



INSTITUTE OF
**PUBLIC
ACCOUNTANTS®**

**Review of the
income tax
residency rules for
individuals**

November 2018

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our **'Review of the income tax residency rules for individuals'** submission. We look forward to working with the Board of Taxation in providing feedback on the implications on its recommendations to reforming and modernising the residency rules.

The IPA is one of the three professional accounting bodies in Australia, representing over 36,000 accountants and students throughout Australia and internationally. The IPA prides itself in not only representing the interests of accountants but also small business and their advisors.

We look forward to discussing in more detail the IPA's submission and its recommendations. Please address any further enquires to Tony Greco, General Manager Technical Policy via tony.greco@publicaccountants.org.au

16 November 2018

Board of Taxation Secretariat

The Treasury – Sydney Office

Level 5, 100 Market Street
Sydney NSW 2000

Via email: taxboard@treasury.gov.au

Dear Sir/Madam

Review of income tax residency rules for individuals

The IPA welcomes the opportunity to provide this submission in response to the Board of Taxation’s (BOT) consultation guide entitled “Review of income tax residency rules for individuals” (the consultation guide).

In its current form, the Australian tax residency rules for individuals have long caused taxpayers uncertainty, are complex and outdated, and are no longer fit for purpose. Therefore, we are supportive of the BOT’s review to reform and modernise the manner in which Australian tax residency for an individual is determined. The case for change is strong especially as the rules no longer reflect global work practices in an increasingly global, mobile labour force. They impose an inappropriate compliance burden on many taxpayers which is problematic under a self-assessment tax regime. The uncertainty in applying the rules is leading to an increased level of disputes and requests for private rulings.

This submission addresses select questions posed in the consultation guide.

Executive summary

We support the BOT’s proposed model of a primary bright-line test and failing that, a secondary factor test applies which is premised on the principle of residency adhesiveness.

In principle, we consider:

- That there be a primary bright-line test, such as the 183-day test, that would make it easier for individuals to establishing their Australian residency status. We are of the view that for this primary test to be effective, the majority of taxpayers should conclusively know their residency status once the relevant primary test for inbound or outbound individuals is applied.
- That a secondary ‘factor’ test be applied for a smaller cohort of taxpayers where the primary test is not satisfied. We consider that such a secondary factor test be comprised of an objective list of factors which provides a ‘tick-a-box’ exercise for taxpayers. We urge that any such test should not replicate the difficulties with the current residency tests where there is a level of ‘fact and degree’ involved. Further, a tiered or points-based weighting mechanism for the secondary test (premised on the principle of residency adhesiveness) would be critical for ease of application and to alleviate complexity.
- That a part-year mechanism be introduced which creates separate notional tax periods for when the individual becomes or ceases to be an Australian tax resident in relation to an income year.
- That the superannuation test be reformed so that only “government officials” undertaking “government functions” are treated as Australian resident taxpayers. In keeping with international standards, the spouses and dependents of such individuals should be excluded with their tax residency determined in the usual way under Australian tax law.
- That to prevent abuse and manipulation by individuals, a temporary absence measure similar to that in the United Kingdom’s (UK) residency tests be introduced. As a fallback, we are also open to a specific anti-avoidance measure to allow the Commissioner to exercise his discretion to disallow residency arrangements undertaken by individuals to reduce their personal tax liability.

1. Bright-line primary test

In our view, a day-count bright-line primary test would best provide certainty, simplicity and reduce overall compliance costs. To be effective, the primary test should enable the majority of individuals to conclude on their tax residency status; with only a small number of taxpayers having to consider the secondary factor test.

The BOT's consultation guide prescribes that the bright-line primary test would differ depending on whether the individual is classed as an "inbound individual" or "outbound individual". Below are our comments on application of the primary test for each classification.

Inbound individuals

- We contend that a 183-day quantitative primary test would be the most appropriate bright-line test. The fact that this proxy is a relatively global standard would at least provide some level of precedence if a similar test were to be adopted.
- We consider that it would not be beneficial to have other primary bright-line tests apply in establishing Australian tax residency; whether as alternatives or in combination. The alternatives proposed in the consultation guide include whether the individual is in full-time employment in Australia and/or whether the individual has a home in Australia. We understand that these examples mirror the automatic tests which are contained in the United Kingdom's (UK) statutory residency test.

Our concern with these alternative tests is that they do not necessarily achieve the desired objective of certainty and simplicity. For example, the UK bright-line test considering whether an individual is in full-time employment in the UK contains an onerous calculation which requires records of the hours worked by the individual and considers any leave taken. If such a test were to be adopted, the presence of an employment contract and pay slips from the

employer may be a simpler alternative of evidencing the individual's employment status.

Another difficulty we anticipate with these tests are that, in some part, they would require a factual assessment of the individual's circumstances against definitions which are under ordinary concepts. For example, the UK's bright-line test on whether that individual holds accommodation in the UK requires an assessment as to whether there is a "home" (within its ordinary meaning). Such a primary test would create undue complexity for taxpayers.

- We support the BOT's view that to guard against manipulation the 183-day standard should be met by an individual if they are present in Australia for 183 days or more in any 12-month period rather than per income year.

Where the time spent spans between two income years, we consider that the individual should be a resident for both income years; however, split into notional tax periods where appropriate. In our view, a part-year mechanism that is based on presence in Australia and aligns with the part-year rules for the tax-free threshold is preferred for its simplicity (per design principle 7).

The above approach should also dovetail well with the operation of s855-45 of the *Income Tax Assessment Act 1997* (ITAA97) which deems certain CGT assets held as being acquired for their respective market values at the time that the individual commences their tax residency. They would also assist with the apportionment for any CGT discount for non-residents who have held certain CGT assets for at least 12 months.

- The temporary residency rules and working holiday maker rules currently operate irrespective of the tax residency status of the individual. Rather, their operation is premised, amongst other things, on the visa type issued to the inbound individual. Should a primary day-count bright-line test be introduced, we do not consider that this would give rise to any adverse implications to the operation of the above rules.

For example, an individual who enters Australia as a 'working holiday maker' for the purposes of those provisions would still be subject to working holiday maker tax rates as was originally intended. The fact that the individual may be in Australia for at least 183-days under a proposed primary bright-line test would not have any bearing on the tax rates which apply.

Outbound individuals

For outbound individuals, we are in agreeance with the principle of residency adhesiveness and the proposed model which prescribes a day-count test subject to whether the individual had previously been a resident (unless the individual has taken up full-time employment overseas).

Our observations and comments in relation to aspects of such a model include:

- To maintain the principle of residency adhesiveness, we consider that the proposed model for outbound individuals strikes the appropriate balance between simplicity and integrity. It should be made more difficult for individuals who have established tax residency to lose that status.
- We agree with the concept that individuals who are in full-time employment overseas should be treated as a non-resident (subject to a day-count test). However, as noted above, there would need to be a simpler way for the individual to prove that the work in which they are undertaking constitutes full-time work apart from hours worked, such as the presence of an employment contract.

Further, we do not consider that a bright-line full-time work test necessarily contradicts the secondary factor test which seeks to identify ties that the individual has with Australia. Notwithstanding that the individual may still have strong ties with Australia, having such a stand-alone full-time employment test outweighs the perceived contradiction and removes unnecessary complexity that is emblematic of the current rules for the taxpayer and/or their employer.

- Similar to inbound individual, we consider that the proposed day-based bright-line tests would be sufficient as a primary test without the need to consider other additional or alternative tests.

In our view, an additional test which assesses whether the individual has a home outside of Australia would unduly increase the level of complexity and would be akin to having the “permanent place of abode” test as contained in the current residency rules (refer below to *Establishment of home outside Australia* for discussion).

With respect to the 12-month period of assessment for the bright-line outbound tests, we consider that these should be applied over any 12-month period (with part year considerations) rather than per income year. This approach would align with that adopted for the 183-day primary test for inbound individuals and will guard against manipulation. We do not consider it necessary to average the days over a longer time frame.

Our concern with this approach however is that it adds complexity in appropriately identifying and establishing the relevant 12-month period for testing; an income year basis would be easier in that regard.

Lastly, to aid users in applying the primary tests, we suggest that a flow diagram outlining the relevant steps in determining the individual’s residency be drafted into the legislation (refer to [s87-5 ITAA97](#) for an example relating to the meaning of “personal services business”).

2. Secondary ‘factor’ test

As a fallback to the primary test, we are open to the use of a secondary “factor test” so long as there is a clear objective list of factors and an appropriate weighting mechanism (discussed below). We urge that this test be drafted in a manner which does not replicate the difficulties encountered with the current residency tests where there is a level of ‘fact and degree’ and uncertainty involved.

The consultation guide outlines these five factors as the most relevant in assessing whether the individual has sufficient ties with Australia, namely:

- the time spent in Australia (subject to whether the individual was previously a resident or not in the preceding year)
- the individual's immigration status (whether they are a citizen or permanent resident)
- the individual's family (whether they are located in Australia)
- the presence of Australian accommodation, and
- economic ties.

We agree that these facts are the most relevant factors for identifying a connection with Australia provided that requirements for each factor are clear and matter-of-fact.

In our view, one additional factor that should warrant further consideration and should be included the above list is the reliance, the individual places on any publicly funded services and social security, such as Medicare and private health cover.

For example, if an outbound individual continues to place reliance on the Australian public health system through Medicare; such a reliance would seem to indicate that the individual has not completely severed their ties with Australia. Another example, is where an outbound individual deliberately chooses to retain their private health cover; notwithstanding that the cover does not extend outside of Australia. This may indicate that individual still relies on the support of the Australian healthcare system.

Discussion on relevant factors

The consultation guide outlines other relevant factors which may impact the strength of an individual's Australian connection. Below are our comments on certain issues.

Immigration passenger cards

We do not believe that the responses on passenger immigration cards upon arrival or departure is relevant in establishing the level of connection with Australia. The

responses to the immigration questions may indicate the individual's intention but may not necessarily reflect their actual activities.

For example, an outbound individual may mark on their departure card that they will be leaving Australia indefinitely, only to return to Australia shortly after due to unforeseen family circumstances. These same circumstances could also happen for an inbound individual. As such, we do not believe any weight should be given to the responses to such documents.

Establishment of a home outside of Australia

This particular factor would be akin to the “permanent place of abode” concept found in the current statutory domicile test. We recommend against having such a factor as this would create undue complexity.

As a case in point, the recent decision in *Harding v Commissioner of Taxation* [2018] FCA 837 highlighted the difficulties in establishing whether the taxpayer had “a permanent place of abode” outside of Australia. Notwithstanding that the taxpayer had lived in an apartment complex for six years while working in Saudi Arabia, this was not sufficient for the primary judge to conclude that the taxpayer had a permanent place of abode outside of Australia. Specifically, the factors which weighed against the taxpayer included the transient and temporary nature of living in a fully furnished apartment and the fact that he did not use this location as his mailing address.

Despite the outcome, the primary judge conceded that the expression “a permanent place of abode” lacked precision and expressed concern that “such a concept is incongruous as, if a person had established a permanent place of abode outside Australia, they must necessarily have lost their domicile here” (ie in Australia).

Australian accommodation

Undoubtedly, whether an individual has “Australian accommodation” is a critical factor in establishing tax residency. The consultation guide suggests that this factor

could be satisfied if the individual had readily accessible accommodation (whether owned or rented) that they use throughout the year.

Apart from owning or leasing premises, the BOT should consider other situations where an individual could have Australian accommodation. For example, an individual who undertakes a 'board and lodging' arrangement should also be taken as having Australian accommodation. A typical example would be adult children who reside in their parents' home (or vice versa).

In this regard, the benefit of established definitions for "main residence" under the capital gains tax provisions, and "place of residence" under fringe benefit tax law may be helpful in drafting an appropriate definition for Australian accommodation.

Economic ties

The extent of financial interests held by the individual in Australia assets would be of relevance in establishing whether there is a connection with Australia.

In that sense, we consider the following tangible financial factors to be appropriate in ascertaining conclusively the level of economic ties:

- any form of employment
- any form of social security receipt
- maintenance of Australian bank accounts
- the level of investment in Australia (including business interests and investments in passive assets Australian real property, shares, managed funds)
- directorships in an Australian company, or acting as a trustee of a self-managed superannuation fund, and
- reliance on funds from family (for example, family trust distributions or stipend)

In our view, the mere fact that the individual holds an Australian Business Number (ABN) does not always demonstrate that the individual is carrying on a business. It is not uncommon for an individual to apply for an ABN online and then to place it aside

without ever conducting a business using that ABN. Instead, to determine if the individual is actually conducting a business it would be necessary to assess the underlying activities performed under that ABN. This could be evidenced by the individual's Business Activity Statements or their income tax return.

In addition, an individual who acts as trustee of a discretionary trust which hold Australian assets should not automatically be assumed to have a connection with Australia unless there is evidence that the individual has previously been or is presently a beneficiary or there is an expectation they will benefit (say, by way of a future distribution). A similar analysis could also be applied to someone who is an executor of a deceased estate.

Family factor

The presence of immediate family in Australia, namely the individual's spouse (married or de facto relationships) and dependent children (under 18 years of age), in our view would demonstrate a significant tie to Australia. This is the approach adopted in the UK statutory residency test as one of its factors and one that we believe should be adopted in an Australian context given its simplicity of application.

While the presence in Australia of an individual's other immediate family members including their parents and siblings would also be a relevant factor this is not necessarily determinative. This would require an assessment on the strength of the relationships; which in turn would increase the level of complexity. Likewise, the presence of any social groups in Australia would result in a similar issue.

3. Weighting mechanism for secondary factor test

In our view, the BOT's proposal of a weighting mechanism using either: (i) a points-based mechanism, or (ii) or a tiered mechanism (premised on meeting a certain number of factors), should simplify the application of secondary factor test. We are supportive of either mechanism so long as it is easy to apply, and any defined terms used are unambiguous.

A current example of a points-based mechanism in the tax law is the “100 point innovation test” under [s360-45 ITAA97](#) for the purposes of the early stage investor concessions. Depending on the relevant innovation criteria, 25, 50 or 75 points are allocated with a total of 100 points satisfying the test.

While a points-based test as above would be more transparent and understandable, we do acknowledge that allocating an appropriate weighting (or points) to each relevant factor for the purposes of establishing tax residency can be problematic and could give rise to arbitrary or unintended outcomes.

This could be avoided however, if each of the factors were allocated equal weighting (ie the same score). The total score to satisfy the residency requirement will then vary subject to whether the individual was previously a resident or not. If this were adopted, a points-based mechanism would be analogous to a tiered approach.

By way of example, if there are eight identifiable residency factors with 25 points allocated to each, then an individual who was a resident in the preceding income year would only need 100 points (ie four of the eight factors) to be classed as an Australian tax resident, while an individual who was not previously a resident may need to accumulate 150 points. (ie six of the eight factors). Such an approach also preserves the principle of residency adhesiveness, and in our view would be fair and equitable for taxpayers.

4. Superannuation test

We do not have any objections to the approach outlined by the BOT in relation to changes to the superannuation test, such that it is consistent with international standards. Specifically, we agree with the proposal that the “superannuation test” only apply to “government officials” undertaking “government functions” and not to their spouses or dependents by way of association. The normal residency rules will apply to these individuals.

5. Integrity measures

The consultation guide outlines alternative measures which could be introduced that would seek to guard against short-term gaming which allows for exemption of Australian tax. Another concern of the BOT was the “resident of nowhere” phenomena. In these circumstances, tax agents and practitioners will not readily be able to identify whether their outbound clients have become a tax resident of a foreign jurisdiction.

In our view, the adoption of a temporary absence rule similar to that of the UK would achieve the objective of preventing individuals from short-term gaming to reduce their tax obligations and allow for easier collection of outstanding tax upon the individual resuming their residency. This is our preferred measure over the concept of an alternative minimum tax or Spain’s targeted deemed residency rule. In our view, these particular measures appear to discriminate against those who legitimately relocate to lower taxing jurisdictions.

Further, as a fallback, we are open to a specific anti-avoidance measure which allows the Commissioner of Taxation (Commissioner) to exercise his discretion in relation to schemes which result in a reduction in an individual’s tax liability from a change of residency. This measure could also address the “resident of nowhere” issue by allowing the Commissioner to deem an individual to remain a tax resident if he is not satisfied that residency has been established elsewhere.

In the usual way, if the Commissioner were to identify an emerging arrangement that is of concern, an ATO pronouncement (such as a Taxpayer Alert or Tax Determination) could be issued as a deterrent to taxpayers by indicating that the anti-avoidance measure would likely apply.

We trust that the BOT finds our submission of value. Please feel free to contact us directly should you require further clarification on any of the issues raised or other questions related to our submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tony Greco', with a stylized flourish.

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