TD 2011/1 - Income tax and fringe benefits tax: can a non-resident entity be: (a) required to withhold amounts from salary and wages paid to an Australian resident employee for work performed overseas under section 12-35 of Schedule 1 to the Taxation Administration Act 1953? (b) subject to obligations under the Fringe Benefits Tax Assessment Act 1986 in relation to benefits provided to an Australian resident employee in relation to work performed overseas?

There is a Compendium for this document: **TD 2011/1EC** .

Taxation Determination

Income tax and fringe benefits tax: can a non-resident entity be:

(a) required to withhold amounts from salary and wages paid to an Australian resident employee for work performed overseas under section 12-35 of Schedule 1 to the *Taxation Administration Act 1953*?

(b) subject to obligations under the *Fringe Benefits Tax Assessment Act 1986* in relation to benefits provided to an Australian resident employee in relation to work performed overseas?

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Ruling

1. Yes.

Pay As You Go withholding

2. A non-resident entity that pays an Australian resident for work performed overseas must withhold an amount in accordance with section 12-35 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) if the non-resident entity has a sufficient connection with Australia. Note that the requirement to withhold in section 12-35 is subject to specific exceptions set out in section 12-1 of Schedule 1 to the TAA.

3. The nature of a sufficient connection is a matter of statutory interpretation having regard to the Pay As You Go (PAYG) withholding provisions in the TAA. Where a non-resident entity pays an Australian resident for work performed overseas, the non-resident will have a sufficient connection to Australia if they have a physical business presence in Australia. A non-resident entity will have a physical business presence in Australia if the non-resident carries on an enterprise or income producing activities (or part of such enterprise or activities) in Australia and has a physical presence in Australia.

Fringe benefits tax

4. If there is a withholding obligation, obligations under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) will arise in relation to benefits provided to an Australian resident employee in respect of the employment of the employee. If there is no withholding obligation, amounts paid to the employee by the non-resident entity for work performed overseas will not be 'salary and wages' as defined in subsection 136(1) of the FBTAA and no obligations under the FBTAA can arise for the non-resident entity in relation to benefits provided to that employee.

Example 1

5. Sheree is an Australian resident for tax purposes. She is employed as a project manager working in the Australian operations of a non-resident consultancy company. The company transfers her overseas for 5 months to work on a new consultancy project. The company continues to carry on business and maintains a physical presence in Australia. Sheree's wages are assessable income in Australia. The company has an obligation to withhold an amount for Australian tax purposes from the salary paid to her.

6. Sheree is provided with a car while overseas and is reimbursed for some additional living expenses. As amounts must be withheld from her salary, her employer will have obligations under the FBTAA in respect of the benefits provided to her. Sheree is not required to include these in her Australian assessable income.

Example 2

7. Raj is an Australian resident for tax purposes. While on a 6 month backpacking holiday overseas, he works as a fruit-picker for a local family-owned business. He is paid by the hour and given free board and lodging. His non-resident employer has no staff or operations in Australia, and therefore no connection with Australia. Raj's wages are assessable income in Australia. However, his non-resident employer has no obligation to withhold Australian tax from the wages paid to him. As there is no obligation to withhold, no obligations under the FBTAA can arise to his non-resident employer in respect of the board and lodging provided. Raj will be required to include this employment income and the value of the benefits received from the non-resident employer in his Australian assessable income.

Example 3

8. Laurren is an Australian resident for tax purposes. She works for an Australian subsidiary of an international hotel chain as an events manager. Under an incentive program for high performing staff, she is offered a 6 month overseas secondment with the group's global parent company. The parent company is a non-resident for tax purposes and does not carry on business in Australia. While on secondment she will be employed and paid by the parent company. Her employer, being the non-resident parent company not carrying on business in Australia and with no physical presence in Australia, has no obligation to withhold Australian tax from the salary paid to her. As there is no obligation to withhold, no obligations under the FBTAA can arise to her non-resident employer in respect of any benefits provided to her. Laurren will be required to include this employment income and the value of any benefits received from the non-resident employer in her Australian assessable income.

Date of effect

9. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
19 January 2011

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Explanation

10. Under section 12-35 of Schedule 1 to the TAA[1] an entity must withhold an amount from salary and wages, commissions, bonuses or allowances it pays to an individual as an employee (whether of that entity or another entity). However, pursuant to subsection 12-1(1), an entity need not withhold an amount under section 12-35 if the whole of the payment is exempt income of the employee.[2]

11. Australian law can be validly enacted with extra-territorial effect.[3] While there is a general presumption of statutory interpretation that a law is not intended to have extra-territorial operation,[4] this presumption can be displaced where there is a clear legislative intention for the law to apply outside Australia.[5] Such an intention can be found in specific statutory provisions or by necessary implication having regard to the policy, object or purpose of the law.[6]

12. The TAA does not expressly provide that its application is limited to events and circumstances within Australia; nor does the Act expressly provide that its operation is extra-territorial.[7] Section 12-35 uses terms that do not have a particular territorial aspect to their meaning and is also silent regarding matters of extra-territorial effect.

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[1] All legislative references are to Schedule 1 of the TAA unless otherwise stated.

[2] A payment may be exempt income under a provision of the tax law (for example, under section 23AF or section 23AG of the *Income Tax Assessment Act 1936*). The withholding obligation under section 12-35 of Schedule 1 to the TAA also does not apply where a payment is non-assessable, non-exempt income: see section 12-1(1A) of Schedule 1 to the TAA.

[3] See section 3 of *The Statute of Westminster* 1931 (UK) adopted in Australia by the *Statute of Westminster Adoption Act 1942*; *New South Wales v. Commonwealth* [1975] HCA 58; (1975) 135 CLR 337, in particular the judgement of Jacobs J at CLR 497-498; *Trustees Executors & Agency Co Ltd v. Federal Commissioner of Taxation* [1933] HCA 32; (1933) 49 CLR 220 per Evatt J at CLR 235. Note also the comments of Mason J in *Koowarta v. Bjelke-Petersen* [1982] HCA 27; (1982) 153 CLR 168 at CLR 223.

[4] This presumption was explained by O'Connor J in *Jumbunna Coal Mine NL v. Victorian Coal Miners' Association* [1908] HCA 87; (1908) 6 CLR 309 at CLR 363 as follows:

> In the interpretation of general words in a Statute there is always a presumption that the legislature does not intend to exceed its jurisdiction. Most Statutes, if their general words were to be taken literally in their widest sense, would apply to the whole world, but they are always read as being *prima facie* restricted in their operation within territorial limits.

See further, for example, Dixon CJ in *R v. Foster; Ex parte Eastern and Australian Steamship Co Ltd* [1959] HCA 10; (1959) 103 CLR 256 at CLR 275.
See also Paragraph 21(1)(b) of the *Acts Interpretation Act 1901*, which gives statutory recognition to this presumption.

[5] For example, in *Birmingham University and Epsom College v. Federal Commissioner of Taxation* [1938] HCA 57; (1938) 60 CLR 572, the High Court found that section 21(1)(b) of the *Acts Interpretation Act 1901* did not apply to restrict the territorial application of a particular taxation exemption where the corresponding taxing provision was expressed to apply to non-residents of Australia and to foreign income of Australian residents.

[6] Isaacs J in *Morgan v. White* [1912] HCA 50; (1912) 15 CLR 1 at 13; *Kumagai Gumi Co Ltd v. Federal Commissioner of Taxation* (1999) 161 ALR 699; [1999] FCA 235 per Hill J at ALR 707.

[7] Section 3 of the TAA provides that the Act extends to every external Territory. Section 17 of the *Acts Interpretation Act 1901* together with section 122 of the *Commonwealth of Australia Constitution Act 1901* defines external Territory to broadly mean Territories not otherwise included within Australia, which are governed by the Commonwealth of Australia, such as Norfolk Island. Notwithstanding that section 3 of the TAA extends the operation of the TAA to these external Australian Territories, it does not prevent the broader extra-territorial application of provisions within the TAA where it is required either expressly or by necessary implication (see for instance section 255-40, Division 263 and subsection 284-145(3) of the Schedule 1 of the TAA.

13. However, the stated object of the part of the Act which contains section 12-35[8] is to ensure the efficient collection of certain specified taxes, including income tax.[9] Residents are, broadly speaking, assessable on their worldwide employment income. Non-residents are, broadly speaking, assessable on their income earned in Australia.[10] As a means of collection of tax payable on foreign-sourced income and income earned by non-residents, the presumption against any extra-territorial operation is inconsistent with the purpose of PAYG employment withholding.

14. The *manner* of a law's operation outside Australia is also a matter of statutory interpretation. In considering whether a law operates extra-territorially and the manner of such operation, regard is had to the presumption that the law is not intended to extend to matters properly within the jurisdiction of a foreign law.[11] Unless there is a contrary intention, a sufficient connection with Australia is required.[12]

15. In *Clark (Inspector of Taxes) v. Oceanic Contractors* [1983] 1 All ER 133; [1983] 2 WLR 94; 13 ATR 901, the House of Lords examined the territorial effect of the UK equivalent of section 12-35.[13] It was held that a non-resident company is subject to withholding obligations where it has a trading presence in the United Kingdom. Lord Scarman said (at All ER 141; 13 ATR 909):

> …the present case is concerned with the territorial limitation to be implied into a section which establishes a method of tax collection. The method is to require the person paying the income to deduct it from his payments and account for it to the Revenue. The only critical factor, so far as collection is concerned, is whether in the circumstances it can be made effective. A trading presence in the United Kingdom will suffice.[14]

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[8] Part 2-5.

[9] Section 11-1 of Schedule 1 to the TAA. See paragraph 11-1(a) of Schedule 1 to the TAA and the *Income Tax Act 1986* which imposes income tax and under section 4 of the *Income Tax Act 1986* incorporates the *Income Tax Assessment Act 1936* (ITAA 1936) (which itself includes the *Income Tax Assessment Act 1997* (ITAA 1997) under the definition of 'this Act' in section 6 of the ITAA 1936).

[10] See section 6-5 of the ITAA 1997. Section 23AG of the ITAA 1936 provides an exemption for residents in limited circumstances in respect of their foreign service income. Amendments applying from 1 July 2009 have narrowed the type of foreign service covered by this exemption.

[11] When looking to the manner in which a law may apply extra-territorially, a specific application of the general assumption against legislation operating extra-territorially is the presumption that general words do not extend to cases governed by foreign law: Pearce, DC and Geddes, RS, 2006, *Statutory interpretation in Australia,* 6th edn, Butterworths, Australia, p. 171. This is also referred to as the comity of nations. For example, in *XYZ v. Commonwealth* [2006] HCA 25; (2006) 227 CLR 532, the High Court considered legislation which expressly provided for extra territorial application. The High Court stated:

> Legislation, including criminal legislation, is commonly expressed without territorial reference, and is construed and applied on the understanding 'that the legislature of a country is not intending to deal with persons or matters over which, according to the comity of nations, the jurisdiction properly belongs to some other sovereign or State': [*Niboyet v. Niboyet* (1878) 4 PD 1 at 7, cited by Dixon J in *Barcelo v. Electrolytic Zinc Co of Australasia Ltd* [1932] HCA 52; (1932) 48 CLR 391 at 424. See also *R v. Jameson* [1896] 2 QB 425 at 430 per Lord Russell of Killowen CJ]. This legislation is expressed to apply to conduct outside Australia, but only where engaged in by persons over whom Australia, according to the comity of nations, has jurisdiction.

[12] See *Wanganui-Rangitikei Electric Power Board v. Australian Mutual Provident Society* (1934) 50 CLR 581 and *Kay's Leasing Corporation Pty Ltd v. Fletcher* (1964) 116 CLR 124.

[13] Section 204 of the *Income and Corporations Tax Act 1970* (UK).

[14] The other two Lords in the majority in the decision in *Clark (Inspector of Taxes) v. Oceanic Contractors* [1983] 1 All ER 133; [1983] 2 WLR 94 gave different reasons for reaching the same conclusion as Lord Scarman. Lord Wilberforce gave emphasis to the fact that the payer entity was within the UK company tax system. Lord Roskill adopted the reasons of both Lord Scarman and Lord Wilberforce without indicating which analysis he preferred. Lord Roskill did however indicate that he was attracted to the view that if the employee's income was subject to taxation in the UK, that would be sufficient connection for the purposes of the PAYE provisions to apply.

16. Similarly, in the context of Australia's PAYG withholding provisions, the work-related withholding obligations in Subdivision 12-B are to be construed as not limited to persons and events in Australia. However, the application of that obligation to persons and events outside of Australia requires a sufficient connection with Australia.[15] The obligation to withhold does not apply where there is no such connection.

17. Whether there is a sufficient connection with Australia for PAYG withholding purposes depends on a consideration of individual facts and circumstances relevant to the purpose, nature and effect of the particular law. Having regard to the wording of section 12-35, matters relating to the entity making the payment, the individual receiving the payment, the employment relationship, and the payment itself are relevant.

18. In the case of a non-resident entity making a payment to an Australian resident for work performed overseas, there is a sufficient connection with Australia if the non-resident carries on an enterprise[16] or income producing activities (or part of such enterprise or activities) in Australia and has a physical presence in Australia (collectively referred to as a physical business presence). As the obligation to withhold is on the non-resident entity, the sufficient connection must be with that entity. The residency of the employee is not a matter that establishes a sufficient connection of the non-resident entity with Australia. Conversely, the fact that the payment is made overseas does not establish that there is no sufficient connection with Australia.

19. A physical business presence in Australia may include having an office, business operations, trading presence and/ or employees in Australia. Owning real estate or other investments in Australia will not of itself be sufficient to create a relevant physical business presence of that entity in Australia. Likewise, merely having Australian clients without any office or employees located in Australia would not be sufficient to create a relevant physical business presence in Australia. A parent company, subsidiary or presence of an associate in Australia will not of itself mean the non-resident entity has a physical business presence in Australia except in the situation where the entity present in Australia:

- carries on the Australian business of the non-resident entity; or
- is the common law agent of the non-resident entity.

20. Where the non-resident entity does have a sufficient connection to Australia for PAYG withholding purposes, the entity is required to withhold tax from salary and wages paid to an Australian resident employee for work performed overseas under section 12-35.

21. An administrative penalty may be imposed under section 16-30 equal to the amount that was not withheld as required. Failing to withhold an amount under section 12-35 when required to do so is a strict liability offence under section 16-25 attracting a penalty of 10 penalty units.[17]

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[15] *Trustees Executors & Agency Co Ltd v. Federal Commissioner of Taxation* [1933] HCA 32; (1933) 49 CLR 220 per Evatt J at CLR 239:

> The extent of extra-territorial jurisdiction permitted, or rather not forbidden, by international law cannot always be stated with precision. But certainly no State attempts to exercise a jurisdiction over matters or things with which it has absolutely no concern.

Re Trade Practices Commission v. Australia Meat Holdings Pty Limited (1988) 83 ALR 299 per Wilcox J at 355.

[16] As defined in section 9-20 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). Section 3AA of the TAA incorporates the definitions from the ITAA 1997. Section 995-1(1) of the ITAA 1997 defines enterprise to have the meaning given by section 9-20 of the GST Act.

[17] At the time this Determination was issued the value of penalty unit was $110: see section 4AA of the *Crimes Act 1914*. Whilst the *Criminal Code* applies to this offence (see section 2A of the TAA), it is noted for completeness that where the non-resident employer has a registered office or a head or principal office in

Fringe benefits tax implications

22. Where a non-resident entity has a sufficient connection with Australia to have an obligation to withhold from payments made to an Australian resident for work performed overseas, it will also have obligations under the FBTAA in relation to any benefit provided to that person in respect of the employment of that person. In these circumstances, the payment will be 'salary or wages' for the purposes of the terms 'current employer' and 'current employee' as defined in subsection 136(1) of the FBTAA. As a result, the non-resident entity and the Australian resident will be an 'employer' and an 'employee' respectively as these expressions are defined in subsection 136(1) of the FBTAA.

Other matters

23. As a practical matter, it is considered that the circumstances giving rise to an obligation to withhold will be infrequently encountered. In many common situations where Australian resident taxpayers work overseas, the non-resident entity is unlikely to have a physical business presence in Australia. The circumstances are most likely to arise in the case of a multinational business which carries on business in Australia.

24. In most cases, the non-resident entity making the payment to an employee will be the employer of that employee. However, it is clear from the wording of section 12-35 that this need not be the case.[18] If the non-resident employer is not the entity making the payment to an employee working overseas, then any withholding obligation must be separately considered from the perspective of the non-resident entity making the payment rather than the perspective of the non-resident employer.

25. There is no withholding obligation under section 12-35 where a payment is wholly exempt from tax pursuant to a double tax agreement.

26. Benefits received in situations where there is no obligation to withhold from payments made to an employee may be Australian assessable income in the hands of that employee.

Australia the failure to withhold can be taken to have been committed in Australia: see subsection 8ZC(2) of the TAA.

[18] Taxation Ruling TR 2005/16: Income tax: Pay As You Go - withholding from payments to employees - provides further guidance in this regard.

References

Previous draft:

Previously issued as a Draft Taxation Determination TD 2010/D1

Related Rulings/Determinations:

TR 2006/10; TR 2005/16

Subject references:

- Australians overseas
- foreign salary & wages
- fringe benefits tax
- PAYG withholding
- salary & wages income

Legislative references:

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- FBTAA 1986 136(1)
- ITAA 1936
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- ITAA 1936 23AF
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- TAA 1953 Sch 1 12-1
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Case references:

- Barcelo v. Electrolytic Zinc Co of Australasia Ltd [1932] HCA 52; (1932) 48 CLR 391
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- Morgan v. White [1912] HCA 50; (1912) 15 CLR 1
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