KPMG

GMS Flash Alert

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Australia – Updated Guidance on Treaties and Remote Workers, Displaced Employees

As the impact of the COVID-19 pandemic on global travel continues, it is essential for employers to review and revisit the Australian tax implications in respect of employees who remain working remotely from Australia.

Further to our recent GMS *Flash Alert* 2020-354 (14 August 2020)[1], the Australian Taxation Office (ATO) has updated the COVID-19 commentary on its website and provided additional guidance and clarity in relation to the sourcing and taxability of employment income for a nonresident who normally resides in a country with which Australia has a double taxation agreement (DTA)[2].

WHY THIS MATTERS

If an organisation still has employees temporarily displaced in Australia, the combination of Australia's domestic tax laws and its DTA network mean there is a risk that the employee may have triggered (or will do shortly) a liability to Australian tax (with potential retrospective application). This brings with it associated employer tax withholding and reporting obligations.

COVID-19 continues to severely limit the ability to travel across the globe and we, at the KPMG International member firm in Australia, are seeing more requests by employees to work remotely from Australia for an extended period of time. As the holiday season approaches, many of these temporarily displaced employees may be seeking to remain in Australia until the new year, and as a result they may (if they have not already) fall foul of the "days test" under the "short-term-visitor exemption" of the relevant treaty.

Employers will need to review the tax position of their remote workers in Australia and seek to understand any resulting employer obligations. The employee may have triggered Australian tax residence (and hence be taxable on a worldwide basis) or even if the employee remains a tax nonresident of Australia, the operation of the DTA may deem the employment income as taxable in Australia, notwithstanding that the employee continues to work for the benefit of the foreign employer.

Additional Details

Under Australian domestic law, employees who: (i) ordinarily reside overseas but have temporarily returned to Australia during the pandemic, and (ii) who continue to be nonresidents of Australia for tax purposes, and (iii) their employment income remains foreign-sourced per the ATO COVID-19 guidance, then the employment income earned during this period would not ordinarily be taxable in Australia.

However, where a DTA exists, this may override the foreign sourcing position under domestic law and deem the employment income to be Australian-sourced. This may occur where:

i) the individuals do not meet the requirements of the short-term-visitor exemption in the DTA; and

ii) they are nonresidents (or treaty foreign resident) of Australia for tax purposes; and

iii) they continue to be tax residents of the DTA country in which they ordinarily reside.

In such a situation, the employment income may be deemed to be Australian-sourced, and as a result, be subject to Australian tax.

KPMG NOTE

In addition, an employee's continued presence in Australia will also require a deeper analysis as to whether the individual has triggered Australian tax residency under the four tests of Australian tax residence, and, if so, from what date. The application of the four tests is complex and requires consideration of the facts and circumstances of each case. A tax resident of Australia will be taxable on worldwide income and gains in Australia (unless they qualify as a temporary tax resident of Australia).

Similarly, the individual's continuing tax residency position in the home location may also need to be reviewed and may trigger home country exit tax filings.

Context

The ATO guidance has continued to evolve as the pandemic has lasted longer than many expected and continues to impact the freedom of movement internationally. The ATO guidance issued to date has assisted employers and employees in understanding the taxability of remote workers with respect to the impact on their personal tax residency status, and the sourcing of their employment income.

It is clear from this guidance that the ATO expects foreign employers (and Australian employers) to meet Australian employer obligations where they have employees who continue to work in Australia and the employment income is liable to Australian tax in the following situations:

- The employee is **an Australian tax resident** and taxable on his or her worldwide employment income; or
- The employee is a nonresident of Australia and the **employment income is Australian-sourced**.

Subject to any concessions, employer obligations may include:

- Single Touch Payroll (STP) reporting;
- Pay-As-You-Go (PAYG) withholding;
- Fringe Benefits Tax (FBT) on benefits provided to employees;
- Superannuation Guarantee (SG) obligations;
- State payroll taxes;
- Workers Compensation requirements.

Foreign employers that would not otherwise have had any employer obligations in Australia may now find themselves needing to make various registrations in order to meet these obligations.

Some of the key considerations for employers are explained further below.

Residency

An individual's Australian tax residency is determined by considering four tests[3], with the satisfaction of any one test resulting in an individual being considered a tax resident of Australia and taxable on his or her worldwide employment income.

The length of time in Australia is becoming increasingly important as well as reviewing the pattern of behaviour of the individual while he or she is staying in Australia. That individual may have triggered Australian tax residence under the "resides" test based on the ordinary meaning of the word or the "183-day test" where he or she has spent more than 183 days in Australia in the tax year.

It is important to note that the 183-day threshold under the 183-day test is not determinative by itself. A person may be in Australia beyond the 183-day threshold and still be a nonresident. For this to apply, all facts and circumstances would need to be considered and the Commissioner would need to be satisfied that the person's usual place of abode remains abroad and that he or she does not intend to reside in Australia.

KPMG NOTE

Whilst it will be possible for a person to maintain a nonresident status beyond 183 days in the tax year, we expect that it will be increasingly more difficult to substantiate as the employee's length of stay in Australia becomes more significant and the living arrangements in Australia become no longer temporary in nature.

Australian-domiciled individuals have the additional hurdle of needing to demonstrate that they continued to have a permanent place of abode outside of Australia, otherwise they will have triggered Australian tax residence while they are in Australia.

Source of Employment Income

A common misconception is that if the individual is a nonresident of Australia and the income is considered foreign-sourced under Australian domestic tax law, then the DTA does not need to be considered. This is not the case. As confirmed in the Full Federal Court decision of *Satyam Computer Services Limited v Commissioner of Taxation* [2018] FCAFC 172, the Court held that the interpretation of DTAs can impose Australian tax that may not otherwise exist under Australian domestic tax law. This case is well known for the principle that a DTA can act as a "sword" imposing tax, as well as a "shield" to prevent double taxation. The implications of this decision have since been codified into Australian domestic law.

In the context of employees temporarily displaced in Australia, where the conditions of the short-term-visitor exemption[4] under the DTA are not met and the exemption does not apply, then the employment income earned by a nonresident of Australia while working in Australia could potentially be deemed to be sourced to Australia under a DTA and hence taxable in Australia. These "deemed sourced" provisions are found in many DTA's and require Australia to exercise its taxing right where allocated to it under the agreement.

KPMG NOTE

When considering the short-term-visitor exemption, each DTA must be reviewed carefully as the wording and the time periods will differ in determining whether the conditions for the exemption have been met or not. For example, Article 14 of the DTA between the U.K. and Australia has a rolling 12-month-period test compared with Article 15 of the DTA between the U.S. and Australia which focuses only on the tax year concerned. Up until recently, most employees "stuck" in Australia will have qualified for this short-term-visitor exemption as they will not have been in Australia for a sufficient period to have over-stayed the days test within this exemption (which in most treaties is 183 days). As we approach Christmas and look to the new year, however, this will no longer be the case.

An example of the deemed source provisions is Article 22 of the DTA between New Zealand and Australia, which states that:

> *SOURCE OF INCOME*
>
> *Income, profits or gains derived by a resident of a Contracting State which, under any one or more of Articles 6 to 8 and 10 to 19 may be taxed in the other Contracting State* ***shall*** *for the purposes of the law of that other Contracting State relating to its tax be deemed to arise from sources in that other Contracting State.*

Similar source articles can be founded in Australia's DTA with Canada (Article 22), the U.K. (Article 21), Singapore (Article 17), and the U.S. (Article 27), as examples.

This deeming will prevail over any inconsistent domestic law provisions. Where the deemed source provisions have not been included in the particular tax treaty, Australia has enacted an equivalent deemed sourcing provisions within its domestic law[5] to help ensure that there is a consistent approach that applies to all treaties entered into force post-27 March 2019.

KPMG NOTE: FINAL OBSERVATIONS AND RECOMMENDED NEXT STEPS

While there is still potentially Australian tax relief available where an employee continues to be a nonresident of Australia for tax purposes, we at the KPMG International member firm in Australia are observing that many individuals who arrived in Australia at the start of the pandemic and who are still in Australia, may have triggered Australian tax residence status or, even if they remain nonresident of Australia, the employment income may be deemed to have an Australian-source and consequently taxable in Australia (with potential retrospective application), if they have come from a country with which Australia has a DTA.

Employers should consider taking take action now to review their employees' circumstances and seek advice on understanding any resulting employer obligations. These issues can be complex and typically would involve an analysis of the individual's facts and circumstances and a good understanding of the operation of any DTA provisions.

Foreign employers will need to register and withhold under the PAYG withholding system where their employees are liable to Australia tax on employment income. Other employment tax obligations, such as Superannuation Guarantee, Fringe Benefits Tax, and state payroll tax obligations will also need revisiting.

Similar source and residency considerations will also apply where employers have continued to report and withhold taxes in Australia for employees who are displaced outside Australia.

We have been assisting many employer and employees to understand and comply with their Australian tax obligations as well as consider possible tax planning strategies in cases where the employee has spent significant time in Australia.

Please contact your local, qualified Australian tax professional for assistance and further information or a member of the KPMG tax team in Australia noted in the below Contact Us section.

FOOTNOTES:

1 Related guidance previously-issued can be found on the ATO's COVID FAQ Portal: https://www.ato.gov.au/general/covid-19/covid-19-frequently-asked-questions/individuals-frequently-asked-questions/.

For related coverage, see the following issues of GMS *Flash Alert*: 2020-195 (24 April 2020) and 2020-098 (23 March 2020). Also see the following issues of GMS *Flash Alert*: 2020-113 (25 March 2020) and 2020-112 (25 March 2020).

2 Refer to updated ATO guidance at: https://www.ato.gov.au/General/COVID-19/Support-for-individuals-and-employees/Residency-and-source-of-income/#Effectofadoubletaxagreementsonemployment for more details.

3 The definition of "resident" or "resident of Australia" is in subsection 6(1) of the Income Tax Assessment 1936 Act.

4 Most DTAs contain an exemption known as the short-term-visitor exemption, which allows individuals who are resident in another country to be exempt from taxation in respect of their employment income in Australia, if the individual is not present in Australia for more than 183 days in the income tax year or a rolling 12-month period; the remuneration is not paid on or behalf of an employer that is an Australian resident; and the remuneration is not deductible against the profits of an Australian permanent establishment of the foreign employer. Please note that some countries have a different "day-count threshold" and hence it is important to check the applicable treaty for the number of days and period in which they should be counted.

5 Section 764-5 of the Income Tax Assessment Act 1997.

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