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Assistant Secretary, Personal and Small Business Tax Branch

Personal and Indirect Tax and Charities Division

The Treasury

Langton Crescent

PARKES ACT 2600

*By email to:* individualtaxresidency@treasury.gov.au

**Consultation paper: Modernising individual tax residency**

The Institute of Public Accountants (IPA) welcomes the opportunity to make a submission in relation to the Consultation paper titled ‘*Modernising individual tax residency*’ released by the Board of Taxation (the **Board**) (the **Consultation Paper**).

***About the IPA***

The IPA is one of the three professional accounting bodies in Australia, representing over 50,000 members and students in Australia and in over 100 countries. Approximately three-quarters of the IPA’s members work in, or are advisers to, small business and small-to-medium enterprises.

***Introductory observations***

The IPA strongly supports the proposal to reform and modernise Australia’s individual tax residency rules and commends the work of the Board.

The Australian tax residency rules for individuals, in their present form, have long caused taxpayers to face a heavy compliance burden. This is due to the inherent complexity of the residency tests in Australia’s domestic tax law, which demand an analysis that is highly subjective and factual, and where the legal principles are far from clear, and constantly litigated.

This presents considerable difficulties in the context of our self-assessment tax system. Our members tell us that many individuals cannot plan their affairs or manage their tax compliance with certainty. Advisors face significant risk when advising on the residency tests and many will recommend to their clients that they obtain (at significant costs and delay) the assurance of a private binding ruling from the Commissioner of Taxation (**Commissioner**).

The case for change is strong. The current Australian tax residency rules for individuals can be fairly described as outdated and incompatible with the modern world, where increased global mobility, advances in technological and evolving economic and social norms, have dramatically changed the way that individuals live and work: the world is a very different and much smaller place today that what it was at the time the rules were first introduced some eighty years ago.

**Our views on the reforms proposed by the Board**

Overall, we consider the Board’s proposed reforms to the Australian residency tests for individuals to be positive and superior to the rules which currently apply.

In particular, we welcome the focus on greater objectivity in the application of the tests, which we consider will lower the compliance burden for taxpayers when seeking to obtain certainty about their residency position in Australia. By anchoring the rules to matters that can be objectively ascertained, such as physical presence in Australia, taxpayers and their advisors will be better placed to self-assess how the rules will apply to them and their circumstances. Taxpayers will have a more solid basis upon which to structure their affairs and comply with their Australian tax obligations with a greater degree of certainty. We anticipate this will achieve compliance efficiency and should reduce the need, and consequently the cost, for taxpayers to seek administrative assurance in the form of a Private Binding Ruling from the Commissioner. It should also reduce the risk that taxpayers will find themselves in dispute with the Commissioner, which often culminates in litigation.

However, we believe there is considerable scope to reconsider and recalibrate aspects of the proposed rules, to ensure the rules better reflect and respond to the practical circumstances that will be encountered by the majority of taxpayers. Our recommendations are set out in the Appendix to this letter, where we provide responses to the questions set out in the Consultation Paper.

Importantly, we consider there is scope to introduce some flexibility and discretion in the rules, aimed at reducing the risk of the rules producing an outcome that is unjust or unreasonable, without diluting the certainty or objectivity of the rules to a substantial degree for the majority of taxpayers.

The aspect of the reforms which the Board has proposed which is of greatest concern to our members is the ‘45-day requirement’ in the secondary commencing residency test.

We consider that a period of 45 days would likely result in a greater number of individuals being Australian residents. This is contrary to Treasury’s statement in the Consultation Paper that the proposed model is not intended to capture more individuals as tax residents, or raise any additional revenue. This also does not accord with the principle of adhesive residency, which provides that it should be harder to cease than to become an Australian tax resident.

The 45 day requirement would also increase overall compliance costs, which detracts from the certainty and simplicity sought to be achieved with the proposed model, as any individual present in Australia for 45 days or more in a year would need to consider whether they are a resident under the secondary test, and then consider the application of any relevant international tax treaties.

Based on the feedback we have received from our members, a period of 45 days may stifle inbound economic activity, whereas a period of 90 days would be better aligned with practical experience and circumstances of most taxpayers and will provide greater certainty and a reduced compliance burden for a majority of taxpayers. The Consultation Paper suggests that the 45-day requirement has an anti-avoidance purpose which is aimed at preventing taxpayers manipulate the rules to obtain an unfair or unintended tax benefit. Respectfully, if that is the policy objective, it can be better achieved by a specific and targeted anti-avoidance provisions, which targets those taxpayers who look to manipulate the rules, without placing an undue compliance burden on the vast majority of taxpayers who are focused on compliance and desire certainty. Lastly, the interaction of our domestic residency rules with outcomes for countries we have double tax agreements should be within scope as part of future reforms.

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If you have any queries or require further information, please don’t hesitate to contact Tony Greco, General Manager, Technical Policy, either at [tony.greco@publicaccountants.org.au](mailto:tony.greco@publicaccountants.org.au) or mobile: 0419 369 038

Yours sincerely

Tony Greco,

General Manager, Technical Policy

Institute of Public Accountants

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**Appendix 1**

**45-day threshold**

**1. How many days in an income year should an individual with strong connections to Australia be able to spend in Australia before they are considered a tax resident?**

The Board has recommended that an individual with strong connections to Australia should be able to spend up to 45 days in Australia before they are considered a tax resident of Australia.

This implies the Board considers physical presence in Australia for 45 days is consistent with a temporary or transient ‘visit’ to Australia, rather residency (or the resumption of residency) in Australia.

The Board refers to the following matters in rationalising this approach. We comment on each of these matters in turn:

* 45 days is longer than the normal annual leave period of 4 weeks:

Respectfully, there is a danger in applying Australian employment conditions and standards to all individuals, and all jurisdictions, as a measure of the durability of an individual’s connection with Australia.

There will undoubtedly be cases where the leave entitlements that a person has in their country of residence may be greater than 4 weeks, which is the norm in Australia: examples may include occupations that place a significant physical toll on an individual or require extensive travel, or where an individual is self-employed. Indeed, many travellers to Australia are not employed at all but in retirement, and so employment conditions and standards have no relevance to their circumstances.

* This period would ensure that tourists and economic other short-term visitors did not become residents, having regard to 2018 migration data that indicates a median stay of 11 days for short-term visitors, with most short-term visitors staying in Australia for less than 60 days:

Again, there is a danger in extrapolating from general statistics about the ‘average’ time that tourists and other short-term visitors spend in Australia to a broad principle of universal application. This is particularly the case where a benchmark based on ‘tourists’ or short term visitors is applied to individuals who have a family or legacy connection to Australia, but who do not reside in Australia in any practical sense.

* Comparable jurisdictions use a similar day count for certain aspects of their residency rules, including New Zealand and the United Kingdom.

We agree that there is merit in considering international precedent and approaches in formulating policy, provided that ‘day counts’ present in the laws of other states are viewed in their legislative context to determine whether they provide an appropriate comparison. However, there is a danger in considering international benchmarks (such as those cited for the United Kingdom and New Zealand) without regard to the broader context of the tax laws of those countries. Moreover, the economic, demographic and tax policy settings which are at-play in those countries may differ considerably to those in Australia. A period of 45 days may also be at odds with the Federal Government’s recent announcements that it wishes to deepen its engagement with Southeast Asia, which may require greater freedom of movement, trade and investment.

While we do not dispute the principle underlying the secondary tests, having regard to the above, we consider that physical presence in Australia of 45 days is an unreasonably low bar for potentially establishing Australian tax residency. Such a low threshold, combined with an added compliance burden (including the possibility that residence is established in two countries and would need to be determined under an international tax treaty), would likely discourage short to medium-term movement or secondments of executives to Australia for businesses with cross-border operations, thereby decreasing Australia’s attractiveness as a global business destination.

We consider that a period of 90 days would be more reasonable, better aligned with practical reality and experience, would result in the Australian residency tests being better targeted, and achieve the stated policy objectives of providing individuals with greater certainty and reduced compliance burden in determining whether they are or are not Australian residents for tax purposes.

Moreover, Treasury states in the Consultation Paper that there is an anti-avoidance policy in play in the formulation of the 45-day requirement (see paragraph 16). In particular, Treasury states that the 45-day requirement aims to address concerns that an individual may be able to manipulate the 183-day test, by spending 183 days in Australia across two income years.

Respectfully, we submit that there is inherent unfairness in seeking to address an avoidance concern by imposing a requirement that could produce harsh and unreasonable consequences, as well as a greater compliance burden, on the majority of individuals who will be seeking certainty in complying with their tax obligations.

We respectfully submit that concerns about the manipulation, or the possibility of the manipulation, of the 183 day test, would be better addressed by a specific and targeted anti-avoidance provision, which place a greater compliance burden only on those individuals where the objective circumstances show an intention to achieve an unfair or unreasonable outcome.

**2. Do you consider that days spent in Australia under certain circumstances should be disregarded for the purposes of the 45-day count? If so, why should days be excluded in some circumstances and not others. Who would decide?**

There will undoubtedly be circumstances where the application of the 45-day test may produce unjust and unreasonable outcomes for particular individuals.

An example that immediately comes to mind is where an individual intends to depart Australia (evidenced by them having a return ticket to their country of residence with a fixed departure date), but are prevented from leaving Australia on their intended date for reasons that are outside of their control. Examples could include they, or a close family member, requiring medical attention, being required or compelled to remain in Australia longer than anticipated due to work demands that they must comply with, or by unanticipated externalities (such as the border restrictions imposed during COVID-19).

While accepting this may detract from the stated policy objectives of certainty and simplicity, we consider that there is scope for the Commissioner of Taxation to be afforded a discretion, that may be exercised in exceptional circumstances, to disregard the otherwise strict application of the 45-day requirement, in circumstances where its usual application would produce unjust or unreasonable outcomes, such as the examples we have provided.

**Factor tests**

**3. Could any of the four factors be defined differently to better achieve the design goals whilst remaining objective and identifiable?**

Right to reside permanently in Australia

We agree that this should be a relevant factor in determining whether an individual is an Australian tax resident and, as a fact that which can be objectively ascertained, it aligns with the stated policy objectives of certainty and simplicity.

Australian family

While accepting that it may detract from the stated policy objectives of certainty and simplicity, we consider that the formulation of this factor should be calibrated such that an exception may apply where the individual can furnish evidence:

* that children under the age of 18 are not dependents of the relevant individual taxpayer or have not lived with the individual taxpayer under a domestic arrangement; and
* in defining who is a person’s spouse, the individual and their spouse are not legally divorced, but the marital relationship has broken down and they are no longer living in a domestic arrangement.

Australian accommodation

Under the Board’s model, an individual would meet the ‘Australian accommodation’ factor if they had ‘a legal right or arrangement to access accommodation at any time during the income year’.

This may apply in circumstances where an individual owned property in Australia which they retained after they moved overseas, irrespective of whether the individual considers the accommodation available to them - for example, it may be a property that is occupied by a family member or a former spouse, who resides in Australia, as their ordinary residence.

Moreover, the proposed requirement merely looks at whether the individual has a ‘legal right or arrangement to access’ the property as a place where they may find accommodation, but it does not consider whether there had been actual occupancy of the property at a time when they were physically present in Australia.

Respectfully, we submit that the requirement should have two elements, both of which would need to be satisfied (and could be satisfied by reference to objective facts):

* first, that the individual had ‘a legal right or arrangement to access accommodation at any time during the income year’, as is presently proposed; and
* second, that the individual did, as a matter of fact, occupy the relevant property during a time when they were physically present in Australia, which can be objectively determined and evidenced.

Australian economic interests

There has been significant judicial consideration in recent years of the notion of what it means to be ‘ordinarily’ resident of Australia. The recent cases show that judges have, to an increasing degree, contextualised particular facts in the light of contemporary and modern circumstances: including the ease and affordability of international travel, advances in cross-border telecommunications and the increasing internationalisation of the workforce and investment markets.

Moreover, Australian Courts have noted that, in the modern context, an individual may have investments outside of the country in which they ordinarily reside, and that it is unremarkable that an individual may hold assets in Australia (particularly Australian real property, given the strength and resilience of Australia’s property markets) whilst they ordinarily reside overseas: see inter alia, *Harding v Commissioner of Taxation* [2018] FCA 837 at [85] (affirmed in *Harding v Commissioner of Taxation* [2019] FCAFC 29 at [63(d)] and *Handsley and Commission of Taxation (Taxation)* [2019] AATA 917 at [43].

Under the reforms proposed by the Board, an individual’s economic interests in Australia would remain a relevant consideration and determinant of the individual’s residency. We comment on the particular economic interests identified by the Board in turn:

*Employment in Australia:*

The Consultation Paper states that an individual may have an economic interest in Australia arising from their employment if they ‘commonly (not infrequently) carried out their employment duties in Australia’. This is a broad statement and with respect, we submit that it detracts from the policy objective of casting the Australian resident residency test for individuals in a manner that can be objectively determined. Moreover, given the substantially increased ability for many workers to undertake employment duties remotely, this element may prove difficult for taxpayers to understand and manage, and may lead to evidentiary and interpretational issues, including factual questions that would arise around what constitutes carrying out employment duties and the location from which those duties are carried out.

We submit at the policy objective of simplicity and certainty would be better achieved if this requirement was expressed to apply in circumstances where:

* the employer is an Australian resident entity; or
* the individual is employed by a foreign employer but is deployed to undertake work in Australia (including secondments to Australian related entities of the foreign employer) and, as a matter of fact, performs their employment duties exclusively in Australia.

*Direct or indirect interests in Australian assets, including:*

*An interest in taxable Australian property*:

We agree that this should be a relevant factor in consider whether an individual is an Australian tax resident but that it should not of itself be determinative: as has been traditionally noted, there is nothing remarkable about a foreign resident individual owning real property in Australia.

*A bank account with an Australian bank with significant cash deposits*:

We agree that this should be a relevant factor in determining whether an individual is an Australian tax resident, but should not of itself be determinative. Moreover the requirement that an individual has ‘significant’ cash deposits introduces an element of subjectivity into the test: as a proportion of net worth, what to one person maybe a significant amount of money may, to another person, be an insignificant amount of money. If it is proposed that a precise dollar amount or threshold be nominated as a significant cash deposit then this amount should be subject to an annual indexation for inflation.

*An interest in a family trust*:

Making reference to an interest in a family trust as an indicator of an ‘economic interest’ in Australia is fraught with complexity and risk.

A person may be a mere object of a discretionary family trust simply by virtue of the fact that they are an individual who falls within a broadly defined class of general beneficiaries. This may be the case even if they have not obtained any financial benefit or advancement from the trust, or if they have no knowledge personally that they are a beneficiary of the discretionary trust.

To achieve the stated policy objective of simplicity, the requirement that an ‘economic interest’ in Australia may be founded on an interest in a family trust should be abandoned. Alternatively, it should apply only if the individual has, as a matter of fact, received as a beneficiary a financial benefit or financial advancement from the discretionary trust (which can be objectively verified).

*Australian social security payments in the preceding income year*:

We agree that this should be a relevant factor in determining whether an individual is an Australian tax resident.

**4. Are there other factors better suited to identifying individuals strongly connected to Australia in an objective, simple and certain way?**

No, we do not consider that there are other factors better suited to identifying individuals with a strong connection to Australia in an objective, simple and certain way. Rather, as we suggest above, the Board's priority and focus should be on better calibrating the factors which are already identified, so that they are adaptable to the practical circumstances to which they may respond, and to further eliminate any element of subjectivity in the evaluation at taxpayers will be required to undertake.

**5. How would any additional factors affect the proposed Factor Test, in particular the operation of the two-out-of-four aspect of the rule?**

We have no substantive comment in response to this question given our response to question 4.

**Commencing residency**

**6. Does having three points of connection (i.e. being physical present in Australia for more than 45 days in an income year, together with two factors) strike the right level of connection to commence residency?**

The current residency test call for a multi-factoral evaluation of an individual’s circumstances: the factors that may play into this evaluation are unlimited.

We consider it to be significant progress if the factors requiring evaluation were narrowed significant, as proposed by the Board. We consider that this strikes the right balance between policy integrity and ease of compliance, and may be further improved by the recalibration of the factors in the manner we have outlined above.

**Ceasing short-term residency**

**7. Does maintaining two points of connection to Australia (i.e. meeting two factors) strike the right level of connection to maintain residency in income years during which an individual is physically present for less than 45 days?**

We consider that this strikes a reasonable balance in light of the stated policy objective of ‘adhesive residency’, although in the particular case where the ‘ceasing residency’ provisions apply, the relevant factors should be recalibrated and better targeted (including as we have outlined in our earlier responses) and can be objectively determined (another stated policy objective of the proposed reforms).

**8. If not, how should the Ceasing Short-Term Residency Rule operate to strike the appropriate balance between adhesive residency, certainty and simplicity?**

We refer to our earlier responses where we suggest ways in which the relevant factors maybe recalibrated so that they align with practical and commercial reality and can be objectively determined.

**Ceasing long-term residency**

**9. Does the Ceasing Long-Term Residency Rule strike an appropriate balance between increasing adhesiveness of residency for individuals with enduring ties to Australia while also providing a clear pathway to non-residency?**

The current formulation of the Ceasing Long-Term Residency Rule may undermine the certainty that the reforms seek to achieve and produce anomalous outcomes, as it requires the evaluation of an individual’s circumstances over a three-year period. This approach to determining tax residency is manageable for the individual. Although it is likely to cause significant uncertainty for employers who are required to determine their PAYG withholding and superannuation guarantee obligations on an ongoing basis throughout the income year, where their withholding and payment obligations are affected by the employee’s tax residence status (see s 27 of the *Superannuation Guarantee (Administration) Act 1992* and s 12-1 of Schedule 1 to the *Taxation Administration Act 1953*) and that tax residence status is not known until the end of the year. That said, we acknowledge that this uncertainty is present in the existing rules.

This may also impede the ability of Australian businesses to hire foreign skilled workers, including senior executives, to work in Australia as they may remain Australian tax residents for up to two years after they leave the country. If they also become a tax resident of the jurisdiction to which they are returning, their residence may ultimately need to be determined under an international tax treaty.

On a broader note, it would be appropriate for certain rules in relation to employer superannuation guarantee and PAYG withholding obligations to be amended to avoid unduly harsh outcomes where an employer adopts a compliance position based on their honest belief of an employee’s tax residence status, as communicated to them by their employee, which is later discovered to be incorrect.

**Temporary residents**

**10. Is it appropriate to only treat a ‘temporary resident’ as a long-term resident if they have been a tax resident for six or more consecutive years? (Note that other individuals will be treated as long-term residents if they have been a tax resident for three or more consecutive income years.)**

Yes.

**Overseas employment rule**

**11. The Overseas Employment Rule allows individuals with enduring connections to Australia to immediately cease being a tax resident, thereby reducing the tax and compliance burden for those individuals and their employers. Do the settings strike the appropriate balance between facilitating the skill development of Australians through international experience while maintaining sufficient integrity?**

Yes, and the simplicity of the proposed approach is welcome. One matter which should be clarified is the requirement that the individual ‘accept an offer of overseas employment for a period of more than two years from when the employment commences’. It should be made clear whether this requires merely that the individual’s employment terms stipulate that they have a minimum two year posting or assignment overseas.

The Consultation Paper proposed an integrity measure that would provide that if an individual applies this rule and is subsequently found to be ineligible, they are treated as never having ceased to be an Australian tax resident under this rule. It is unclear whether this would apply only to instances of intentional misapplication of this rule. It should be made clear what implications will arise if, as a matter of fact judged in hindsight, the individual spends less than two years working overseas, whether by choice (e.g. they resign and return to Australia) or by reasons outside of the individual’s control (e.g. they are terminated or made redundant), or where the commence employment with a different employer on different terms.

**12. The effect of the Overseas Employment Rule is to cause the individual to become a non-resident (and provide certainty for employees and their employers) rather than to exempt the overseas employment income. Is this the appropriate outcome?**

Yes, we do consider this is an appropriate outcome, although it will be important that individuals affected by these rules arrange their affairs and obtain appropriate professional advice to ensure that they fully understand the implications of them being non-Australian resident, including the extent to which they may be disentitled to certain tax concessions that are available only to Australian residents.

**Other matters**

**13. There will be a need for transitional rules when moving from the existing residency rules to the new framework. How would you suggest these transitional rules operate? For example, how should the Overseas Employment Rule apply to individuals who are already partway through their overseas employment at the time the new residency rules come into effect?**

As would be the case with any significant taxation or reform, there should be a reasonable and sufficient period of time to enable affected taxpayers to arrange their affairs in a way that will allow them to be compliant with the new regime and to obtain certainty regarding their tax affairs.

Additionally, as part of the transition to the new regime (should it be implemented) then in our view, there should be an ‘anti-detriment’ provision. This is a provision that would provide that an individual could maintain their tax residence status under the existing rules, if the proposed new rules would cause them to change their tax residence in a way that would cause them to have a comparatively unfavourable tax profile. This transitional provision should apply for a fixed period of between one to three income years. This is an important consideration, having regard to Treasury’s statement in the Consultation Paper that the proposed model is not intended to capture more individuals as tax residents, or raise any additional revenue.

To the specific question of how the Overseas Employment Rule should apply to individuals who are already part-way through their overseas employment at the time the new residency rules come into effect, our view is these individuals should have the option of ***either***:

* continuing with their present arrangements or tax status (e.g. as an Australian resident); or
* opting into the new regime and being treated as a non-resident from the date the rules receive Royal Assent, if they would have been treated as a non-resident if the new rules were in place at the time they entered into their employment arrangement.

This flexible approach will ensure that those taxpayers who arrange their affairs in a way that allowed them to comply with the former rules will not be prejudiced as a consequence of the introduction of the new rules.

**14. Do you have any other insights or observations to make about the framework?**

While Australia’s international tax treaties are beyond the scope of the consultation paper, it is in our view appropriate to consider the implications for taxpayers, and in particular the compliance burden taxpayers may face, due to the interaction of Australia's international tax treaties with what will be Australia's domestic law, if the proposed reforms to the residency rules are enacted. This is particularly the case if, contrary to the stated policy objective, the new residency rules have the practical result that more individuals fall within the definition of an Australian tax resident than is the case presently.

In particular, the ‘tie breaker’ provisions in a number of Australia’s international tax treaties often require taxpayers to undertake a factually dense analysis similar to what is required under Australia’s current domestic rules. For example:

* Our tax treaty with the United Kingdom provides that if an individual is a tax resident of Australia and the United Kingdom, the individual is deemed to be a resident only in the country in which a ‘permanent home’ is available to them. If a permanent home is available to them in both countries, or in neither country, they are deemed to be a resident only of the country with which their ‘personal and economic relations’ are closer (known as their ‘centre of vital interests’).
* Our tax treaty with the United States of America provides that if an individual is a tax resident of Australia and the United States of America, the individual is deemed to be a resident in the country in which the individual maintains their ‘permanent home’.

In both cases, the determination of where they maintain their permanent home or where their centre of vital interests is, requires close analysis of their personal circumstances, and invites a subjective analysis, which detracts from the certainty that is sought with the proposed model.

It is appropriate for Treasury to consider possible reforms to the current ‘tie breaker’ provisions in Australia’s international tax treaties to achieve greater certainty and simplicity for affected individuals.