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cutting through complexity

Managing the labor supply chain in the oil and gas sector: comparing the tax compliance burden and cost of employment in Australia, the UK and the US

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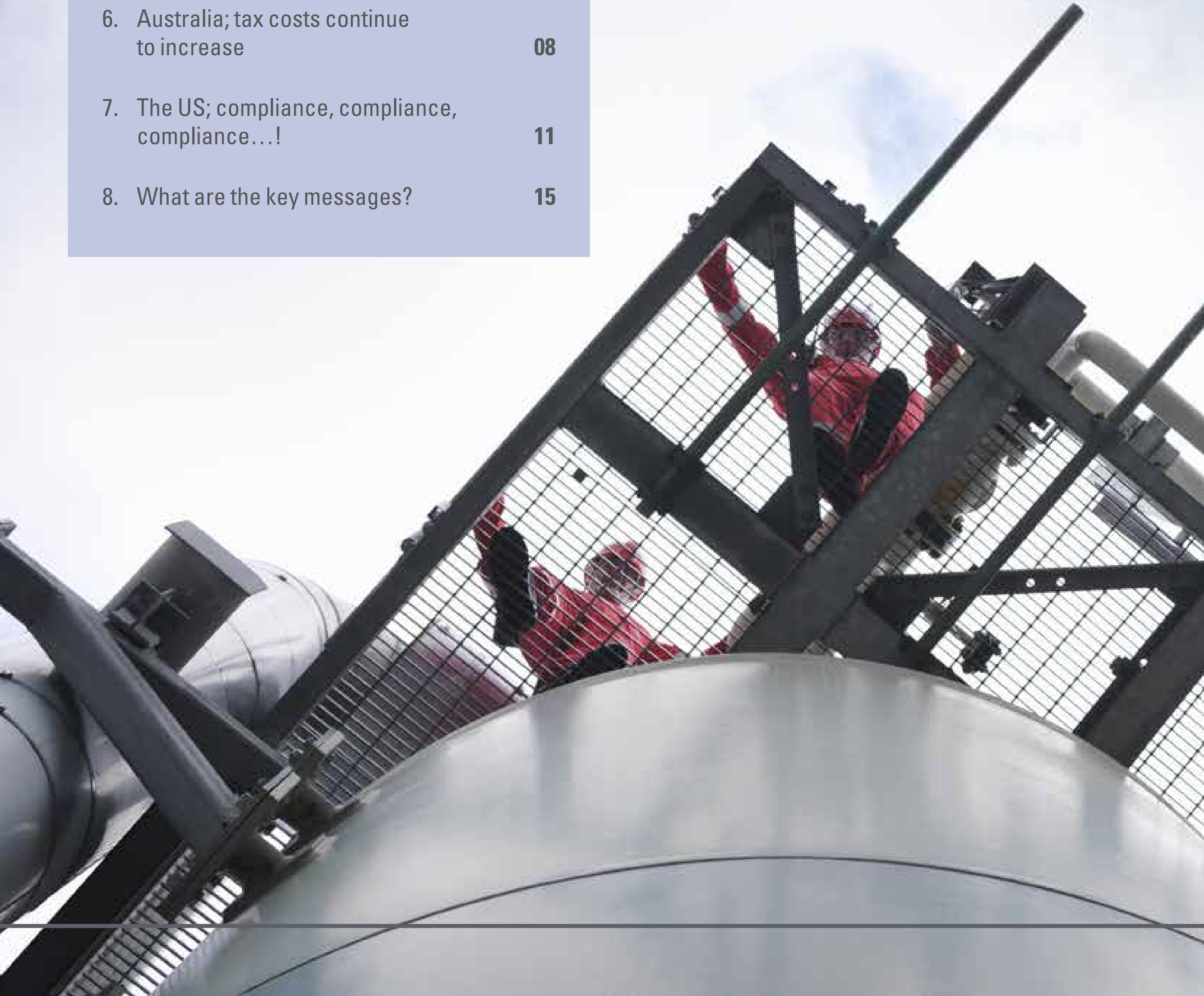

Introduction

Dealing with tens of thousands of workers based in some of the remotest locations in the world and with a need to recruit and retain the very best for diverse and yet often specialist roles… this is a huge challenge but one faced every day by multinationals operating in the oil and gas sector. Couple this with the risk of potential instability in a number of locations and an absolute priority on safety and it becomes clear that the challenge requires managers to engage with, and to respond to, a vast array of critical issues in a timely and efficient manner. Whether a project involves exploring for oil and gas on the UK Continental Shelf, extracting bitumen in the US, hydraulic fracturing (fracking) in Australia or producing and retailing biofuel in Brazil the complexities involved are immense, requiring the right people, with the right skills to be operating as a close-knit team in accordance with strict and precise protocols. And, to be doing so in a way which respects the environment, engages positively with the local community, harnesses the best available technology, values the workforce and ultimately, of course, returns profit to shareholders.

But were all this not enough there is another key factor which looms, ever present on the horizon. And that is the specter of taxation. Certainly in terms of the production, shipping, trading and retailing of oil and gas, and the allied biofuel and petrochemical sectors, this is true in spades given that operations can be conducted in upwards of 50 or even 100 countries worldwide.

Whether it is local corporation tax, income tax, sales taxes, excise duties or social security contributions and whether impacting on the corporate, employees, expatriate workers or sub-contracted labor, each country will have its own rules and regulations which they will demand are adhered to. And if the rules are broken for any reason then, aside from financial penalties, the business may also suffer significant reputational damage by finding itself the subject of a front page news story.

This piece focuses on the labor supply chain in the oil and gas sector and compliance issues around employment taxes. But we cannot hope to cover the position in each and every jurisdiction and so we limit ourselves to comparing and contrasting the issues in just three, albeit major, locations. These are Australia, the UK and the US. In doing so we will touch on both recent developments and more longstanding issues affecting the sector in these countries and how businesses are addressing them. But in many ways, the approach should likely be no different from that adopted in dealing with the other challenges identified above, namely ensuring effective communication across the business, keeping close to operations, having a keen sense of priorities, a clearly defined sense of responsibilities and accountabilities and taking professional advice as and when needed.

Whose responsibility **it is anyway?**

In dealing with taxation impacting on both the corporate and perhaps tens of thousands of workers operating in a multitude of geographies around the world, it is vital that there is a clear protocol informing the approach to tax compliance, the standards to be upheld, the approach to tax planning, engagement with professional advisers and who is ultimately responsible and accountable for what.

This is a matter of due process and governance and to this end a group tax policy is required which needs to be endorsed, and indeed enforced, from the top but properly understood and operated locally by all those involved in making decisions with a potential tax impact. In this way the group board takes overall responsibility for the tax policy, albeit clearly day-to-day it is the tax director and their global tax team who apply that policy, supplemented (as necessary) by local country guidance, to the myriad of issues that arise in the business. However, this cannot be done in a vacuum. So, for example, in the case of employment taxes, the local tax teams need to be fully aware of what is happening on the ground. Whether it be it concerning oil rig operations, oil and gas trading, construction of buildings and infrastructure, cross-border shipping and transport, engagement of agency or third party labor, the assignment of employees from one country to another, business visitors from abroad, ventures in new countries etc…the list is a long one! And to be involved this means the local tax team needs to engage effectively with a range of stakeholders to ensure that tax compliance is properly promoted in the context of day-to-day management of the business. This should encompass contacts in operations (engagement of local workers and business visitors), the reward team (taxes on employee benefits, share plans and pensions), company secretarial (awards under share plans), the global mobility team (movement of employees cross-border), building and infrastructure teams (e.g. regarding the UK Construction Industry Scheme tax rules), finance (in providing for any potential exposure) etc. And having to hand a summary of the key issues, how they are being addressed, who is responsible and categorized as to importance and urgency (red, orange, green etc.) is also critical in helping ensure that tax team resource is being properly focused.

There is, of course, a difference between being available to advise on an issue and being accountable and taking ultimate responsibility for it. Indeed, it would be more typical for the local tax team to work closely with the relevant operational team to identify issues and advise on how they are best addressed (in accordance with the tax policy) than to be empowered to instruct and direct colleagues on how to manage business operations. That said, clearly if the local tax team do have concerns, they need to be appropriately escalated within the business so that the necessary steps can be taken to avoid exposure to tax penalties and reputational risk in the marketplace.

What's the cost if we get it wrong?

But when we talk about exposure to tax, penalties and reputational risk, what exactly do we mean? Are there any differences between the oil and gas sector and other commercial business organizations? Perhaps the first point to make is that the sector contains many well-known household names, i.e. the global public recognize these names so that any bad publicity, be it in relation to tax or safety or any other matter, is likely to resonate within the marketplace. And the marketplace here comprises dozens of different jurisdictions across the globe and in many of these jurisdictions tax is very much front page news, be it around multinationals and perceived aggressive tax planning, compliance failures by corporations and individuals, everyone paying their fair share of tax in an age of austerity etc. Quite apart from the financial consequences in terms of penalties for tax compliance misdemeanors for failures, say, to withhold payroll taxes or social security, or to report income on time. Indeed, there is a is distinct possibility of a business finding itself on the wrong side of the public debate on tax, with a knock-on adverse effect on its ability to do business and on its share price. Further, with certain lobby groups who may be hostile to the oil and gas sector at the best of times, such bad publicity only adds grist to the mill.

That noted, the financial penalties should not be underestimated. Certainly in the UK where Her Majesty's Revenue & Customs (HMRC) uncovers a careless compliance failure involving a prompted disclosure (i.e. prompted by HMRC) the minimum penalty is now 15 percent of the tax or social security involved. This is, of course, in addition to having to make good the tax and social security itself, often on a "grossed-up" basis so that the individuals themselves are not adversely affected (and particularly where they are tax equalized). So mis-classification of labor as self-employed (as opposed to employed), failure to engage properly with the new UK rules on offshore employment intermediaries, mis-allocation of an international assignee's employment income tax as between one country and another, failure to withhold payroll/social security on equity awards or as regards to work done by short term business visitors could all prove to be unpleasant surprises for the finance team when it comes to year-end provisioning.

The sheer complexity…

Quite apart from the sheer number and complexity of the different operations typically involved across the business, the multiple geographies and the numerous stakeholders, there is also constant change in terms of tax legislation, practice and case law. So the tax team needs to be kept fully up-to-date given the potential tax impact on the labor supply chain. And if one thing is for certain, the tax landscape is getting more complicated rather than more straightforward, despite the best efforts of the Office of Tax Simplification in the UK. If we take the UK as an example, the Finance Act 2013 introduced a new statutory residence test for individuals and abolished the concept of "ordinary residence", and the Finance Act 2014 makes significant changes to the Pay As You Earn (PAYE) rules for businesses engaging agency labor and individuals employed by offshore intermediaries, and introduces special rules for oil and gas workers operating on the UK Continental Shelf. The Finance Act 2014 changes being coupled with similar changes to the social security rules. And, indeed, a narrowing of the special social security exceptions applicable to mariners which will have a material cost impact across the oil and gas sector. So keeping up-to-date is vital for the tax team, not just in terms of the activity within the business but what the tax authorities are doing, when and where. Industry networking groups and attendance and participation in relevant conferences and roundtables, coupled with access to experienced, clear and commercial professional advice, is critical. Also essential is constructive relationships with the local tax authorities so that trickier issues can be discussed and a practical way forward agreed. That said, the sheer plethora of issues means the tax team needs a clear and cool-headed approach to put everything into perspective.

So what's making the news on employment taxes in Australia, **the UK and the US in the** oil and gas world?

It would be easy to get lost in discussing recent developments on employment taxes in Australia, the UK and the US. We intend therefore to restrict ourselves to key developments in each country, see if we can discern the direction of travel in terms of the oil and gas sector and then compare and contrast the position in terms of one country and another. We do not intend to go into the legislation in depth.

The UK; **promoting enterprise**, anti-avoidance, dialogue with **HMRC and the need** for quality data

The cost of doing business in the UK

When the Conservative-Liberal Democrat Coalition assumed power in the UK in May 2010 it inherited a top rate of income tax of 50 percent for income over 150,000 British pounds (GPB) per annum. This had effect from 6 April 2010 and represented an increase from the previous top rate of 40 percent. However, the Coalition was concerned to understand the impact of a 50 percent top rate on the Exchequer tax yield and in his Budget 2011 statement the Chancellor asked HMRC to research into how much the 50 percent rate actually raised in tax.[1]

The conclusion was that *"high tax rates in the UK make its tax system less competitive and make it a less attractive place to work, finance and grow a business. The longer the [50 percent] rate remains in place the more people are likely to consider it a permanent fixture of the UK tax system and the more damaging it would be for competiveness".* The 50 percent rate was subsequently reduced to 45 percent from 6 April 2013. While the argument on the effect of the 50 percent rate continues to be debated in the UK, certainly one positive result for multinationals is that tax equalizing or tax protecting senior executives assigned to work in the UK became less expensive from 6 April 2013. That said, employers' social security contributions have crept up over the years to 13.8 percent of earnings, with the employee rate now being 12 percent for earnings up to GBP41,865 and 2 percent for earnings above this level. While the level of social security contributions in the UK is significantly less than in, say, France or Belgium, nevertheless employer contributions, in particular, are still viewed by many as a "tax on jobs", acting as a brake on growth and entrepreneurship. The UK Government appears to have taken this on board, though for the 2014/15 tax year their focus is on smaller businesses rather than multinationals with the introduction of an "Employment Allowance" of GBP2,000 per year per business which can be offset against employer social security contributions. The idea being to reduce employment costs in those businesses, albeit potentially acting via a multiplier effect to impact across the UK labor supply chain as a whole. However, from 2015/16 we will see an exception from employer social security contributions for those aged under 21 for earnings up to the "upper earnings limit" (expected to be GBP42,285 for 2015/16). This should be of rather greater direct benefit to the oil and gas sector in terms of reducing employment costs, or indeed enabling a recycling of the savings back into a more competitive reward package for the under 21s – encouraging them to work and build a career in a sector where it is reported that the trajectory of the peak age of oil company technical personnel increased from 43 in 2000 to 50 in 2006 and was heading for 60 in 2012[2]. The point here being that getting the younger generation on board and interested in developing their careers in engineering and allied disciplines remains a real focus across the sector.

PAYE and Real Time Information

Aside from headline rates, thresholds and exceptions there is no doubt that much greater demands are being placed on all employers through the recent introduction in the UK of PAYE Real Time Information (RTI) which represents the greatest change to the way PAYE payroll deductions are reported since the introduction of PAYE in 1946. RTI is designed to ensure that HMRC receives information on amounts being paid to employees "on or before" these payments are paid, rather than after the tax year end as has traditionally been the case. Designed to support the introduction of a new system of Universal Credits for those receiving welfare benefits (so that benefit entitlement can be tied more precisely to income level in real time) PAYE RTI poses challenges to the oil and gas sector, particularly in terms of dealing with employees on an international secondment to or from the UK, business visitors to the UK from non-treaty countries (a significant issue in itself) and where equity awards are satisfied by a non-UK parent company and where any delays in internal communication make the "on or before" requirement very challenging. While HMRC have announced that they will take a "common sense approach" to what constitutes a "reasonable excuse" for not operating PAYE RTI to the strict letter of the law, it remains to be seen precisely how this will pan out in practice. Indeed UK tax teams will be well advised to explain the approach that they are taking, and intend to take, to HMRC and seek their confirmation that HMRC agree that the business is adopting a "common sense approach", that any "reasonable excuse" defense applies and that no penalties therefore arise.

1. See "The Exchequer effect of the 50 percent additional rate of tax", HMRC, March 2012
2. See "Oil industry's talent shortages require new staffing strategies", Oil & Gas Financial Journal, 1 November 2011

Clamping down on workers from outside the UK

But aside from PAYE and RTI we have also seen a continuing clamp down on avoidance in the UK in recent years. This has been evidenced recently by new legislation, both for tax and social security purposes, which is aimed at preventing planning designed to avoid (i) workers being subject to PAYE and social security as employees and instead being treated as self-employed and (ii) the effect of the social security "host employer" rules which apply when employees are employed outside the UK but provide services to a business located in the UK. HMRC say that such planning has been prevalent both domestically in the UK through engagement of workers via agencies, as well as in relation to labor employed by non-UK employers based offshore, supplied to the UK business but falling outside the host employer rules. The common theme being that the workers concerned are argued not to provide their services "personally" but as part of wider so-called "composite services" undertaken by a third party for the UK business; or, otherwise on the basis that they can provide a substitute to deliver the contracted for services so undermining key planks of both the UK agency worker PAYE and social security rules and the host employer rules. The combined estimated revenue loss to the UK Exchequer over the period to the end of the 2018/19 tax year is GBP2.5 billion[3] and HMRC and the UK Treasury are clear that immediate action is warranted to stem this loss. This will likely have a significant effect on the oil and gas sector in the UK, particularly when coupled with another important change which came in concurrently on 6 April 2014. This latter change materially curtails the employer social security exemption that applies for oil and gas workers who are "mariners" and who work on a ship or vessel for a non-UK employer and is a reaction against the 2009 decision in favor of the taxpayer in *Oleochem (Scotland) Ltd v HMRC, SpC 731.* It applies, in particular, to workers on the UK Continental Shelf who work on, or in connection with, an "offshore installation". An offshore installation is, broadly speaking, a structure (including a ship or a vessel) which is put to a "relevant use" while standing or stationed in water. And a "relevant use" includes exploiting mineral resources, exploring for mineral resources, the storage or recovery of gas, the conveyance of things via a pipe, providing related accommodation and decommissioning any structure which is put to such a use. But there are exceptions for certain workers and certain structures…this is not simple.

To this end, a new PAYE and social security regime will operate for workers engaged by offshore intermediaries in the oil and gas sector and carrying out their duties on the UK Continental Shelf. The upshot of this is that the overall liability for PAYE or social security will rest with the oil field licensee, unless a non-UK employer has an "associated company" that is based in the UK, or is otherwise formally "certificated" by HMRC.

Suffice to say that the sheer speed with which these changes have been introduced has been so fast that the oil and gas majors, their immediate third party suppliers of labor and, in, turn, their suppliers have been scrambling to determine precisely which workers and which operations will be affected by the new order, and what the cost impact may be (i.e. regarding employers' social security at 13.8 percent) for both existing and planned projects. This is a real issue at the moment and, aside from PAYE and social security compliance, there is a lot of reading and re-reading of contracts going on to decide which party carries the can for the extra cost.

Moves to deter tax avoidance

The reality these days is that any tax planning undertaken which is perceived by HMRC to clash with government policy on the applicability of allowances, reliefs or exemptions is likely to be challenged robustly. And, just in case the law has not been expressed clearly enough to prevent what is viewed by HMRC as "unacceptable" tax avoidance, the UK introduced a General Anti-Abuse Rule (the GAAR) in Finance Act 2013. So the oil and gas sector, in common with UK business as a whole, will want to reflect very carefully on any proposals around UK tax or social security planning. This is something which would be expected to be covered in the tax policy framework referred to already, in the context of good governance. The position comes in to even starker focus if planning is ultimately successfully challenged by HMRC under the GAAR (or any similar rule overseas), or is planning which is notifiable to HMRC under the UK's special rules on Disclosure of Tax Avoidance Schemes (or any similar rule overseas) and again is successfully challenged. In particular, and aside from the tax at stake, the UK Cabinet Office has made it clear that the tendering of central government contracts should take into account such an "Occasion of Non-Compliance" in deciding whether or not to exclude the supplier from the government's procurement process where a contract is for GBP5 million or more[4]. This will clearly be a material concern for any business that is involved in work for the UK Government.

Mention has been made of the importance of a constructive relationship with HMRC so that emerging and trickier issues can be discussed as they arise and a pragmatic approach taken to addressing them. But nevertheless, a note of concern is warranted following a recent tax case heard in the UK Upper Tier Tribunal (UTT) where the business (not an oil and gas business) approached HMRC for informal clearance that amounts previously paid to employees and taxed as salary could, instead, be paid as a tax free travel allowance for travel to and from temporary places of work[5]. In fact such an approach might also apply in the oil and gas sector where employees are required to travel frequently to and from a temporary workplace and the detailed conditions are satisfied. However, the UTT decided that

3. See the respective "Summary of Impacts" included in the consultation documents issued by HMRC entitled 'Offshore Intermediaries" (30 May 2013) and "Onshore Employment Intermediaries: False Self-Employment" (20 December 2013)
4. See "Procurement Policy Note: Measures to Promote Tax Compliance", Admin Note 06/13, Cabinet Office, 25 July 2013.
5. See Reed Employment PLC and others v HMRC, [2014] UKUT 0160 (TCC).

while HMRC's agreement was ostensibly obtained for what the business had proposed it had not *"put all [its] cards face upwards on the table"*. The consequence was that it could not then rely on what HMRC had said so that the paying of travel allowances on a tax free basis was not warranted. In turn, this meant that, factoring in the number of years over which the travel allowance arrangements had operated, the business owed HMRC the staggering sum of GBP158 million in back taxes and social security contributions. Whether the taxpayer will succeed in any appeal remains to be seen but this is nevertheless a salutary tale for all in emphasizing the need for clear and accurate dialogue with HMRC.

Completeness and accuracy of data

Finally, we turn to a challenge which faces all multinational employers with staff moving to and from the UK. This might, for example, relate to a secondment *to* the UK where an individual becomes a UK tax resident and taxable on their worldwide income (subject to, e.g. overseas workdays relief). Or it might relate to a secondment *from* the UK to another country where UK tax residence is broken but where the employee still remains subject to UK social security contributions under one or other of the UK's reciprocal agreements, the EU treaty or the domestic "52 week rule".

In these circumstances it is vital to have a clearly defined process for gathering all the different components of the employee's reward package (salary, benefits, expenses, pension, equity, any settlement of tax liabilities etc.) and ensuring that each is properly considered from a UK tax and/or social security perspective. This is both from a payroll withholding viewpoint as well as in calculating the final UK tax return liability. But unfortunately this is much easier said than done and requires a clear methodology, effective global communication and co-ordination, clear accountabilities (and indeed empowerment) and best-in-class technology to ease administration and to minimize potential data handling errors. That said, devoting time and effort to getting this process right is an investment well worth making as international businesses within and outside the oil and gas sector are increasingly recognizing. Certainly questions around the effectiveness of global compensation feature prominently on HMRC's agenda and their focus now on the employer's processes and systems. Further, the bar is continually being raised in terms of HMRC's expectation that global businesses will harness technology to ensure that their reporting is accurate and complete…and with settlements that can otherwise run into £millions it is a good idea to work to get this one right.

Australia; tax costs continue to increase

Recent changes

Traditionally, the oil and gas sector has been a large importer of human capital to Australia, often under tax equalized arrangements. And notwithstanding the high labor costs in Australia, the cost of such arrangements continues to rise, with a number of recent tax changes that have been implemented.

The present Government's first Budget, handed down in May 2014, is aimed at bringing the budget back to surplus. The key measure in this regard has been the introduction of a Temporary Budget Repair Levy (TBRL) that will apply for 3 years, commencing 1 July 2014. The TBRL is payable at a rate of 2 percent on annual taxable income over 180,000 Australian dollars (AUD).

When combined with an increase in the Medicare Levy at 1 July 2014, a taxpayer's top marginal rate of Australian tax will rise from 46.5 percent to 49 percent. Further, with the introduction of the TBRL, the Fringe Benefits Tax (FBT) rate will also increase from 47 percent to 49 percent, so that the rate of FBT remains equal to the top personal marginal tax rate.

As the FBT year commences on 1 April and concludes on 31 March, the increase in the FBT rate is to be applied from 1 April 2015 (to increase the rate part way through the FBT year would create a large administrative burden on employers).

With access to the FBT concessions applicable to living away from home benefits severely restricted since October 2012, the increase to the FBT rate will also have a significant impact on the industry.

Who bears the costs of tax equalization?

It is typical that the oil field operator will ultimately be responsible for the tax equalization costs of its investors. Successfully accruing for such costs, and managing the invoices, is a critical function of the finance team, especially with the current focus on keeping costs on budget, and looking to properly close out projects on a timely basis. But this process is not as easy to manage as one might expect.

There are a number of different taxes that ordinarily comprise the tax equalization cost – Pay As You Go (PAYG) withholding, FBT, payroll tax (a state-based tax assessed on an employer in respect of all remuneration paid to employees and some contractors) and superannuation, with a credit for home country hypothetical tax.

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In addition, there is the variety of ways in which employers can manage the application of its tax equalization arrangements, ranging from shadow payroll gross-ups, to deferring the payment of income tax on net salary until lodgement of the expatriate's personal tax return under a PAYG withholding variation (that must be requested from the Australian Tax Office (ATO) in respect of each employee). In this first scenario, the Australian tax is accounted for in the month the salary is paid, in the latter the FBT due when the employer pays the employee's tax liability on their behalf may not arise until 3 years later.

Another significant complexity under these arrangements worth noting is the Australian tax treatment of employee share scheme (ESS) income. The challenge for those accruing for the related tax costs is not only the uncertainty of the quantum of tax that may be due on the income, but the fact that Australia does not require any form of tax withholding on ESS income, so that payment is deferred until personal tax returns are lodged, which can be up to 2 years after the taxable event.

Tax departments must play an important role in developing processes that enable the operator to accurately identify what taxes will be due and when, so that this process can be managed effectively.

Changing the way in which human capital is deployed

With the increased focus on managing costs, employers are demanding an increased flexibility from their workforce, requiring employees to relocate at short notice and for short periods of time so that global opportunities can be maximized.

Australia's living away from home (LAFH) rules provide significant concessions in relation to food and accommodation assistance, where an employee is required to temporarily live away from the place that they usually live, to perform the duties of their employment.

As mentioned previously, access to these concessions has been severely restricted since October 2012. To be eligible to access the LAFH FBT concessions, in addition to the conditions that previously existed, an employee must maintain a home in Australia in their usual place of residence that is available for their immediate use and enjoyment at all times during which the concession is to be applied.

Although specific exceptions to this requirement may apply to some Fly-in Fly-out (FIFO) workers, the requirement to maintain an Australian home at somewhere other than an expatriate's work place limits access to the concessions for benefits provided to foreign nationals on assignment in Australia.

As a consequence, there has been much debate over the differentiation between someone who is living away from home and someone who is traveling on business. Where someone is traveling on business, tax concessions remain available for accommodation assistance and per diems. But the long-held view of the ATO has been that anyone traveling for a consecutive period of more than 21 days was living away from home, rather than traveling on business.

However, based on a number of recent rulings published by the ATO, this view appears to be relaxing, to align with the development of the work practices previously described, as the ATO has ruled that an employee traveling on business where the time away has been extended beyond 21 days.

Key to these decisions has been the nature of accommodation provided when traveling (e.g. camps and shared accommodation), and the uncertainty over where an employee may be required to work at any one time.

The nature of the accommodation at the temporary work place is important to help determine whether the arrangements indicate someone who is living away from home or traveling on business, i.e. where this cannot clearly be determined from the duration of the stay away from home.

If the accommodation is similar to that which the employee would live in at the usual place of residence, then it is likely that they are living away from home. Employers are developing their own guidelines upon which to make this assessment, with common considerations including:

- an employee's ability to stay in the accommodation during weekends or public holidays, even though the employee might not be required to work in the host location on these days
- if the accommodation includes self-catering facilities that allow the employee to cater for themselves in a similar manner to how they would have done if they had been at their usual residence
- if the accommodation is of a standard (and size) that immediate family members could easily stay with the employee for weekends/holidays.

Although the nature of most accommodation provided to employees working under FIFO arrangements is unlikely to be of a similar nature to their home accommodation, regard must also be had to the length of the arrangement (and not just the period of the roster spent working). Provided this remains relatively short (e.g. 3 months), the employees may be traveling on business. It is therefore important that tax departments work closely with their HR counterparts, to ensure that the tax concessions available are properly used.

Outbound investment

There has been an increase in the amount of outbound investment from the Australian oil and gas sector, as companies look to exploit the IP developed on recent Australian infrastructure projects, or are otherwise required to oversee the design and construction phases of development undertaken offshore. Where an employee is able to establish that they have become a non-resident of Australia for tax purposes when working overseas, the tax costs of the assignment are typically significantly reduced.

Australian tax residence is based on an employee's individual facts and circumstances, but as a broad rule of thumb, an employee who is accompanied by their family when undertaking a foreign assignment in excess of 2 years, may be considered a non-resident. However, there appears to be an increased ATO focus in this regard, as recent rulings have been issued and audits undertaken that have assessed an individual as a tax resident in situations where previously one might have considered them to be a non-resident. The important point here is that an incorrect assessment of an employee's Australian tax residency situation can result in significant additional tax costs with possible interest and penalties for failure to comply with tax reporting and withholding obligations.

Prior to any outbound assignment, appropriate planning should be undertaken, on behalf of the employee and employer, to ensure that a correct assessment of an employee's tax residency position is made at the outset, so that these problems can be avoided. Certainty of an employee's Australian tax residency position can be obtained in the form of a binding ruling from the ATO. Based on the edited versions of rulings that are publicly available, and our experiences, such rulings have at times been inconsistent. As a result, taxpayers more commonly choose to self-assess the tax residency position, ensuring that appropriate records are maintained to support the analysis, should it be questioned during a subsequent review or audit of the taxpayer's affairs.

The US; compliance, compliance, compliance…!

Roll back time 10 years or so, and it was almost acceptable to US federal and state tax authorities for companies to claim they were "trying" to be compliant or they were "working on processes" to address gaps in their compliance. Fast forward to today when better data analytics allow tax authorities to perform more efficient audits, governments feel the pinch of their budget shortages and more aggressively enforce "the rules", and preparer penalties have become one of tax authorities' "sticks" with which to enforce compliance. Thus, the trends currently in the US can be broken down into three categories: compliance, compliance, and compliance!

Here we focus on the following US tax authorities' "hot topics" which are especially noteworthy for the oil and gas sector: (1) stronger enforcement of long standing tax rules involving state-to-state business travelers; (2) potential tax exposure regarding the US Outer Continental Shelf; and (3) the far reaching impact of the Foreign Account Tax Compliance Act (FATCA).

State-to-state business travelers

Employees of businesses with interstate operations may be required to travel outside their resident state for work. What may not be clear to everyone is that these trips may translate to significant regulatory burdens for employers and employees in complying with non-resident state income tax withholding laws. To make matters more complicated, each state has its own requirements for filing non-resident individual income tax returns and commensurate rules for employer withholding on those employees. Of the 41 states that impose income tax on wages, only 15 states have a *de minimis* threshold for non-residents before taxes must be withheld and paid. That means that 26 states may impose an income tax obligation for just a single work appearance in the state.

Accurately tracking employees' time and wages in other states means having to adjust time-keeping systems and payroll systems. Employers must be able to flag when an employee is working in another state. Unlike international air travel where keeping track of an employee's whereabouts is possible through flight records, not all interstate business travel requires an employee to fly. Moreover, while travel records and documentation are certainly good sources of information, many employers find it difficult to get hold of this type of information. However, when an audit is triggered, the burden of proof will be on the employer. Leading employers are keeping records of where employees are traveling for work and tying these travel records back to time-keeping and payroll systems to comply with state tax withholding.

In order to ease the burden on employers, a potential solution is currently making its way into federal legislation. This solution proposes to uniformly treat multistate employees. It is known as the "Mobile Workforce State Income Tax Simplification Act of 2013".

With the proposed legislation on the table, if an employee travels and works in another state, withholding of state tax in that state would commence after a predetermined time period, such as 30 days. This would apply uniformly to all 50 states. The Mobile Workforce State Income Tax Simplification Act provides for a uniform, fair and easily administered law and helps to ensure that the correct amount of tax is withheld and paid to the states without the undue burden that the current system places on employees and employers. While this may ultimately simplify things, employers will still have the burden to prove time and wages of employees working in multiple states.

The oil and gas sector falls squarely within the states' crosshairs on multistate taxation. The recent boom across the US attributed to shale oil and gas plays such as Bakken, Eagle Ford and Marcellus have given rise to operators and service company employees working a significant portion of the year outside their home states. Knowledge of these temporary work visitors is not unknown to state taxing authorities and targeting companies bringing employees into a particular state has provided state taxing authorities with "low hanging fruit" for payroll audits.

The US Outer Continental Shelf

A few years ago, the Internal Revenue Service's (IRS) Large Business and International (LB&I) division posted an Industry Director's Directive as guidance for IRS examiners with respect to the application of employment taxes. This Directive covered (i) income tax withholding under IRC Section 3402, (ii) Federal Insurance Contributions Act (FICA) tax withholding under IRC Section 3121, and (iii) Federal Unemployment Tax Act (FUTA) tax on salary and wages paid for work performed on the US Outer Continental Shelf (OCS), in the Gulf of Mexico.

The LB&I Directive indicated that many employers were not complying with their federal employment tax obligations for non-resident alien individuals they employed on the US OCS.

As the Directive explains, non-resident alien employees are subject to US income tax on compensation effectively connected with the conduct of a trade or business within the US. Non-resident alien employees that perform services on structures permanently or temporarily attached to the US OCS, or on vessels or other devices engaged in activities related to the exploration for and exploitation of natural resources on the US OCS, are generally engaged in a US trade or business. Moreover, the Directive sets out the withholding tax requirements for wages paid by the employers of these individuals, as well as a discussion of the related US employment tax liabilities.

The Directive states that services performed on the US OCS are deemed to be services performed within the US and so subject to US employment taxes, but that services performed by an individual on or in connection with a vessel that is not an "American vessel" is not subject to US employment taxes, provided that certain conditions are met.

As mentioned above, the clear target of the IRS' scrutiny of activity on the US OCS are those companies involved in the oil and gas industry. The IRS uses sophisticated monitoring and vessel tracking systems, such as Sea-Web, Vessel Tracking Services and satellites, to track movement of many vessels. Accordingly, US companies and foreign vessel owners should be ready to respond to inquiries by analyzing their specific facts as they relate to the Directive. Moreover, those involved on the US OCS will also need to look to the future and adjust their tax compliance procedures as needed.

The far reach of the FATCA

FATCA provisions were enacted in March 2010 as part of the Hiring Incentives to Restore Employment Act (HIRE Act). The FATCA provisions were in response to tax policy concerns that some US persons have avoided paying taxes by sheltering assets offshore in foreign bank accounts, trusts, or corporations. To reduce tax evasion and promote transparency, a number of measures were enacted that impose significant reporting and information collection obligations on individual taxpayers and third parties. And the reporting obligations directed at individual taxpayers have increased the complexity of income tax returns and the data required and time it takes to prepare them.

Starting in 2011, US taxpayers were required to report ownership of specified foreign financial assets to the extent the total value of those assets exceeds certain thresholds. The instructions to Form 8938 provide that specified individuals with specified foreign financial assets in excess of 50,000 US dollars (USD) on the last day of tax year, or USD75,000 at any time during the tax year, for unmarried and married filing separate taxpayers (USD100,000 and USD150,000, respectively for married filing joint taxpayers) are required to file the Form 8938. Other thresholds apply for taxpayers living in foreign countries. Although the majority of the required information may be duplicative, when compared to FinCen 114 - formerly Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) - the new Form 8938 does not replace the FBAR, and requires the reporting of several additional items of information. It is also important to keep in mind that the new form is required to be included with the individual's tax return by the due date of the tax return (including extensions), while the FBAR is filed separately from the tax return by June 30 of the year following the reporting year.

In general, US citizens, US resident aliens for any part of the year, non-resident aliens who make an election to be treated as residents for joint filing purposes, and individuals who qualify as US resident aliens but elect to be treated as non-residents (pursuant to the residency tie-breaker provisions of a treaty) will be required to file as long as they meet the filing thresholds mentioned above.

The definition of a "specified foreign financial asset" is quite broad, and is one of the reasons for the increased complexity of the tax return. The term "specified foreign financial asset" includes any depository, custodial, or other financial account maintained by a foreign financial institution as well as (a) any stock or security issued by foreign persons, (b) any financial instrument or contract held for investment that is issued by or has a counterparty that is not a US person and (c) any interest in a foreign entity.

A foreign pension plan which is "funded" and in which the assignee is "vested", is identified as a "specified foreign financial asset".

Investment vehicles such as foreign mutual funds, foreign hedge funds, and foreign private equity funds are obvious examples of what is reportable on Form 8938. However, reporting is also required with respect to foreign trusts, passive foreign investment companies (so-called "PFICs"), deferred compensation plans, and foreign pension plans.

A foreign pension plan which is "funded" and in which the assignee is "vested", is identified as a "specified foreign financial asset". This is just one example of the additional holdings that are not reported in the FBAR but are required to be reported on the new Form 8938. According to the requirement, the assignee is required to determine the fair market value of their interest in the pension plan as of last day of the tax year and report it on Form 8938.

Due to the inclusion of foreign pension plans in the definition of foreign financial assets and the relatively low filing threshold for individuals living in the US, many foreign nationals working in the US will be required to file Form 8938.

Non-compliance with the new reporting requirements can result in substantial penalties. Failure to properly report foreign financial assets can result in a penalty of USD10,000 with additional penalties of up to USD50,000 for continued failure to disclose after receiving a request from the IRS. Additional penalties can be assessed if there is unpaid tax on unreported income related to foreign financial assets.

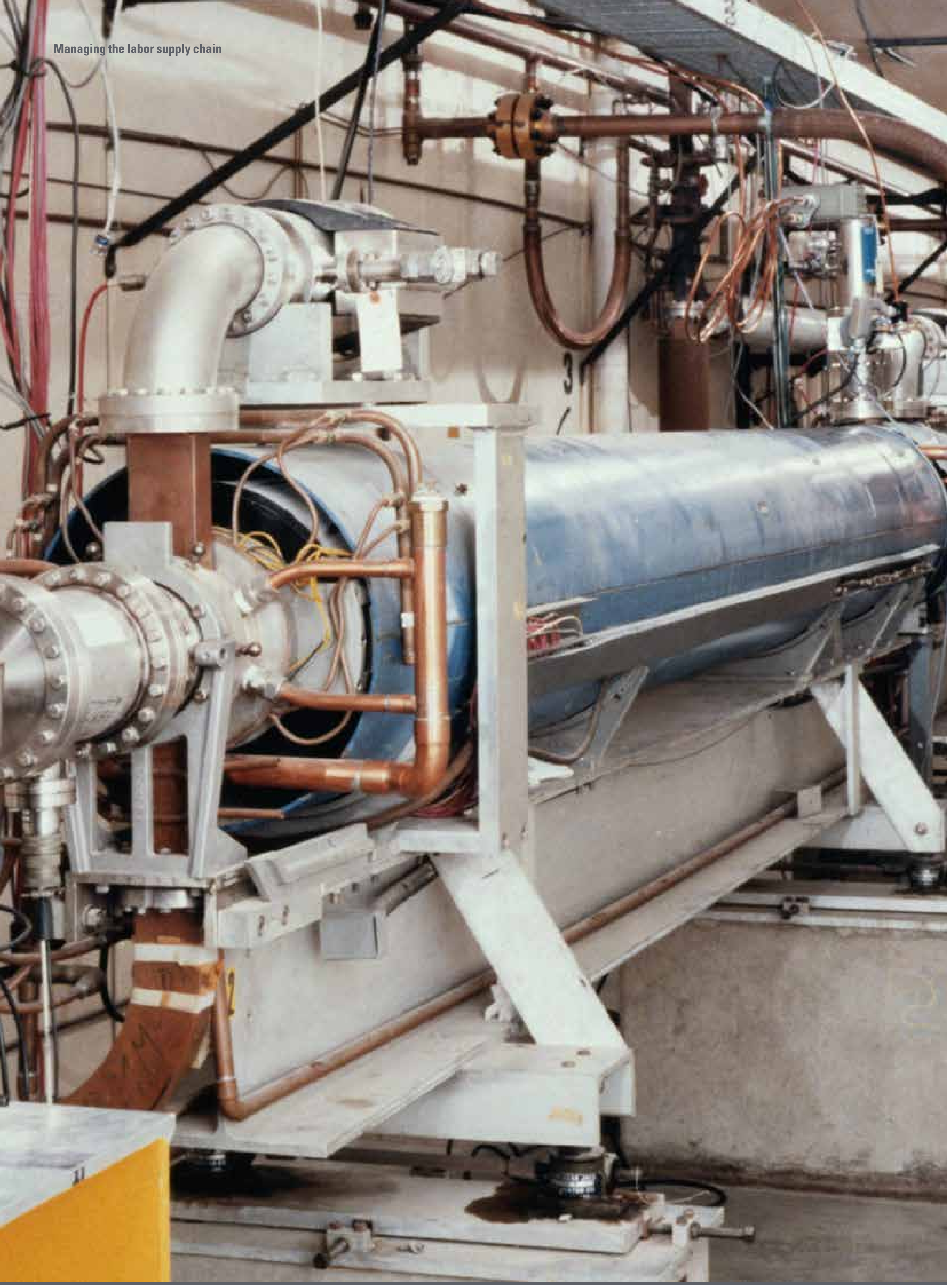
Like the two US issues mentioned previously, FATCA causes an additional compliance burden. Moreover, because the oil and gas industry necessitates the use of a globally mobile workforce, this additional burden is particularly relevant. Accordingly, it will give rise to associated costs for employers and employees, whether as regards to time related to gathering newly required information, professional services required to adhere to the rules, or indeed actual increased tax costs. Preparing for these costs and addressing who will bear them is essential to the success of any global mobility program.

What are the key **messages?**

Managing the labor supply chain in the oil and gas sector clearly poses numerous challenges – whether around health and safety, project management, harnessing the latest technology or in coping with the sheer number of people involved and the geographical spread in which operations are conducted. From a tax and social security perspective, the challenge is no less. In many ways, employment and global mobility teams are now experiencing the perfect storm with a much greater focus by the tax authorities on compliance and penalties, more and more detailed legislation and business activity taking place in many more locations across the globe; all playing against the multitude of operations undertaken by the workforce in different parts of the business. In Australia, the UK and the US we see significant moves to clamp down on tax avoidance – whether it be in the tightening up of the UK rules governing offshore workers, similar changes in the US relating to the US Outer Continental Shelf or in Australia in terms of the LAFH rules as well as the increased scrutiny on whether someone really is non-Australian resident. But there are some differences in approach. For example, in the UK there are moves to incentivize employers to take on more staff, e.g. with the exception from employer social security contributions for the under 21s that will apply (up to the upper earnings limit) from 2015/16 and, more generally, the move away from the 50 percent income tax rate to a 45 percent rate from 6 April 2013. Also, in the UK it is possible, particularly for larger employers, to reach informal agreement with HMRC on trickier tax and social security positions by way of ongoing dialogue facilitated by a nominated "Customer Relationship Manager". This is not the norm in the US and Australia. In those two countries, it is much more a case of forming your view, taking professional advice as necessary, and thus independently assuring that you have a solid position.

However, a common feature across the three countries is the need for clear accountabilities and responsibilities on tax matters and clear communication with all the stakeholders involved. This applies just as much to compliance matters directly affecting the business as it does to issues ostensibly impacting only on the individual, such as the US FATCA rules.

For the complex businesses operating in the oil and gas sector a robust system of due process and governance is key. Without this it is likely that attempts to manage the tax compliance burden and the cost of employment will be *ad hoc* and uncoordinated at best, and this can then lead to both a problematic relationship with the tax authorities and unbudgeted tax costs. However, if you get the governance building blocks right, sharpen up roles and responsibilities and ensure staff are properly up-to-speed on developments in the business and tax worlds you will be well on your way.



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