[9] According to Austrade, the main intent of section 23AF is to ensure that Australian consultants and contractors working overseas on approved projects do not suffer a tax disadvantage compared to similar workers of foreign countries, allowing them to operate and compete under tax-free conditions.[10]

7.20 The Committee is aware of concerns that a recent reinterpretation of section 23AF means that many who may previously have benefited from this section may now miss out. The Committee notes that the Joint Committee on Foreign Affairs, Defence and Trade has been inquiring into this issue as part of a broader inquiry into expanding Australia's trade and investment relationship with the economies of the Gulf States. The report of the Joint Committee may throw some light on this matter.

Superannuation

7.21 As with tax, superannuation was a common area of comment and concern amongst submissions. Two superannuation issues raised were:

- portability of superannuation; and
- residency requirements for small superannuation funds.

Portability of superannuation

7.22 Many expatriates wish to establish the basis for a retirement income by contribution to superannuation or similar tax-sheltered retirement savings vehicles, even while they are overseas. However, a number of submissions raised concerns regarding the 'portability' of such overseas retirement savings. 'Portability' in this context refers to the expatriate's ability to repatriate their retirement savings without

9 Mr Mitchell Ellis, *Submission 419*, p. 2.

10 Mr Martin Walsh, Australian Trade Commission, *Committee Hansard*, Joint Standing Committee on Foreign Affairs, Defence and Trade, 21 June 2004, p. 13.

facing punitive taxation penalties. This was particularly a concern for expatriates in the US and UK, but was not limited to residents of those nations.[11]

7.23 In the US, retirement savings are commonly accumulated through what are known as '401k accounts'. These are analogous to Australian complying superannuation funds. An Australian who lived and worked in the US, and who contributed to a 401k account, would face severe penalties upon their return to Australia:

> Let me illustrate here what would happen in the case of an Australian (the same would happen in reverse to an American). There are a number of permutations (usually all adverse), but the following basic example will illustrate the dilemma. As noted above withdrawal from the US schemes is restricted until usually a person reaches a certain age. If an Australian were to return home, he must leave his 401K or IRA in the US since they cannot be moved or liquidated without a severe tax penalty (e.g. all cumulative gains would be taxed at current rates plus a 10% early withdrawal penalty). However, from an Australian tax perspective, as I understand, the Australian upon returning to reside in Australia would find that the Australian government would tax all dividends and interests and certain other gains in the year they arose even though the returning expatriate would not have access (without penalized withdrawal) to the funds in the account to pay the Australian tax that was levied. Although Australian tax law may recognize Australian tax sheltered savings vehicles, they do not recognize foreign ones and vice-versa in the US for an expatriate returning to the US who would have an Australian or other foreign sheltered scheme.[12]

7.24 This issue was recently considered by the Senate Select Committee on Superannuation, in its July 2002 report *Taxation Treatment of Overseas Superannuation Transfers*. While the Select Committee examined *all* incoming superannuation transfers, whether from returning expatriates or migrants entering Australia for the first time, its conclusions are relevant to the current inquiry.

7.25 The Select Committee recommended concessional taxation for the earnings of lump sums from foreign superannuation which were transferred to Australia. This is somewhat different to the situation described above, where the superannuation funds are to be held in the 401k account until retirement. In considering such accounts, the Select Committee was less prepared to offer concessions, arguing instead that such funds should be treated in the same manner as Australian non-complying funds:

> The Committee also notes that, while an overseas entity may have many of the characteristics of a complying fund, it may be difficult to justify why earnings from such a source should be treated differently from earnings from any other non-complying source … Specifically, if the earnings of an

11 See, for example, Dr Ron Hackney, *Submission 349*, who describes similar concerns in Germany.

12 Mr Frank Orban, *Submission 14*, p.2.

> overseas non-complying fund are to receive concessional treatment, there may be a presumption that the same should apply to resident non-complying funds. However, the Committee considers that such a move may weaken the current distinction between complying funds which forms the basis of superannuation regulation in Australia.[13]

7.26 While the Committee is aware of the importance of the distinction between complying and non-complying superannuation funds, workers in Australia are inevitably able to contribute to complying funds. If they choose to contribute to a non-complying fund, they may make this choice with a full appreciation of the taxation consequences. An expatriate, in most cases, will *not* have the choice of making contributions to an Australian complying superannuation fund. It therefore seems anomalous to press a tax disadvantage upon them.

7.27 The Committee notes that the Senate Select Committee on Superannuation has made a full investigation of this issue. However, the Committee considers that consideration should be given to recognising some forms of foreign superannuation, which have characteristics similar to Australian complying funds, as complying funds for Australians resident in that nation at the time the contributions are made.

Residency requirements for small superannuation funds

7.28 For superannuation funds to attract concessional taxation, they must be *resident* superannuation funds. However, this may not be feasible in the case of small, self-managed superannuation funds operated, for instance, by a couple who then move overseas for a relatively short period. In recognition of this, the *Income Tax Assessment Act 1936* was amended to provide that a small fund could remain resident for tax purposes so long as its trustees are not absent from Australia for more than two years.

7.29 One submission argued that this two year period is too short:

> Many expatriates are sent on overseas assignments for periods in excess of 2 years at the behest of their employers, a matter that is largely beyond their control.
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> It is submitted that the residency test for a superannuation fund should be amended to allow for a long-term 'hiberation' of 'mum and dad' funds to the eventual return of the expatriates or at the very least, extend the 'hibernation' period beyond 2 years, to perhaps 5 years.[14]

7.30 The Committee considers that the current two year permitted absence is adequate. If an expatriate plans to leave for more than two years, they have the options

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13 Senate Select Committee on Superannuation, *Taxation Treatment of Overseas Superannuation Transfers*, July 2002, p. 25, para 3.29.

14 Mr Michael Blake, *Submission 598*, p. 3.

of appointing resident trustees or transferring the assets of their self-managed superannuation fund into a larger, resident, complying superannuation fund.

Driver's licence issues

7.31 Another issue of concern raised in the course of the inquiry relates to the reciprocal recognition of driver's licences and between Australia and other countries. The Committee notes that Australia has recognised a number of countries with equivalent driver's licensing standards and procedures. Under reciprocal agreements with these countries, applicants for licences are not required to undergo a practical driving test. They are still required to pass a knowledge test.[15]

7.32 For countries where no reciprocal arrangement exists, however, many Australian expatriates experience difficulties when attempting to obtain a driver's licence. The SCG argued that due to language difficulties and time and cost issues it is not uncommon for expatriates who have been resident in a country for a number of years to continue driving on international driver's licences which have been issued in Australia. This is illegal in their country of residence and could result in serious consequences such as their not being covered by insurance in the event of an accident.[16] The SCG also pointed out that an Australian who becomes resident in an overseas country is required to obtain a local licence within a defined period of becoming a resident.[17]

7.33 The SCG voiced particular concern that Australia's policy towards foreigners driving in Australia has a direct impact on policies towards Australians in other countries. Ms Anne MacGregor of the SCG was critical of Austroads, the association of Australian and New Zealand road transport and traffic authorities. Austroads plays an important role in considering and approving applications for overseas countries seeking recognition of their driving licences in Australia. Ms MacGregor told the Committee:

> Austroads does not seem to have grasped that its policy on the treatment of foreigners arriving in Australia with foreign licences directly impacts on the way other countries treat Australians overseas on this matter. Attempts are also under way to achieve a reciprocal licence arrangement with Belgium but these are going to be hindered if Australian licensing authorities are not prepared to allow Belgian citizens to swap their licences for Australian licences. A great deal remains to be done in this area. Many employment opportunities for expat Australians depend on the ability to be able to drive legally in their country of residence.[18]

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15 A list of recognised countries can be found at http://www.austroads.com.au/overseas.html (accessed 26 November 2004).

16 *Submission 665A,* Attachment, p. 11.

17 ibid.

18 *Committee Hansard*, 4 August 2004, p. 3.

7.34 Increasing economic globalisation and movement of people will inevitably lead to a growing need on the part of many countries for reciprocal recognition of driver's licences. The Committee notes that other countries are also grappling with this issue. In the US, for example, the American Association of Motor Vehicle Administrators (AAMVA) has recognised that multinational corporations are relocating staff and their families around the world for extended periods, and that there is a rise in the number of countries seeking reciprocity agreements.[19] The AAMVA has established a working group to assist states (of the US) and provinces (of Canada) in their consideration of applications from other countries for reciprocity agreements.

7.35 The Committee notes that Austroads, through its Registration and Licensing task force, is continuing its work in this area, and encourages Austroads to expedite applications from other countries.

Medical insurance issues

7.36 The SCG raised some concerns in relation to medical insurance issues, in particular the issue of Medicare coverage overseas. The SCG submitted that Medicare will only cover Australians outside Australia where Australia has a reciprocal health care arrangement with the particular country in which medical assistance is sought.[20]

7.37 Australia has reciprocal health care agreements with some countries, including Finland, Ireland, Italy, New Zealand, Norway, Sweden and the UK. The SCG submitted that these agreements 'generally exclude long-term members' of the Australian expatriate community.[21]

7.38 According to the SCG, whether an Australian in one of these countries will be covered by the relevant agreement concerned then usually turns upon whether the person is an Australian resident for the purposes of the *Health Insurance Act 1973* at the time he or she seeks medical assistance in the country with which Australia has the reciprocal agreement. The SCG submitted that generally the agreements cover people who are 'temporarily in the territory' of the other country but not ordinarily resident there.[22]

7.39 The SCG argued that this has the effect of creating confusion, for example, for those Australians overseas on working holiday visas for a 12-month period.[23]

7.40 Further:

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19 See the American Association of Motor Vehicle Administrators, http://www.aamva.org/drivers/mnu_drvIntlIssues.asp (accessed 26 November 2004).

20 *Submission 665A*, Attachment, p. 12.

21 *Submission 665*, p. 136.

22 *Submission 665A*, Attachment, p. 12.

23 ibid.

> Pure travel insurance in order to obtain medical coverage may be feasible for those who are away for up to 12 months, but it is not always available, advisable or even necessary for longer periods. Once employed overseas, many overseas Australians and their dependents are covered by the health systems in their country of residence through their social security or national insurance contributions, or in the US, for example, by employer health benefits.[24]

7.41 The SCG suggested that it would be advisable for DFAT to explain in brochures such as *Living and Working Overseas* that, where this is not the case, expatriates should obtain their own private insurance locally where travel insurance is not available or not appropriate. In addition, the SCG suggested that it would be helpful if a link could be provided to an Australian Government website which includes detailed information in plain English on eligibility under Australia's existing reciprocal health agreements, concentrating on the particular areas which cause many people confusion.[25]

7.42 A further issue relates to those expatriates who have not obtained private health insurance by the age of 30 in Australia. On repatriation, people who purchase hospital cover for the first time after the 1 July following their 31st birthday must pay a Lifetime Health Cover Loading, based on the person's Lifetime Health Cover Age. This loading equals 2 per cent for each year the person's Lifetime Health Cover Age is over 30.[26] One submission expressed concern in this regard as follows:

> Naturally, we are worried about our own situation when the time comes for us to take up residency as far as membership of Medicare is concerned. In the meantime we are aware of changes to membership of private health insurance. We did try to get private insurance with HBA but were told that without Medicare cards it was not available to us. We did this before the system changed in such a way that if you were not enrolled in private health care before the age of 30 (we are in our 50's) you would have to pay increased premiums if and when you did join. So we are also concerned that we will be unable to get reasonably priced private health cover when we return.[27]

7.43 The Committee notes that there is no provision, under the Lifetime Health Cover scheme, for taking into account the contributions made by expatriates to foreign private health insurance whilst resident overseas. Thus for those returning after the age of 30, there is no way of avoiding the additional insurance premium that must be paid. This is a matter for consideration by the Department of Health and Ageing.

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24 ibid, p. 13.

25 ibid.

26 See further: http://www.health.gov.au.

27 *Submission 463*, p. 1.

Social security agreements

7.44 The Department of Family and Community Services (FaCS) informed the Committee that Australia currently has international social security agreements with 14 different countries, including Canada, Germany, Italy, New Zealand, Spain and the US. Negotiations for an agreement with Greece have been continuing for a number of years.

7.45 Australia previously had an agreement with the UK, however this was terminated from 1 March 2001 because of the UK's decision not to index the pensions it pays to UK pensioners living in Australia.[28] The SCG noted that the termination of the agreement with the UK has 'been of great concern to, and the subject of much lobbying by, expatriate groups representing the recipients of British pensions'.[29]

7.46 FaCS pointed out that an emerging priority with agreements which is of interest to the expatriate and international business community 'is the incorporation of provisions regulating compulsory employer/employee contributions to retirement income schemes (in Australia's case the Superannuation Guarantee)'.[30] These are included in existing agreements with the Netherlands, Portugal and the US and in new agreements with Belgium, Chile and Croatia. Wherever possible, such provisions will be included in all future negotiations for social security agreements.[31]

7.47 The SCG submitted that, in its view, the current momentum that has built up in establishing bilateral social security agreements should be maintained.[32]

Working holiday arrangements

7.48 Australia currently has working holiday agreements with 15 countries, including Canada, Italy, Japan, Sweden and the UK. Negotiations are taking place to establish agreements with 11 other countries.[33]

7.49 The SCG argued that working holiday schemes are an important element of arrangements for Australian expatriates. Amongst other things, working holiday schemes provide the following advantages:

- young Australians, between the ages of 18 and 30, have the opportunity to stay for an extended period of time in the host country;

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28 *Submission 566*, p. 9.

29 *Submission 665*, p. 135.

30 *Submission 566*, p. 9.

31 ibid.

32 *Submission 665*, p. 135.

33 ibid, p. 133.

- working holiday visa holders are exposed to the culture, language, lifestyle and working environment of the host country; and
- the significance of the Australian expatriate phenomenon is enhanced to family and friends of the visa holder and the Australian public generally, particularly through those returning to Australia on the termination of their visas.[34]

7.50 In evidence at one of the Committee's hearings, Mr Bryan Havenhand from Global Exchange argued that the traditional working holiday program model could usefully be improved to promote travel by Australians to a greater number of countries:

> Australia now has something like 17 working holiday-maker destinations and New Zealand I think has about 18, but some of those countries are exclusive to one or the other. I think with the two put together there are about 23 countries that accept either Australian and/or New Zealanders. Unfortunately the expansion in the Working Holiday Maker program, while it is good in its own right and does provide additional opportunities to work in other countries, still has not changed the traditional model much, in the sense that I estimate 25,000 or 30,000 Australians go overseas each year, the first time on a working holiday visa. But the bulk of them still go to London. Of those 20,000-odd you are still getting about 18,000 to 20,000 going to London; 5,000 or 6,000 going to Canada; up to about 1,500 to Japan. Then other countries might get one or two or three, literally.[35]

7.51 In particular, Mr Havenhand suggested that the following improvements could be made to some elements of the existing scheme:

> There needs to be maybe some encouragement, some direction to get students to look at going to other countries as well that provide opportunities. I suppose at some level that meshes in with the developing program now about student exchange and trying to get students to go to a whole range of different countries and generally encouraging students to go as well. That is outside the parameters of this investigation, but those sorts of issues mesh together a bit.
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> I would not look at any more countries or any more deregulation but perhaps making the current system work better in terms of getting people to go to more of the different countries and getting some of those other countries to loosen up their employment rules.[36]

7.52 The SCG recommended that the Australian Government take steps to hasten the finalisation of those agreements currently under negotiation and mount a pro-

34 ibid, pp. 133-134.

35 *Committee Hansard*, 27 July 2004, p. 39.

36 ibid, p. 40.

active campaign to establish working holiday agreements with other countries where there is an existing or potentially significant Australian expatriate community.[37]

7.53 The Committee agrees that the working holiday scheme is a positive and beneficial scheme which should continue to be promoted and expanded. The Committee also considers that the agreements currently under negotiation should be finalised as soon as possible, with development of an extended agenda.

37 *Submission 665*, p. 134.