



Australian Government

The Board of Taxation

REVIEW OF THE INCOME TAX RESIDENCY RULES FOR INDIVIDUALS

the **board** of **taxation**
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the **board** of **taxation**

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Communications
The Treasury
Langton Crescent
Parkes ACT 2600
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FOREWORD

The Board of Taxation (Board) is pleased to submit this report to the Minister for Revenue and Financial Services following its self-initiated review of the individual income tax residency rules.

This report explores the legal rules that apply to determine the residency status of individuals for income tax purposes. More specifically, the Board has considered:

- whether the existing Australian individual income tax residency rules that are largely unchanged since enactment in 1930:
 - are sufficiently robust to meet the requirements of the modern workforce;
 - address the policy criteria of simplicity, efficiency, equity (fairness) and integrity;
- integrity concerns that came to the attention of the Board both prior to and during the review;
- the increase in litigation relating to the residency rules since 2009; and
- any changes that could be adopted to improve the residency rules.

To manage the review, the Board appointed a Working Group, chaired by Board member Dr Mark Pizzacalla, and including Board Chair Mr Michael Andrew AO and an external advisor to the Board Ms Rosheen Garnon. The Working Group also included officials from Treasury and the Australian Taxation Office (ATO) as well as members of the Secretariat to the Board.¹

The Working Group undertook an extensive consultation process comprising a wide range of private sector consultees, including; individuals, tax practitioners (including expert expatriate tax advisers), migration agents, and academics that have specialised expertise in tax residency law and policy.

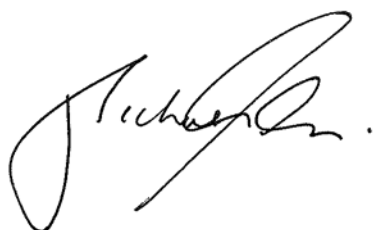
The Board would like to thank all of those who so readily contributed their time and expertise to assist in the review process.

This report makes a number of observations and recommendations to Government on ways in which the law and its administration could be improved to address a number of concerns that consultees brought to the attention of the Board during consultation.

1 References to the Working Group in this report are not to be taken as the views of the Treasury or the ATO.

While the key focus of this report is on evaluating the residency rules in a modern context, a number of ancillary issues were also raised during consultation. The Board has considered these issues and made a number of observations which are included in the Annexures to this report.

The ex officio members of the Board – the Secretary of the Treasury, John Fraser, the Commissioner of Taxation, Chris Jordan AO, and the First Parliamentary Counsel, Peter Quiggin PSM – have reserved their final views on the observations and recommendations for advice to Government.

A handwritten signature in black ink, appearing to read 'Michael Andrew AO', with a large, stylized initial 'M' and a trailing flourish.

Michael Andrew AO
Chair, Board of Taxation

A handwritten signature in black ink, appearing to read 'Dr Mark Pizzacalla', with a large, stylized initial 'M' and a trailing flourish.

Dr Mark Pizzacalla
Chair of the Board's Working Group

CONSULTATION

The Working Group's consultation included meetings with representatives of the following organisations:

- Arnold Bloch Leibler;
- BDO;
- Chapman Eastway;
- Deloitte;
- EY;
- Grant Thornton;
- Hayes Knight;
- Jackson McDonald;
- KPMG;
- Lendlease;
- Macquarie Bank;
- Telstra;
- PriceWaterhouseCoopers;
- William Buck; and
- The University of Sydney.²

The Working Group also consulted Her Majesty's Revenue and Customs of the United Kingdom (HMRC).

2 It is noted that where references in this report are made to consultees or consultation groups, these references do not necessarily reflect the opinions of any one consultee or the above named firms. Further, no such references refer to representatives of the Treasury or the ATO.

EXECUTIVE SUMMARY

1.1 The Board of Taxation has completed its review of the tax residency rules applying to individuals in Australia (the residency rules).

1.2 Following an extensive consultation process, the Board has concluded that the existing residency rules are no longer appropriate as the fundamental basis of individual income taxation. The Board considers the rules must be modernised and recommends that they are reformed. The imperatives that the Board considers best demonstrate the case for change are that the residency rules:

- (a) no longer reflect global work practices in an increasingly global mobile labour force, that have changed both the frequency and nature of interactions with the residency rules;
- (b) impose an inappropriate compliance burden on many taxpayers with relatively simple affairs as the rules are inherently uncertain to apply, include outdated concepts and rely on a 'weighting' system that leads to inconsistent outcomes, which also gives rise to integrity risks; and
- (c) are an increasingly prevalent area of dispute for taxpayers and the ATO given the fundamental difference in tax consequences for residents and non-residents – this is illustrated by the increased number of court decisions and ATO private rulings issued since 2009 (and the amendments to narrow section 23AG of the *Income Tax Assessment Act 1936*).

1.3 While the above may not be fully unexpected, given that the current definition of 'resident' was enacted over 80 years ago, the inadequacy of the existing rules is of increasing prevalence and has the potential to undermine the integrity of the income tax system. Since the 1930s, the global environment has changed significantly and the Board has concluded that the residency rules no longer reflect modern work patterns in Australia – they have not kept pace with changes in the nature of travel, work practices, or the complexity of modern remuneration.

1.4 The Board considers that modernised residency rules should reflect the following principles that were developed during consultation:

- (a) reflect current global work practices;
- (b) provide certainty to individuals of their tax residency status;
- (c) can be applied by an ordinary individual without tax advice in all but the most complex of cases;

- (d) remove antiquated concepts such as domicile; and
- (e) adopt factors that are easy to understand, reduce reliance on common law definitions, and are less open to manipulation.

1.5 The Board's preferred recommendation is to replace the current 'resident' definition as follows:

- (a) there should be a policy statement, such as an objects clause, that outlines the Government's overarching individual tax residency policy addressing the tax policy objectives of equity, efficiency, simplicity and integrity;
- (b) in accordance with the policy statement, the new resident definition should include separate definitions for individuals establishing residency and ceasing residency:
 - (i) each definition should commence with a simple bright line 'days count' test that ensures the vast majority of individuals can determine their residency quickly and with certainty; and
 - (ii) for individuals that do not satisfy either bright line test, an objective test based on the individual's facts and circumstances should then apply to determine residency on the basis of specific key factors (to determine the individual's connection or relationship to Australia);
- (c) a rule should be adopted to the effect that Australian residency is maintained until tax residency is provably established in another jurisdiction, to address integrity concerns identified during consultation;
- (d) the current rule that seeks to deem Government officials and their families resident no longer captures many Government officials and, as such, any new definition should include a more effective rule that reflects the Government's position regarding public servants (such as a specific government services rule).

1.6 The Board considers that this approach best addresses the issues highlighted in paragraph 1.2 by aligning with global work practices, reducing compliance costs for taxpayers as well as the potential for disputes.

1.7 The Board considered a number of other policy options to modernise the residency rules. These other options were:

- (a) to enact a number of targeted changes to the existing residency rules (leaving the current definition in place but with some legislative changes); or
- (b) to codify the existing common law into a statutory test (akin to the process undertaken recently in the United Kingdom).

1.8 These options, both improvements on the current law, were not preferred by the Board as they do not address the underlying problem; being that the current rules are deficient in their operation, impose an inappropriate compliance cost on taxpayers and the ATO, and should be replaced to reflect modern social, living and working standards.

1.9 The case for reform is stronger than ever given the globalisation of the modern workforce and increased labour mobility across jurisdictions. The Board's recommendations seek to provide simple, administrable rules that provide greater certainty to taxpayers, whilst reducing the ability for the manipulation of residency outcomes.

LIST OF SPECIFIC RECOMMENDATIONS AND OBSERVATIONS

Board Recommendations and Observations

Recommendation 1

The Board recommends that the Government modernise the individual income tax residency rules.

Policy options for the modernising the residency rules

Observation 1

The Board observes that the UK 'statutory residency test' would improve certainty for individuals applying the residency rules. However, the Board does not consider that the increased complexity and divergence from 'principles based drafting' is justified.

Observation 2

The Board notes that a number of improvements could be made to the current residency rules without undertaking wholesale reform. While the Board would support any improvement to the current rules, the Board considers that such a 'piecemeal' approach will not address the underlying causes of judicial and administrative uncertainty as well as the significant compliance burden currently placed on individuals and their employers.

Recommendation 2

The Board recommends modernising the residency rules via reconsideration of the underlying policy settings and replacing the residency definition with new, enhanced principles based rules that focus on certainty, simplicity and integrity.

The Board's preferred policy option: a new residency definition

Recommendation 3

The Board recommends that the Government legislate to adopt a policy statement (for example, an objects clause in the *Income Tax Assessment Act 1997*) that provides legislative guidance on the parameters of individual residency.

While the Board considers that access to the economic and social benefits of Australian society should be used as a basis for any statement, the Board recommends the Government commission further consultation to develop this statement.

Recommendation 4

Subject to the policy statement, the Board recommends two separate residency tests be adopted, for inbound individuals and outbound individuals respectively.

Recommendation 5

Subject to the policy statement, the Board recommends that each residency test begin with a primary bright line test to remove the facts and circumstances based tests for the majority of individuals. The Board recommends that further consultation on these bright line tests be based on the New Zealand and United Kingdom residency rules.

Recommendation 6

Subject to the policy statement, the Board recommends that a secondary test based on applying the facts and circumstances of an individual against a list of key factors be adopted. The nature and composition of these factors should be determined in consultation.

Observation 3

Subject to the policy statement, the Board observes that each residency test may declare a weighting for each of the relevant factors to provide greater certainty and simplicity in determining the outcome of the relevant test.

The Board considers that this warrants further consideration in policy development having regard to the appropriate balance of certainty of outcomes against potential manipulation of outcomes and increasingly complex legislation.

Recommendation 7

The Board recommends that the new residency test for outbound individuals ensures that all residents remain resident unless and until tax residency is established in another jurisdiction.

Recommendation 8

The Board recommends that the new residency definition not include the Superannuation test. Should the Government continue to treat Government officials as residents, the new residency definition should include a more effective rule that reflects the Government's position, such as a specific government services rule.

Further recommendations

Recommendation 9

The Board recommends that the Government consider reviewing the indirect consequences arising in relation to the amendments made to section 23AG in 2009 and the impact on Australian individuals, employers, and labour mobility. In particular, the Board considers the following consequences require further consideration:

- the double taxation of fringe benefits as a consequence of the amendments;
- the administrative compliance burden placed on employers (and resultant cash flow consequences for employees); and
- the potential simplification benefits that may arise by addressing these matters.

Recommendation 10

Subject to the Government's current immigration review, the Board recommends that:

- temporary resident tax concessions should be amended such that the concessions are not available where an individual has been in Australia for more than 4 years; and
- should the Government adopt the Board's modernisation recommendations, temporary residents should be subject to non-resident income tax rates.

Recommendation 11

The Board recommends that the Government consider a review in relation to the interaction and possible alignment of the individual tax residency rules and Australia's immigration visa regime. The Board considers that this may benefit from the work undertaken during the Government's current immigration review.

Annexure B

Observation 4

The Board observes that payment and reporting systems for many visa holders remain substandard. This issue has been raised with the Black Economy Taskforce.

Observation 5

Consistent with the Government's regulatory reform agenda, the Board considers that the information supplied to the Department of Immigration and Border Protection to obtain a visa, where the person has the right to work in Australia, should be available to the ATO to facilitate the automatic generation of an application for a tax file number.

Observation 6

The Board notes that consultees raised concerns regarding the lack of harmonisation and potential for manipulation of the tax residency rules and access to other Government services. The Board observes that the Government should commission a review of how individuals that reside overseas continue to access Government services but are not subject to tax as Australian residents.

Observation 7

The Board observes that while some individuals may seek to manipulate CGT event I1, the Board considers that the ATO should increase its compliance efforts to identify 'deemed-TAP' assets that should be taxable in Australia.

The Board suggests any assets which taxpayers have elected to be deferred as a 'deemed disposal' upon ceasing residency should be catalogued and reported to the ATO to use as a reference point for the tracking of any future disposal of such assets. This could be incorporated as part of the annual tax return process.

HISTORY AND BACKGROUND

1.10 In recent years, tax policy considerations of the global tax system have focused on ensuring international tax rules are appropriate and sufficiently robust to deal with the increasing globalisation of companies and their workforces. This is best evidenced by the G20/Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project which equips governments with the instruments to address multinational tax avoidance.³

1.11 As these BEPS initiatives relate to corporate taxpayers, the Board considers it timely to also focus on whether Australia's individual income tax residency rules (the residency rules) remain adequate, having regard to Australia's evolving modern economy and society and in light of integrity concerns raised with the Board.

1.12 In this review, the Board considered whether the residency rules, a fundamental cornerstone for determining how an individual will be taxed in Australia, are appropriate and sufficiently robust. To provide a framework for the review, the Board considered whether the rules meet the policy objectives of simplicity, equity, efficiency and integrity (in particular, the prevention of tax avoidance).

BACKGROUND TO THE BOARD'S REVIEW

1.13 The current definition of a resident was enacted in 1930, over 80 years ago, at a time when most Australians did not have access to international travel. Consequently, when the definition was introduced, the question as to where one resided was easily established in the vast majority of cases.

1.14 As a consequence of the move from an assessment-based tax reporting system to self-assessment in 1986, the responsibility is on each individual to determine how the residency rules apply to their circumstances.

1.15 Prior to that time, the ATO assessed the residency status of an individual taxpayer based on the income tax return and any information the individual furnished. In the absence of an assessing function to correct any mistakes prior to assessment, should an individual be audited post-assessment and found to have incorrectly applied the residency rules, they may be subject to additional liabilities including interest and penalties.

3 OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <<http://www.oecd.org/tax/beps/>>

1.16 A number of the key definitions in the residency rules – ‘resides’, ‘permanent place of abode’, ‘usual place of abode’ and ‘domicile’ (an antiquated legal concept developed as part of British jurisprudence going back to the 19th century) – are not defined in Australian tax law. Their meanings have developed as part of common law since their introduction but, importantly, none of these terms have fixed meanings. Each relies on a different test of factors that, when evaluated holistically, determine whether an individual is a resident.

1.17 Over time, the Commissioner of Taxation (Commissioner) has issued public rulings and other guidance to assist individuals to determine their residency status with further guidance material and checklists contained on its website.⁴ However, these materials do not have the force of law nor can they provide absolute certainty.⁵

1.18 The process of self-assessment can be difficult. The Board has formed the view, based on its review outlined in the following chapters and unanimous feedback received during consultation that the residency rules are uncertain and complex to apply.

1.19 Consultation confirmed that advice is usually sought by taxpayers that are entering or leaving Australia (both temporarily and permanently) from either, or both, advisers and the ATO. However, it is also not unusual for taxpayers to determine their own residency status hoping that they will not be detected by the ATO.

1.20 Industry consultation established that the cost of tax advice on the residency rules has grown significantly in recent years for these individuals. Figures provided during consultation indicated a basic letter of advice could cost between \$5,000 and \$10,000 per individual.⁶ The Board was informed that the number of people affected is substantial. This leads to rules that lack efficiency given the costs can be disproportionate to the complexity of the taxpayer’s underlying tax affairs (for example, a salary and wages taxpayer with simple affairs other than the fact they may travel overseas).

1.21 The Board considers that the magnitude of these compliance costs justify further consideration as to whether the residency rules could be simplified to reduce compliance costs and increase certainty.

4 In particular, Taxation Ruling IT 2650 Income tax: residency – permanent place of abode outside Australia and Taxation Ruling TR 98/17 Income tax: residency status of individuals entering Australia.

5 Noting the Commissioner’s legal obligations with respect to rulings issued: refer Division 357 of Schedule 1 to the *Taxation Administration Act 1953*.

6 While the individual may be entitled to a tax deduction for the cost of managing their tax affairs, this does not wholly offset this significant cost.

1.22 The Board learned from consultation that disputes and ATO private rulings statistics (both having increased since 2009) are the 'tip of the iceberg', with many consultees stating that professional advisers assist thousands of taxpayers with affairs that are extremely difficult to determine under the residency rules. This increases the cost to taxpayers and potential equity and integrity risks to the income tax system given the inherent uncertainty in the residency rules.

1.23 There are significant equity and integrity concerns. The Board understands the position taken by individuals can vary based not only on the underlying facts and circumstances, but also on the individual or their adviser's interpretation of judicial and administrative guidance.

1.24 Numerous examples were cited during consultation of analogous fact patterns producing different tax outcomes as a result of varying risk profiles. This results in taxpayers using these interpretations to avoid or reduce their Australian tax obligations.

1.25 This highlights a concern that equity is not being achieved for individuals and the current operation of the rules provides opportunities for manipulation of residency outcomes.

1.26 Consultation also brought to the Board's attention that employers are commonly faced with increased administrative burdens for employees adopting different residency positions on very similar fact scenarios. One particular example provided to the Board involves the consequences of amendments to narrow section 23AG of the *Income Tax Assessment Act 1936* (ITAA 1936). The changes eliminated the broad exemption from income tax for foreign employment income in most circumstances.

1.27 Consultees submitted that this now provides an incentive for taxpayers to argue non-resident status during their employment overseas (particularly where the tax rates are lower), as overseas secondments commonly span two to three years, where the law is most unclear.

1.28 The Board understands from consultation that there is evidence of employees approaching their employers to extend the period of the employment/assignment in a contract, even though both parties may actually intend the actual length to be shorter.

1.29 For example, this may occur where an employee of an Australian employer is seconded to an overseas office for two years. In such a case, the residency of the employee impacts whether or not an Australian employer is required to account for pay-as-you-go withholding (PAYG) from the salary and wages paid to the employee. If an employee remains a resident and is subject to tax on their foreign salary and wages, the Australian employer is required to apply PAYG withholding. In contrast, where an employee is a non-resident, the income is exempt from Australian income tax and no PAYG withholding is applied. This would represent a clear ‘gaming’ of the rules, with the potential for such manipulation representing a significant integrity concern.

1.30 Accordingly, the distinction between whether an individual is an Australian resident or not assumes increased importance.

1.31 Based on the foregoing and the Board’s consultation, given the number of individuals affected and the difficulties that arise in the self-assessment system, the uncertainty and complexity of the existing law that increase costs and reduce efficiency, and the potential for anomalous or manipulated outcomes that lead to inequity and reduced integrity, the Board concluded that the current definition of resident is deficient in practice. That is, the rules do not meet the objectives of simplicity, efficiency, equity and integrity as they are currently applied in modern Australia, and require reform as a matter of priority.

AN OVERVIEW OF AUSTRALIAN INDIVIDUAL TAX RESIDENCY RULES

1.32 During the course of this review, the Board has undertaken independent research and engaged with consultees to better understand the current individual residency rules that apply for income tax purposes.

1.33 In the following paragraphs, the Board provides an overview of the residency rules, including some commentary from the Board and consultees which were provided throughout the consultation process regarding the equity, integrity, simplicity and certainty of the current residency rules. Further analysis of the Board’s observations and consultations is contained in the next chapter.

Residence based taxation

1.34 In 1930, Australia replaced its original territorial based personal income tax system with a residence-based system.⁷ That is, since 1 July 1930 an individual that is a resident of Australia has been subject to Australian income tax on their worldwide income, whereas an individual that is not a resident (a non-resident) is generally only subject to Australian income tax on income earned from an Australian source.

7 Explanatory Notes to the *Income Tax Assessment Bill 1930*.

1.35 More specifically, relevant consequences include the following:

- individual residents are subject to tax only on income above the tax-free threshold;
- the Medicare levy only applies to residents;
- non-resident withholding taxes (sometimes at lower rates than relevant individual income tax rates) can apply to certain categories of income;
- capital gains tax (CGT) events occur once an individual ceases to be a resident and becomes a non-resident, giving rise to a deemed disposal of essentially all non-real property assets and interests, that may crystallise significant capital gains or losses and related tax liabilities;⁸ and
- a range of CGT concessions (including the CGT discount and main residence exemption) are available to residents only.⁹

1.36 These consequences illustrate that a significant variation in the tax liability of an individual will arise depending solely on whether they are treated as a resident or non-resident. Determining whether an individual is a resident is, therefore, fundamental to the operation of the Australian personal income tax system.

Definition of residency

1.37 An individual's residency for tax purposes is determined according to a definition that has been operating since 1 July 1930.¹⁰ From that date, residents have been subject to tax on their worldwide income and while the definition has undergone minor changes since that time (such as the insertion of paragraph (iii)), the current definition in subsection 6(1) of the ITAA 1936 has remained largely unchanged since enactment.

1.38 Subsection 6(1) defines individual residency as follows:

resident or resident of Australia means:

(a) a person, other than a company, who resides in Australia and includes a person:

⁸ Section 104-160 and Division 855 of the *Income Tax Assessment Act 1997*.

⁹ Divisions 115 and 118 of the *Income Tax Assessment Act 1997*. The Board notes that the Government announced in the 2017-18 Budget to stop foreign and temporary tax residents from claiming the main residence capital gains tax exemption when they sell property in Australia from Budget night. Foreign and temporary tax residents who hold property on Budget night can continue to claim the exemption until 30 June 2019. See: <http://www.budget.gov.au/2017-18/content/glossies/factsheets/html/HA_16.htm>

¹⁰ Section 4 of the *Income Tax Assessment Act 1922 – 1930*.

(i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia;

(ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia; or

(iii) who is:

(A) a member of the superannuation scheme established by deed under the *Superannuation Act 1990*; or

(B) an eligible employee for the purposes of the *Superannuation Act 1976*; or

(C) the spouse, or a child under 16, of a person covered by sub-subparagraph (A) or (B);¹¹

[Emphasis added – the terms underlined above are not defined in Australia's tax legislation and, therefore, their meanings have been developed under common law]

1.39 It is generally accepted that there are four tests for determining whether an individual is a resident under the definition. The ATO refers to these tests as:

- residence according to ordinary concepts (or the resides test);
- the domicile and permanent place of abode test;
- the 183 day test; and
- the Commonwealth superannuation fund test.

1.40 An individual is only required to pass one of these tests to be considered a resident of Australia.

1.41 **Annexure A** provides a diagrammatic representation of how these tests are applied. Each test is discussed in more detail below.

11 Subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) contains the definition of 'Australian resident', being a person who is a resident of Australia for the purposes of the ITAA 1936.

Interpretation: facts and circumstances

1.42 Each of the residency tests require some level of analysis of an individual's facts and circumstances against common law principles that have been established through case law, with some of these cases being decided more than 80 years ago.¹² Further, many of the principles that continue to be relied upon today were formed in British jurisprudence dating back to the 19th century. Consequently, consultees informed the Board, during consultation, that the level of analysis required is often significant and costly. This burden is particularly acute given the self-assessment nature of the income tax system in Australia, and the potential for penalty and interest liabilities to arise should an individual incorrectly apply the residency rules.

1.43 To assist the public to determine their residency status, over time, the ATO has issued public rulings which provide guidance on the various factors that require consideration. Two significant taxation rulings currently in operation are:

- Taxation Ruling IT 2650 *Income tax: residency – permanent place of abode outside Australia* (IT 2650);¹³ and
- Taxation Ruling TR 98/17 *Income tax: residency status of individuals entering Australia* (TR 98/17).¹⁴

1.44 These rulings are 26 and 19 years old respectively, and do not carry the force of law and therefore are provided as guidance. Consultees noted that limited further guidance has been issued by the Commissioner since that time to reflect changes in jurisprudence and the significant evolution of travel, working arrangements and the impact of globalisation.

1.45 Notwithstanding the age of these rulings, it is generally accepted that the residency rules, and ATO guidance, can be categorised as either relating to:

- individuals establishing residency – inbound individuals (addressed in TR 98/17); and
- individuals ceasing residency – outbound individuals (addressed in IT 2650).

1.46 This characterisation is useful when identifying the practical application of the residency rules and is further discussed below.

12 For example see cases such as *FC of T V Miller* (1946) 73 CLR 93; *Gregory v Deputy Commissioner of Tax* (WA) (1937) 57 CLR 774 and recent AAT decisions such as *The Engineering Manager and Commissioner of Taxation* [2014] AATA 969 and *Re Dempsey and Commissioner of Taxation* [2014] AATA 335.

13 IT 2650 published on 8 August 1991.

14 TR 98/17 published on 25 November 1998.

Establishing residency (inbound)

1.47 For an individual determining whether they have established residency (including those known as inbound individuals), the relevant tests are:

- the resides test; and
- the 183 day test.

The resides test

1.48 This is the primary test for establishing residency and is derived from the phrase 'a person, other than a company, who resides in Australia'.¹⁵ If an individual is a resident according to the ordinary meaning of the word 'resides', they are a resident and no further analysis is required.¹⁶ This captures the majority of individuals that live and work in Australia including those that might, on occasion, temporarily travel overseas for work-related trips or holidays.

1.49 The Explanatory Notes to the *Income Tax Assessment Bill 1930* (in which it was enacted), stated that:

'The primary test is actual residence in Australia. If a person is in fact residing in Australia, then irrespective of their nationality, citizenship or domicile he is to be treated as a resident for the purposes of the Act.

The result will be that the extension of the scope of the Act to income from sources outside Australia will apply not only where such income is derived by an Australian who ordinarily lives in Australia, but also where it is derived by a person of foreign origin who, though he may recognise Australia as his usual place of residence, has not abandoned his foreign nationality, citizenship or domicile.'¹⁷

1.50 While the Board considers that this test applies to most individual residents, there is no singular ordinary meaning of the word 'resides'. In TR 98/17, the Commissioner cites the Macquarie Dictionary to define resides as 'to dwell permanently or for a considerable time; to have one's abode for a time' and in the Shorter Oxford English Dictionary as 'to dwell permanently, or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'.¹⁸

15 Section 6 of the ITAA 1936.

16 TR 98/17, paragraphs 12 and 33.

17 Explanatory Notes to the *Income Tax Assessment Bill 1930*, page 9.

18 TR 98/17, paragraph 14.

1.51 The leading case on the meaning of resides is *Federal Commissioner of Taxation v Miller* (1946) 73 CLR 146.¹⁹ This case, and those that followed it, considered that the term should be given the same meaning that similar expressions had received in England.²⁰

1.52 These ordinary meanings generally encompass permanent and temporary migration unless an individual does not intend to reside in Australia permanently, at which point the facts and circumstances of the individual must be considered.²¹

1.53 In TR 98/17, the Commissioner outlines a variety of factors that are useful in determining residency. Factors include the length of time in Australia and the individual's behaviour in Australia, including:

- the intention or purpose of their presence in Australia;
- the family and business/employment ties;
- the maintenance and location of assets; and
- the social and living arrangements.²²

1.54 No single factor (including time) is determinative and many of the factors are interrelated. The factors must be weighed in a holistic review of the individual's circumstances and the weighting may vary depending on the individual's circumstances.²³ In particular, the Board notes that the use of an individual's intention can be difficult to corroborate.

1.55 For inbound individuals, determining residency based on this definition is difficult and uncertain as it relies on individuals and advisers to review and weigh the relevant factors, which can be a significant undertaking. Further, it requires consideration of:

- common law developments on the meaning of 'resides' (any case law including determining the *ratio decidendi* and *obiter dicta*);
- new Administrative Appeals Tribunal (AAT) decisions;

19 This case and many that followed in Australia drew principles directly from British income tax law decisions including, significantly, *Reid v The Commissioner of Inland Revenue* (1926) 10 TC 673, *Levene v Inland Revenue Commissioners* (1928) 13 TC 486 and *Inland Revenue Commissioners v Lysaght* (1928) 13 TC 51.

20 See also Dixon J in *Gregory v Deputy Commissioner of Taxation* (1937) 57 CLR 774 and further information in TR 98/17.

21 TR 98/17, paragraphs 15 to 18.

22 TR 98/17, paragraph 20.

23 TR 98/17 paragraphs 21 and 39 to 63.

- new private rulings that may indicate the ATO's view on similar fact patterns (noting the significant increase since 2009);
- TR 98/17 in light of these developments and any other ATO guidance;
- the weighting of the relevant factors; and
- an analysis and conclusion on the 'resides' test.

1.56 Under the self-assessment system, this carries the increased risk of penalties and interest liabilities arising should the conclusion be incorrect. Consultees overwhelmingly noted that the lack of contemporary definitive guidance from the courts, AAT or ATO and consequential lack of certainty exacerbate this problem.

1.57 The Explanatory Notes to the *Income Tax Assessment Bill 1930* also acknowledged the difficulty inherent in determining whether an individual resides in Australia. It stated that a subsequent test, the 183 day test, was necessary:

'to obviate the great difficulties which occasionally arise in establishing to the satisfaction of a Court that a person is resident in any particular country.'²⁴

1.58 It is clear from this statement that in 1930 it was well understood by the legislature that determining whether an individual satisfies the ordinary meaning of resides could be a significantly difficult matter to resolve (even where the Commissioner assessed all income tax returns and could bring his resources to bear on the matter). The Board considers that, given advancements in global travel and working arrangements, it is no longer the occasional case that gives rise to significant difficulties of interpretation; indeed, it is the Board's view that it is frequently complex to resolve.

The 183 day test

1.59 The 183 day test is intended to simplify the operation of the residency rules for inbound individuals, as noted above in the Explanatory Notes to the enacting law. There is a prima facie assumption that an individual, in Australia for 183 days, is deemed to be a resident unless the Commissioner is satisfied that the individual's 'usual place of abode is outside Australia' and, if so, the person 'does not intend to take up residence in Australia'.

24 Explanatory Note to the *Income Tax Assessment Bill 1930*, page 10.

1.60 This test does not apply to individuals that ordinarily reside in Australia. In TR 98/17, the Commissioner considers that in most cases, an individual that does not ordinarily reside in Australia will have a usual place of abode outside of Australia.²⁵ On this interpretation, this test would not appear to apply in many circumstances and, therefore, does not operate to simplify the residency rules for individuals.

1.61 The Commissioner's statement requires that, regardless of the 183 day requirement, the factors in relation to whether an individual has a usual place of abode outside Australia and intends to take up residence in Australia will be determinative of whether an individual satisfies either test. This would lead to the conclusion that the 183 day test does not expand residency beyond those that ordinarily reside in Australia.

1.62 The usual place of abode of an individual is determined on their facts and circumstances. Notwithstanding the Commissioner's view outlined above, the usual place of abode has not been the subject of many cases nor substantive ATO guidance. While similar to the resides test, a 'usual' abode is also generally comparative (that is, where an individual is more usually located).²⁶

Board observation

1.63 As outlined above, there is a lack of certainty provided by inbound individual residency tests. These tests are complex to apply, require an understanding of common law and often require an individual to seek third-party tax advice. Further, given this uncertainty, the Board understands that this may lead reasonable minds to reach different conclusions (even when based on analogous facts and circumstances), undermining the equity and integrity of the current residency rules.

1.64 The Board considers that the residency rules relating to inbound individuals raise significant concerns, in particular those that require analysis of undefined terms that have been clarified (to varying degrees) under common law, that consequently require further consideration.

25 TR 98/17, paragraph 37.

26 See *Federal Commissioner of Taxation v Applegate* (1979) 38 FLR 1 and *Federal Commissioner of Taxation v Executors of the estate of Subrahmanyam* [2001] FCA 1836.

Ceasing residency (outbound)

1.65 For an individual determining whether they have ceased residency (also known as outbound individuals), the relevant tests are the:

- resides test;
- domicile test; and
- Superannuation test.

1.66 As the primary test for residency, the resides test is also relevant for an outbound individual. While it is more likely that an outbound individual would not be physically present in Australia and not residing in Australia, this would depend on the facts and circumstances weighed in accordance with the resides test as outlined earlier in this chapter.

1.67 The domicile and Superannuation tests only apply where the resides test is not satisfied. That is, they are extensions of the class of individuals that are subject to tax as residents.

The domicile test

1.68 The domicile test is intended to treat as residents of Australia those individuals that do not reside in Australia (and may not have any intention to reside in Australia) but are nonetheless domiciled in Australia, unless the individual's permanent place of abode is outside Australia. Domicile was adopted because the concept evolved to differ from residency through its development in private international law to determine whether a country may have jurisdiction over an individual.²⁷ It generally applies for resident individuals that move to work or live overseas for a period of time.

1.69 When enacted, the Explanatory Note to the *Income Tax Assessment Bill 1930* stated that the domicile test was implemented to ensure Australian public officials that were posted overseas at that time (such as the High Commissioner for Australia in London) were subject to income tax on their worldwide income, analogously to their Australian resident counterparts.²⁸ Consultees questioned whether the rationale for this test, were it based solely on this example, is relevant in 2017 as the test applies to determine the residency of all outbound individuals (a category that has grown significantly since 1930).

1.70 The two relevant matters in this test, domicile and permanent place of abode, both require some level of analysis, having regard to the individual's facts and circumstances, as such tests have developed at common law over time.

27 Explanatory Note to the *Income Tax Assessment Bill 1930*, page 10.

28 Explanatory Note to the *Income Tax Assessment Bill 1930*, page 10.

Domicile

1.71 For the domicile test to apply, a person must first be domiciled in Australia. Domicile is generally considered to have two main categories:

- domicile of origin – broadly, the country of one of an individual’s parents as at the individual’s birth (which is retained until another domicile is established);²⁹ and
- domicile of choice – the country an individual moves to and intends to make his or her home indefinitely.³⁰

1.72 The Commissioner has outlined his view as to how a domicile of choice is acquired in IT 2650. The Commissioner considers that the requisite intention is to make a home indefinitely in another country, which requires more than a working visa.³¹ Domicile, determined according to the *Domicile Act 1982* (Cth) and Australian and British common law, is a longstanding concept.³²

1.73 Importantly, an individual must have only one domicile; that is, an individual must be domiciled somewhere, and cannot be domiciled in two places (contrasting where an individual can be tax resident in two or more jurisdictions or, in certain jurisdictions, be a citizen or subject of more than one country).

1.74 It is generally accepted that domicile of origin is not easily abandoned and that it will subsist, for example, where an individual working overseas intends to return to their country of origin at the end of the period of employment.³³ This is a common scenario for many employees in which it is difficult to effect a change in domicile. Therefore, this requires many outbound individuals that do not reside in Australia (but are domiciled in Australia) to determine their residency status based on the permanent place of abode test.

29 Sections 8 and 9 of the *Domicile Act 1982*.

30 Section 10 of the *Domicile Act 1982*. There is also a category referred to as ‘domicile by operation of law’, which is where domicile is otherwise imposed by law.

31 IT 2650, paragraph 21.

32 For example, see *Henderson v Henderson* (1965) 1 All ER 179 and *Sully v Federal Commissioner of Taxation* (2012) 89 ATR 991. It is worth noting that British legislation uses three concepts to determine the income which is charged to tax: domicile, ordinarily resident and resident. Thus, the income charged to tax for a person domiciled, resident and ordinarily resident in the UK is different to someone who is non-UK domiciled, resident and ordinarily resident. In comparison, the term domicile is only used in the Australian tax legislation to determine an individual’s residency status.

33 IT 2650, paragraph 10

Permanent place of abode

1.75 The phrase 'permanent place of abode' was first considered in the landmark case of *Federal Commissioner of Taxation v Applegate* (1979) 38 FLR 1, and is still considered to be the leading authority on this matter.

1.76 Permanent place of abode incorporates two concepts, being: 'permanent' and 'place of abode'. A place of abode is considered to take its meaning from British income tax law, broadly meaning a dwelling or physical surrounding in which a person lives.³⁴

1.77 The adjective 'permanent' means, in this context, that the place of abode must be a place that an individual has an enduring relationship with, when contrasted with a temporary or transitory place of abode. In *Applegate*, Fisher J stated:

'the taxpayer's fixed and habitual place of abode. It is his home, but not his permanent home. It connotes a more enduring relationship with the particular place of abode than that of a person who is ordinarily resident there or who has there his usual place of abode. Material factors for consideration will be the continuity or otherwise of the taxpayer's presence, the duration of his presence and the durability of his association with the particular place.'³⁵

1.78 This demonstrates that a permanent place of abode requires a more significant connection to a location than the resides test. This test therefore establishes a high threshold for outbound individuals to satisfy on the basis of their facts and circumstances.

1.79 The Commissioner's views on permanent place of abode are set out in IT 2650. Similar to the resides test, the usual place of abode test, and domicile (all outlined above), permanent place of abode is also determined by common law and therefore to the weighting of relevant factors. As the focus on the permanent place of abode test is whether an outbound individual has established a presence outside Australia, the Commissioner stated that different factors are likely to be relevant but that there are no 'hard and fast rules' as 'the weight to be given to each factor will vary with individual circumstances of each case and no single factor is conclusive'.³⁶

1.80 In this regard, IT 2650 lists the following factors:

- a) the intended and actual length of the taxpayer's stay in the overseas country;
- b) whether the taxpayer intended to stay in the overseas country only temporarily and then to move on to another country or to return to Australia at some definite point in time;

34 IT 2650, paragraph 12 and *Levene v Inland Revenue Commissioners* (1928) 13 TC 486 and *Inland Revenue Commissioners v Lysaght* (1928) 13 TC 51.

35 *Federal Commissioner of Taxation v Applegate* (1979) 38 FLR 1; 79 ATC 4307 at 4317.

36 IT 2650, paragraph 5.

- c) whether the taxpayer has established a home (in the sense of dwelling place; a house or other shelter that is the fixed residence of a person, a family, or a household), outside Australia;
- d) whether any residence or place of abode exists in Australia or has been abandoned because of the overseas absence;
- e) the duration and continuity of the taxpayer's presence in the overseas country; and
- f) the durability of association that the person has with a particular place in Australia, ie, maintaining bank accounts in Australia, informing government departments such as the Department of Social Security that he or she is leaving permanently and that family allowance payments should be stopped, place of education of the taxpayer's children, family ties and so on.³⁷

1.81 In order to explain these factors and their application, the Ruling provides 13 separate examples and references 13 Australian cases and five UK cases (dating back to the nineteenth century).

1.82 These factors reflect the intention that permanent place of abode is only applied for outbound individuals to determine whether they have ceased to hold Australian residency. Under this test, outbound individuals are required to undertake a significant review of common law, the Commissioner's guidance, and their own facts and circumstances to determine their residency status as noted earlier.

1.83 Consultees noted that analysis of domicile and permanent place of abode under the domicile test is a significant undertaking.

1.84 The Board considers that the uncertainty such a term brings to this test is manifest in the test's wording (for example, 'domicile' and 'permanent place of abode') and subsequent judicial analysis, and this is most telling in *Applegate*, the first case to interpret the provision, whereby Fisher J stated that the provision was difficult to apply.³⁸ Consultees advised the Board that this difficulty continues to persist today.

1.85 Consultees also noted that differences of opinion on similar or analogous facts can also be reached in relation to the domicile test, increasing the uncertainty of this test. Further, this also gives rise to similar potential for manipulation.

37 IT 2650, paragraph 23.

38 Fisher, Northrop and Franki JJ decided the appeal to the Full Federal Court in *Federal Commissioner of Taxation v Applegate* (1979) 38 FLR 1, affirming the decision of Sheppard J in the NSW Supreme Court in *Applegate v Federal Commissioner of Taxation* (1978) 1 NSWLR 126.

The Superannuation test

1.86 Broadly, the Superannuation test applies to outbound individuals that are not residents under the other tests. Generally, this test treats an individual as a resident if they are a member of certain Government superannuation funds, established under the *Superannuation Act 1990* or the *Superannuation Act 1976*. It also treats the spouse, or child under 16, of such a member as a resident. The Board understands that this test has applied since 1939 to ensure that Commonwealth officers are treated as residents regardless of any physical absence from Australia (presumably in the service of the Australian Government).³⁹

1.87 Some consultees commented that the relevant superannuation funds under this test are no longer open to new members. As such, the effectiveness of this test in meeting its original stated objective should be subject to further consideration.

Board observation

1.88 The outbound individual residency tests are complex and difficult to apply due to the use of concepts such as domicile and permanent place of abode. This leads to significant uncertainty for individuals in determining their residency status. The domicile test requires an examination of an individual's permanent place of abode, while the Superannuation test exhibits notable concerns regarding satisfying its original policy intent. Accordingly, the Board considers that these rules require further consideration in this report.

Other tax provisions impact on residency

1.89 The taxation of individuals is also affected by specific provisions in the ITAA 1997 and ITAA 1936 regarding the movement of individuals into and out of Australia in certain circumstances. These provisions affect the tax consequences for certain individuals by modifying, to some extent, the impact of the worldwide income basis of taxation for residents. The Board considers that it is appropriate to be aware of these measures when evaluating the residency rules and has briefly outlined them below. Some of these issues are explored further in subsequent chapters.

Inbound individuals: temporary resident concessions

1.90 A number of temporary resident rules have been enacted in the last decade to target specific immigration and skilled labour policy matters. These measures are commonly linked to specific visa classes (for example, the former 457 visas for skilled labour, 416 visas for seasonal labour, 417 and 462 for working holiday makers) and provide concessional tax treatment for the relevant visa holders. These measures are:

39 Explanatory Memorandum to the *Income Tax Assessment Amendment Bill 1976*.

- Temporary Resident Rules: introduced in 2006, these rules facilitate Australia's growth as a regional centre by significantly reducing administrative and compliance costs to Australian businesses of employing highly mobile skilled expatriates. The rules provide concessional tax treatment to certain inbound individuals.⁴⁰ While the individual will still need to determine their residency status under the residency rules, this concession provides that most income from foreign sources other than certain employment income will not be subject to income tax in Australia.
- Seasonal Labour Mobility Program: introduced in 2008 and expanded in 2012, these concessions have been enacted to attract seasonal labour from certain countries in the Asia-Pacific region.⁴¹
- Working Holiday Makers: introduced in 2016, these concessions provide a lower rate of tax on income earned by working holiday makers, as well as providing certainty for other tax consequences (such as superannuation). These concessions are aimed at attracting tourists to Australia that will operate as mobile unskilled labour.⁴²

1.91 These concessions reflect specific Government policy responses to changes in the global workforce since 1930 due to developments such as globalisation and the ability to access international travel.

1.92 In contrast to the above inbound measures, there are only limited tax concessions aimed at assisting or enhancing the ability of Australian residents to temporarily work overseas. In particular, given Australia's residence based income tax system, the lack of exemptions (or concessions) on foreign source income that is generally taxed overseas, necessarily means that relief from double taxation is undertaken by the Foreign Income Tax Offset (FITO).⁴³ However, while the FITO may reduce, to the extent necessary, double taxation, it does not address any duplication of compliance (including PAYG withholding) that affects employees and employers.

Outbound individuals: limited foreign services exemption

1.93 A significant tax measure that addresses individuals working overseas is section 23AG of the ITAA 1936. As originally enacted, this section facilitated Australian-based labour temporarily relocating overseas (for continuously more than 91 days while maintaining their residency status) by exempting from tax certain types of foreign income earned in the course of providing services (such as labour as an employee). This reduced the employee and employer compliance burden while providing an

40 Subdivision 768-R of the ITAA 1997.

41 Subdivision 840-S of the ITAA 1997.

42 *Treasury Laws Amendment (Working Holiday Maker Reform) Act 2016* and *Income Tax Rates Amendment (Working Holiday Maker Reform) Act 2016*.

43 Division 770 of the ITAA 1997.

incentive for individuals to remain Australian residents (while foregoing the additional income tax revenue of any difference between the foreign jurisdiction's income tax rate and that applicable in Australia).

1.94 In 2009 this exemption was narrowed. Since amendment, most of the previously exempt income is now subject to tax with a related FITO as relevant.

1.95 As a non-resident is not subject to Australian income tax on such foreign income, this creates a significant difference based solely on the outbound individual's residency status (both in terms of income tax and compliance burden for employees and employers). The absence of an exemption requires outbound individuals to rely on the relative uncertainty of the above four residency rules to determine whether their foreign income is subject to tax. As Australian employers are generally required to comply with PAYG withholding obligations only for Australian resident employees working overseas (among other obligations), an individual will be required to inform their employer of their residency status upon commencing overseas employment.

Double tax agreements: overriding Australia's residency taxation

1.96 As noted earlier, an individual can be a tax resident of multiple countries at the same time.⁴⁴

1.97 Broadly, Australia's double taxation agreements (DTA) allocate taxing rights over individuals by virtue of the operation of the relevant Resident Article (usually Article 4). For example, in the Australian – Germany DTA, signed in 2015, Article 4 states that a 'resident of a Contracting State' in the case of Australia is any person who 'is liable to tax as a resident of Australia'.⁴⁵

1.98 It is noted that should an individual be a resident under the ITAA 1936 and ITAA 1997 they will be subject to income tax accordingly (for example, including access to the tax free threshold). Generally, the practical effect of a DTA tiebreaker test, where it is determined that the individual is also resident of the overseas jurisdiction under the treaty, is to identify which country has primary taxing rights in respect of specific types of income.

44 TR 98/17, paragraph 29.

45 Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance signed on 12 November 2015. The DTA also includes a tiebreaker that incorporate concepts such as where a person's 'permanent home', 'personal and economic relations' and 'habitual abode' are. It is not necessary for the purposes of this paper to elaborate on these tests, but it is worth noting that these tests do differ from Australia's domestic residency rules.

Board assessment

1.99 The Board considers that the above analysis can be summarised as follows in Table 1.1.

Table 1.1

Individual	Residency analysis framework
Ongoing residents	Resides test
Inbound individuals	<ol style="list-style-type: none"> 1. Resides test 2. 183 day test 3. Potential DTA residency analysis 4. Temporary resident concessions
Outbound individuals	<ol style="list-style-type: none"> 1. Resides test 2. Domicile test 3. Superannuation test 4. Limited foreign employment exemption 5. Potential DTA residency analysis

1.100 The foregoing analysis demonstrates the complex matrix that must be navigated to determine an individual's residency. While the Board considers that the majority of individuals that are resident will satisfy the resides test, inbound and outbound individuals must evaluate a number of complex thresholds that are subject to significant administrative and judicial uncertainty.

1.101 The reliance on holistic facts and circumstances tests that must be applied, on a case-by-case basis, against a variety of uncertain legal concepts in many cases, indicates that the residency rules have evolved in a way which lacks simplicity, does not provide certainty, and can result in inequitable and anomalous outcomes as between taxpayers. Further, there are also integrity concerns that arise.

1.102 The Board has collated feedback from consultees in the following section, together with the Board's own assessment of the issues raised.

ISSUES IDENTIFIED WITH THE RESIDENCY RULES

1.103 The Board conducted extensive consultation on the effectiveness of the individual residency rules and potential concerns relating to equity, simplicity, certainty, and integrity.

1.104 The Board received overwhelming and consistent feedback from consultees that changes to Australia's individual tax residency rules are well overdue.

1.105 The following is a summary of key consultee feedback and Board observations on the imperatives for residency reform raised throughout the consultation process.

ABSENCE OF A CLEAR ARTICULATION OF MODERN RESIDENCY POLICY

1.106 The current residency rules do not contain a clear articulation of individual tax residency policy. Consultees commented that, as there are limited public records of any consultation concurrent with, or since, the definition of resident was introduced in 1930, it is difficult to identify intended policy outcomes. Consultees supported a contemporary discussion of the policy settings as to who should be an Australian resident for tax purposes.

1.107 Consultees also noted that, in the over 80 years since the residency rules were introduced, there has been considerable advancement in the way in which individuals work, travel and live. There has also been much change in the global income tax system. It was suggested that some aspects of the residency rules, such as adopting the concept of domicile, are now outdated and require reconsideration.

1.108 Consultees identified a notable absence in the current residency rules of a clear articulation of the Government's individual tax residency policy. That is, taxpayers and advisers do not have a clear statement of who should be a resident in order to consider whether the consequences in any given situation are intended or unintended (that is, to judge the integrity of the rules).

1.109 As there is no overarching policy statement (akin to an objects clause as used in the ITAA 1997) for what individual residency represents, this absence leads to uncertainty as to the scope and intent of Government policy. During this review, it was noted that the question 'what methodology represents the best means for achieving the existing policy aims of the Government?' is difficult to answer, as residency policy must be divined from the numerous tests of the current rules. This leads to uncertainty in application.

DIFFICULTY APPLYING THE CURRENT RESIDENCY RULES AND INTEGRITY CONCERNS

1.110 Consultees informed the Board unanimously that the residency rules are difficult and costly to apply. Many advisers noted that, given the numerous tests and complex nature of their common law meanings, providing definitive advice on residency is difficult, and requires significant resources at a substantial cost to the individual.⁴⁶

1.111 As noted earlier in this report, figures provided during consultation indicated a basic letter of advice could cost between \$5,000 and \$10,000 per individual, and that the number of individuals seeking advice is substantial, and potentially increasing.

1.112 This is also supported by a significant trend of increased engagement with the ATO in recent years. Since 2009, a significant increase in private rulings on residency has been identified. Very few rulings were historically issued before 2009 – since then the ATO has issued hundreds of rulings. Further, there have been more than 30 cases heard collectively by courts and tribunals, and Australian employers continue to apply for class rulings from the ATO to obtain certainty regarding their employer obligations under relevant income tax and fringe benefits tax legislation.

1.113 The Board confirmed during consultation that these statistics, while compelling, under-represent the magnitude of the issue and may be likened to being the ‘tip of the iceberg’, with many consultees stating that professional advisers assist thousands of taxpayers with affairs that are extremely difficult to determine under the residency rules. Further, consultees stated that many taxpayers do not necessarily seek tax advice from advisers, or the ATO, and instead seek to rely on Australia’s self-assessment regime – that is, they hope not to be detected by the ATO.

1.114 Consultees also noted there is an absence of recent guidance to provide clarity. However, it was not clear to consultees how the Commissioner could provide greater certainty given the inherent difficulties of the residency rules.

1.115 Consultees also noted that individuals might seek to manipulate their residency status through a number of known integrity issues that arise when applying the test, which can be exploited by individuals with a high-risk appetite.

1.116 Consultees generally agreed that the best solution to resolve the issues of certainty, simplicity, integrity and equity is through wholesale legislative change.

46 While it was noted that the cost of receiving tax advice is tax deductible to the individual as the cost of managing their tax affairs, this reduces but does not eliminate the compliance burden.

Board assessment of key feedback

1.117 The Board received this feedback during the course of its review and has considered the concerns raised by consultees during Working Group and Board deliberations. These concerns highlight the inadequacy of a fundamental income tax policy setting. The different residency tests have, over time, evolved into a complex area of income tax law. It is the Board's view that it is not appropriate that these tests, applicable to every individual, should be this complex and therefore require simplification.

1.118 The Board agrees with consultee feedback on these matters and appreciates that the ATO's data may under-represent the magnitude of the issue as it appears in practice.

1.119 As outlined in the previous chapter, the Board considers that the complexity, lack of certainty, inconsistent outcomes and integrity issues inherent in the residency rules is significant and warrants reconsideration.

1.120 Further, the Board considers that the significant costs of compliance have increased to levels that do not, in the Board's view, appear appropriate. Given the fundamental importance of the residency rules, the complexity and difficulty in their application exacerbates this cost that is borne by a large number taxpayers – such a compliance cost drastically increases the priority of simplification in this area. The Board considers this information to be of significance.

1.121 Ultimately, the Board considers that this feedback reflects an overwhelming consensus from consultees during this review that the current individual residency rules do not operate effectively in the modern world. The rules have become increasingly costly for individuals to comply with, leading to increasing engagement with the ATO and disputes being resolved in Australian courts and tribunals.

1.122 Having regard to the legal analysis in the preceding chapters and feedback received during consultation, the Board has concluded that the residency rules do not outline any overarching policy guidance, while the individual tests no longer adequately provide certainty, equity, simplicity or integrity.

1.123 Accordingly, the Board considers that the residency rules should be modernised to address these concerns. In the following chapter, the Board analyses the policy options that could be adopted and provides its recommendations for the Government's consideration.

OTHER FEEDBACK

1.124 The Board also received feedback from consultees on various other specific issues that arise when applying the current residency rules, and considers that these issues warrant further consideration. The Board has also had regard to such issues in its policy recommendations in the next chapter.

Absence of an objective ‘bright line’ residency test

1.125 As previously noted, Australia’s residency rules currently commence with the resides test, requiring the interpretation of common law principles and available ATO guidance material being applied to a range of personal circumstances. Consultees stated that, for most inbound and outbound individuals, this is an unnecessary complication which commonly requires the need for specialist tax advice in order to determine residency status. The multitude of tests, each uncertain due to the lack of clear guidance (judicial and administrative), imposes a significant compliance burden on taxpayers and their employers.

1.126 Consultees noted overseas comparisons. For example, recent international developments have seen the United Kingdom and New Zealand adopt tests that include ‘bright line’ components into their residency rules, using a ‘days count’ test. For example:

- in New Zealand an inbound individual is automatically a resident if they are physically present in New Zealand for more than 183 days in a 12 month period;⁴⁷ and
- in the United Kingdom, an inbound individual present in the UK for 183 days or more in a tax year is automatically a resident.⁴⁸

1.127 Consultees stated that the majority of residency cases could therefore be settled with a simple, objective test with only additional, more complicated fact-based tests being applied should the individual fail the bright line test. This should significantly reduce the compliance burden for individuals (and, in many cases, their employers under ancillary obligations such as PAYG).

47 YD1 of the *Income Tax Act 2007* (NZ). An outbound individual does not cease to be a resident until absent from New Zealand for more than 325 days in a subsequent 12 month period; however, in New Zealand the permanent place of abode test may override the 325 day test and as such there is no primary bright line for outbound individuals. This rule is subject to limited exceptions.

48 Schedule 45 to the *Finance Act 2013* (UK). For outbound individuals, there are a number of day based tests to determine when residency ceases that depend on the length of time the individual has been a UK resident.

1.128 Many consultees considered that the introduction of a bright line test to Australia's residency rules would address a major concern, and settle the vast majority of residency cases. Consultees suggested that, if calibrated correctly, a bright line test would improve simplicity as an objective, factual test that provides greater certainty for most taxpayers. It was also suggested that different bright line tests may be appropriate for inbound individuals vis-à-vis outbound individuals.

Board observation

1.129 The Board considers that this proposal would improve the current residency tests for both inbound and outbound individuals by increasing certainty and simplicity for taxpayers when determining their tax affairs.

1.130 While the Board observes that there is a risk of arbitrary and potentially inequitable outcomes should such a bright line test be set incorrectly, the Board considers that a 'days count' test is preferable to the current matrix of residency tests applicable to all individuals.

Alignment with labour and capital mobility policy: the distinction between inbound and outbound individuals

1.131 Consultees considered that more clarity and certainty in the operation of the residency rules would enhance the attractiveness of Australia as an employment jurisdiction. It was suggested that explicitly separated tests for inbound and outbound individuals would increase certainty and clarity for individuals, while targeting the appropriate policy settings for the different considerations that arise.

1.132 Consultees also positively noted the Government's policies to encourage inbound investment and innovation through alignment of tax concessions with certain visa classes in measures such as the Temporary Resident rules, the Seasonal Labour Mobility Program and the Working Holiday Maker changes.

Board observation

1.133 The Board considers that the current residency rules practically demonstrate that residency attracts different considerations in relation to inbound and outbound contexts. This is also demonstrated in ATO guidance material (for example, IT 2650 and TR 98/17 applying to outbound and inbound respectively).

1.134 Any updated residency rules should encapsulate the distinction between inbound individuals and outbound individuals, as this would provide for greater simplicity and certainty to individuals.

1.135 The Board observes that the current alignment of tax concessions and visa classes significantly increase certainty and simplicity for qualifying individuals. While the Board notes that the Government's policy considerations may differ between

immigration and tax for certain visa classes, the Board considers that alignment, to the extent possible, is advantageous. For example, the Board would suggest that in developing any new visa classes, the Department of Immigration may consult Treasury and the ATO about the likely tax outcomes. This suggestion is developed further in the chapter 'Further Interactions and Recommendations'.

Addressing integrity risks and resident of nowhere arbitrage

1.136 Many consultees noted that a commonly understood integrity concern persists in the residency rules, known as the 'resident of nowhere' scenario. This arises in situations where an outbound individual is no longer a resident but not legally qualifying for residency under another country's tax law. This may arise where an individual ceases Australian residency through any of the applicable tests (including those that were never domiciled in Australia and were only residents pursuant to the resides test). Consultees noted examples where some individuals seek to avoid tax by arguing that they are a resident of nowhere.

1.137 Some consultees noted that whether this outcome is appropriate or not is a matter of policy. In practice, it relies on the assumptions of individuals and their advisers as to the unstated policy aims of the residency rules (that is, that such people should be taxed as residents). Consultees suggested that Australia may seek to tax such an individual as a resident and the issues that arise due to the technical aspects of the law may need to be addressed through legislative reform.

Board observation

1.138 The Board considers that this arbitrage occurs due to the way in which the various residency rules operate in each country and is likely to be a transitional concern (that is, it occurs only when individuals change residency).

1.139 Individuals are able to cease Australian residency without establishing residency in another country. This indicates that the outbound individual tests (in particular, the domicile test) no longer provide the integrity necessary in the Australian income tax system.

1.140 Ultimately, the Board (and most consultees) expect any tax residency policy (should it be articulated) would seek to treat these individuals as residents.

1.141 The Board considers that this integrity risk should be addressed.

Superannuation test now outdated

1.142 Consultees noted that the two superannuation schemes – the Commonwealth Superannuation Scheme (CSS) and the Public Superannuation Scheme (PSS) – that were previously offered to Commonwealth officials are no longer a reasonable proxy for capturing all Commonwealth officials. In particular, these schemes are now closed to new members and the Commonwealth no longer obliges officials to join its superannuation funds. This accords with the Board’s understanding.

Board observation

1.143 The Board agrees that this test warrants reconsideration. This test no longer meets its objective to treat all Commonwealth officials as residents; should that continue to be Government policy, a new formulation is necessary.

The domicile test — updating outbound residency rules to reflect modern values

1.144 Consultees noted that the domicile test was initially introduced in 1930 to capture outbound individuals that had previously acquired an Australian domicile. In particular, while at the time it was aimed at ensuring foreign-based Australian public officials were taxed the same as their Australian-based counterparts (regardless of their location or length of stay overseas), the domicile test has consequences, and must be considered, for most outbound individuals. Consultees noted the integrity concerns outlined in connection with the resident of nowhere scenario, and also advised the Board of the significant compliance burden this complex test places on individuals and their advisers.

1.145 During consultation, it was also noted that domicile is a term used in countries that have a common law basis (generally limited to those countries that have adopted the UK legal system and jurisprudence). It was submitted, that the term domicile is not used by countries with other legal systems and is difficult to explain to individuals from those particular countries.

1.146 As the outcome of the domicile test requires consideration of Australian and British common law precedent that is ultimately uncertain when applied to an individual’s facts and circumstances, consultees noted that it is common for employees to take different positions on residency in analogous circumstances.

1.147 Consultees also observed that the concept of domicile, based on a fundamental attachment to a single country, reflects the limited access to high-speed travel of that time and the consequential limited capacity for individuals to move between countries on short notice at affordable prices. Many consultees stated that, on this basis, the concept of domicile was no longer appropriate in the modern day context.

Board observation

1.148 The Board considers that the use of domicile warrants reconsideration. As noted earlier, the integrity concern regarding the resident of nowhere should be addressed, and is arguably exacerbated by the diverging development of the domicile and resides tests over time.

1.149 Further, as the concept of domicile does not align with inbound residency rules in most other countries (or Australia's DTAs), the Board agrees that this test should be replaced (or amended) to more closely align with modern residency standards. This would provide individuals and their advisers with a richer source of guidance, by leveraging considerable international expertise and materials that currently exist.

1.150 Improving this test can improve simplicity and certainty, as well as addressing an important integrity concern.

Absence of sufficient certainty leading to inequity and integrity concerns

1.151 Throughout the consultation process, the issue of complexity for individuals was consistently raised.

1.152 Many consultees emphasised that the current rules are open to manipulation. In particular, consultees noted that the complexity of the residency tests (and their reliance on resource intensive tests of facts and circumstances) mean that a variety of reasonably arguable positions are open to individuals. This uncertainty also creates opportunities for taxpayers to manipulate the rules.

1.153 Consultees observed that the test requires significant ATO resources for the Commissioner to rebut the position taken by an individual. As the ATO must appropriately target its limited compliance resources, this means that the ATO might not target all incorrect residency outcomes in a self-assessment environment as it will direct resources to areas it determines to be high risk. Consultees conveyed that the position taken in many of these circumstances therefore relies on the risk appetite of the individual; however, the risk can be reduced by obtaining compelling specialist tax advice. Consultees noted that much of this advice is provided in the absence of a private ruling from the ATO.

1.154 It was suggested that this undermines the equity of the residency rules as individuals could residency 'shop' for the most preferential outcome, should they be able to afford the advice.

1.155 Consultees noted that, in their experience, in addition to conscious manipulation of the residency rules, the interpretative undertaking of the residency tests can lead to reasonable positions being taken that vary significantly dependent not only on the underlying facts and circumstances, but also on the individual or adviser's understanding of judicial and administrative guidance.

Board observation

1.156 The Board considers that the feedback of consultees regarding complexity and manipulation raise fundamental issues of equity and integrity. While issues of manipulation may, in some circumstances, be addressed by increased compliance by the ATO, the Board considers the magnitude of this undertaking would likely be significant given the number of individuals in Australia (as well as inbound and outbound individuals).

1.157 Further, as the risk is inherent in the law as drafted (through its reliance on a variety of common law principles and tests), the Board considers that the more cost effective solution to this concern is through legislative change.

Absence of modern guidance

1.158 Consultees observed that the key ATO guidance material has not been materially updated since the 1990s (in particular, 1991 and 1998) and, therefore, the ATO guidance on the residency rules does not reflect modern work and life patterns in a globalised economy. The accessibility and affordability of high-speed and short-notice travel, the advent and proliferation of complex work and travel arrangements on a global scale, the ability to work remotely (both in geographical and technical terms), as well as developments of modern remuneration (such as employee share and option schemes and allowances) were all stated as supporting the need for reform.

1.159 It was also noted that other guidance, including examples provided, that appear on the ATO website are ambiguous and capable of differing interpretation while also not binding on the Commissioner (that is, it is not binding like a ruling nor does it have the force of law).

1.160 Some consultees considered that, should further guidance as to the operation of the residency rules be provided, the imperative for reform was somewhat reduced. In particular, those consultees sought guidance on issues such as the weighting that should attach to relevant factors under the resides, and the permanent and usual place of abode tests.

Board observation

1.161 The Board considers that the Commissioner's view as to the residency rules and in particular, the factors and the weighting, is an accurate reflection of the current law and it is arguable that the Commissioner cannot provide any legally defensible guidance that would definitively provide certainty without a holistic analysis of an individual's circumstances.⁴⁹ Thus, it is unlikely that any such guidance can satisfy consultees on the law as it stands.

1.162 The Board considers that the difficulties posed are insurmountable and demonstrates the imperative for legislative reform.

⁴⁹ For example, the Commissioner could not state the weight to be given to any particular factor, as that would be contrary to the common law.

POLICY OPTIONS FOR MODERNISING THE INDIVIDUAL RESIDENCY RULES

1.163 Following an extensive consultation process, the Board has concluded that the existing residency rules are no longer appropriate as the fundamental basis of individual income taxation. The Board considers the rules must be modernised and recommends that they are reformed. The imperatives that the Board considers best demonstrate the case for change are that the residency rules:

- (a) *the residency rules no longer reflect global work practices in an increasingly globally mobile labour force, that have changed both the frequency and nature of interactions with the rules;*
 - (i) there is an increasingly globally mobile labour force, which not only increases the number of times that residency needs to be determined but also alters the relative importance of several factors that are considered in the current assessment of residency;
 - (ii) the Board understands that a large number of individuals are registered with international labour mobility firms and looking for opportunities to work overseas;
 - (iii) the significance of an individual's resident or non-resident status has increased in importance, including as a consequence of the largely effective repeal of an exemption for foreign sourced income and the consequent interactions with Australia's fringe benefits tax provisions;
 - (iv) residency of individuals as part of Australia's tax settings will be an increasingly important factor in attracting talent to work in Australia (inbound individuals) and in providing a bright line test for residents working overseas (outbound individuals);
- (b) *the residency rules impose an inappropriate compliance burden on many taxpayers with relatively simple affairs as well as the ATO, given;*
 - (i) the residency tests including: 'resides', 'permanent place of abode' and 'usual place of abode' are inherently uncertain and difficult to apply due to their ambiguous meanings (which have been developed under Australian and British common law since inception);

- (ii) the relative weighting of factors in assessing residency is currently an assessment by individual advisers and identical facts may be treated differently increasing the likelihood of inappropriate outcomes, being an integrity risk for the tax system and an equity risk for taxpayers;
 - (iii) the existing residency rules include several outdated concepts such as domicile;
 - (iv) the current definition was enacted over 80 years ago, at a time when most Australians did not have access to international travel and therefore the question as to where one resides is no longer as simple to answer; and
 - (v) the rules are an increasingly prevalent area of dispute for taxpayers and the ATO given the fundamental difference in tax consequences for residents and non-residents – this is illustrated by the increased number of court decisions and ATO private rulings issued since 2009 (and the recent amendments to narrow section 23AG of the ITAA 1936);
- (c) *there is a lack of alignment between Australia's tax, transfer and immigration settings regarding residency;*
- (i) the interaction between taxation revenue collections and Australia's transfer system is important in relation to the sustainability of Australia's tax base and should apply a consistent and/or coherent notion of residency to protect that sustainability; and
 - (ii) the interaction between Australia's taxation and immigration regimes should be internally consistent and/or apply a coherent notion of residency,
- (d) *the residency rules are otherwise deficient;*
- (i) in their practical application by taxpayers and practitioners alike, as highlighted throughout the consultation process; and
 - (ii) when judged against, and balancing, the four key tax policy objectives of equity, efficiency, simplicity and integrity (including the prevention of tax avoidance).

Recommendation 1

The Board recommends that the Government modernise the individual income tax residency rules.

1.164 The Working Group undertook further consultation in relation to the way in which such modernisation can be undertaken. This chapter considers three policy options that were raised during the consultation process.

OUTLINE OF POLICY OPTIONS FOR MODERNISING RESIDENCY

1.165 A number of alternative methods for modernising the residency test were raised during consultation, which are summarised as follows:

1. codifying the current law, including writing the principles of common law into statute to make the current matrix of tests more certain;
2. updating the current residency rules to address specific concerns while generally maintaining the current policy settings and legislative components; or
3. reconsidering the policy settings and replacing the residency definition with new, enhanced principles based rules that focus on simplicity, certainty, equity and integrity.

1.166 The Board has considered these policy options below. Each of these policy options would require further analysis and consultation during the policy and law design process; however, in order to assist the Government to appropriately target resources in any further residency policy development, the Board has outlined its preliminary observations and recommendations below.

Codification of the current law

1.167 The Board considered whether a codification approach would improve the existing residency rules.

1.168 The Board examined the recent changes to the United Kingdom in the *Finance Act 2013* (UK), which codified their residency rules into a 'statutory residency test'. The Board understands that this codification translated common law principles into legislation to make compliance simpler and ultimately provide taxpayers with increased certainty to the maximum extent possible. Generally, while there was no change in the residency status of individuals whether applying the previous residency rules or the new statutory residency test, individuals could now determine their residency status through statutory formulae and accompanying guidance material.⁵⁰

1.169 The Board consulted the HMRC to gain an appreciation of the statutory residency test in operation. During the Board's consultation it was observed that, once

50 Her Majesty's Revenue and Customs, Guidance note: Statutory Residency Test, August 2016
<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/547118/160803_RDR3_August2016_v2_0final_078500.pdf>.

the new rules were implemented and understood, the test facilitated self-assessment and significantly improved certainty leading to unprecedented low levels of enquiries to the HMRC.⁵¹ It was suggested that the adoption of codification in Australia could increase certainty for individuals in a similar way.

1.170 Consultation also brought to the Board's attention the risks of adopting a codified statutory test. The Board noted that, while the current residency rules are drafted in a very concise manner, with support from common law principles, codifying the residency tests and complementary common law principles will necessarily require a significant drafting exercise with more prescriptive rules leading to more detailed legislation.

1.171 During consultation, HMRC noted that while the statutory test provides certainty, the legislation is quite lengthy and can be resource intensive to learn and apply. Consultees generally agreed with this observation during the consultation process.

Board assessment

1.172 On balance, the Board considers that codification akin to the UK approach would not align with the Government's simplification agenda and the Board's preferred principles based drafting approach. The overly complex drafting of the law and increased length of legislation is in direct conflict with simplification. Further, as codification is solely a process of importing into strict legislative provisions the current common law and guidance on the residency tests, it would not allow for the modernisation of the rules that the Board considers necessary.

1.173 The Board does not recommend that codification akin to the UK statutory residency test be adopted.

Observation 1

The Board observes that the UK 'statutory residency test' would improve certainty for individuals applying the residency rules. However, the Board does not consider that the increased complexity and divergence from 'principles based drafting' is justified.

Updating the current law

1.174 A number of the Board's consultees' concerns could be addressed to a certain extent by amending the current rules, with examples including:

- eliminating the resides test;

51 This was noted by HMRC representatives during consultation in October 2016.

- replacing the domicile test with an updated globally recognised residency concept for outbound individuals;
- amending the 183 day test to create a bright line test for inbound individuals;
- replacing the Superannuation test to reflect Government policy with regard to Government officials; and
- increasing the quality of administrative guidance to reflect the modern work force and lifestyle patterns.

1.175 Consultees suggested the above proposed changes in a variety of combinations.

1.176 Such changes would go some way to updating the law, while maintaining the existing policy framework. Other than the bright line test, residency would still ultimately be determined in each case on a holistic analysis of the requisite facts and circumstances pertaining to each individual by reference to common law principles.

Board assessment

1.177 The Board considers that each of the above suggestions, in isolation, is worthy of further consideration. However, the uncertainty identified by consultees and outlined by the Board is incapable of being effectively addressed through a ‘piecemeal’ approach.

1.178 Rather, these suggestions address the isolated symptoms rather than underlying causes of the inadequacy of the residency rules. As outlined in Table 1.1, inbound and outbound individuals are required (and would still be required) to determine residency by applying all of the relevant tests, which are reliant on undefined terms that are interpreted in accordance with common law. This is a significant burden that the Board considers warrants fundamental reform.

1.179 While the Board would support any Government initiative that addresses these concerns by adopting some of these suggestions as interim measures, the Board does not recommend that such an approach be adopted as a longer term solution.

Observation 2

The Board notes that a number of improvements could be made to the current residency rules without undertaking wholesale reform. While the Board would support any improvement to the current rules, the Board considers that such a ‘piecemeal’ approach will not address the underlying causes of judicial and administrative uncertainty as well as the significant compliance burden currently placed on individuals and their employers.

Simplification and modernisation of Australia's Residency Test

1.180 During consultation, the Board found that there was a high correlation of academics, employers, advisers and industry participants advocating for the residency rules to be modernised such that they would be simpler to apply, resulting in increased certainty for individuals, as well as being less open to manipulation.

1.181 Significantly, consultees suggested that the process of modernisation requires reconsidering the policy parameters that define when an individual is considered to be a resident and a non-resident. To do so, a statement of how this defining line is intended to be drawn should be made (as this does not currently exist).

1.182 Consultees further indicated that this statement would then inform the formulation of new, principles based residency rules that reflect modern work, life and travel arrangements. This would include reconsidering the need for multiple tests applying to all individuals. Some consultees suggested that the modernised rules could be improved by explicitly creating different inbound and outbound tests. This feedback was outlined in the previous chapter.

1.183 This process involves reconsidering the way the existing rules have developed under the common law, and identifying principles that reflect the modern workforce.

Board assessment

1.184 The Board considers that this policy option is the most effective alternative to address the concerns identified throughout the consultation process. The Board does not consider that the current rules should be codified or modified; it is necessary that they be replaced to ensure they reflect the modern workforce and lifestyles of individuals and address inherent equity and integrity concerns.

1.185 Accordingly, the Board considers that there is not an effective way in which the current rules can be improved through piecemeal reform to provide greater certainty, integrity, simplicity, and equity.

1.186 The Board recommends that the Government reconsider its policy and replace the existing residency definition with new, enhanced principles based rules.

Recommendation 2

The Board recommends modernising the residency rules via reconsideration of the underlying policy settings and replacing the residency definition with new, enhanced principles based rules that focus on certainty, simplicity and integrity.

THE BOARD'S PREFERRED RECOMMENDATION: A NEW DEFINITION OF INDIVIDUAL RESIDENCY

1.187 The Board considers that a new definition for individual residency should be developed. It is the Board's view that a combination of economic and social considerations should form the basis of individual tax residency policy. These considerations inform the Board's recommendations below.

1.188 The Board observes that, given the number of potentially affected individuals, any modification of the residency rules has the potential for significant revenue implications should the modification not be appropriately targeted. In light of this, the Board expects the development of a new definition to be undertaken in consultation with Government consultees including the Treasury, the Department of Immigration and Border Protection, the Department of Social Services, the ATO, as well as non-government consultees including individuals, industry bodies, companies, members of academia and specialist tax advisers.

Statement of individual residency policy

1.189 The Board has reflected on the policy question of 'who should be an Australian resident?' and considers it to be a guiding principle for further review and, ultimately, requiring an answer.

1.190 The Board agrees with consultee feedback identifying that there should be an overarching policy statement of individual residency (akin to an objects clause as used in the ITAA 1997). This statement is necessary to determine what individual residency represents, as consultees indicated its absence leads to some uncertainty as to the scope and intent of Government policy.

1.191 The Board considers that this policy statement should identify how the residency rules address the tax policy objectives of simplicity, equity, efficiency and integrity (in particular, the prevention of tax avoidance). In particular, this will help taxpayers and the ATO understand whether taxation (or its absence) in any given context is an intended outcome or the result of tax avoidance.

1.192 The Board considers that the starting point for determining residency should be the extent of the individual's access to the Government, economic and social benefits that an Australian society provides. Substantial access to such benefits should, *prima facie*, lead to a finding of residency for the subject individual.

1.193 The Board considers the following matters further illustrate the way in which residency benefits manifest:

- access to the privileges of Australian citizenship (or similar) – government infrastructure, security, medical and other services the Government provides to the individual;
- access to the Australian economy – the ability to access Australia’s resources such as the capital market, a steadfast banking system, natural resources and the labour market; and
- other benefits of physical location in Australia – property (home) ownership and proximity to Australian goods, services and consumers.

1.194 While this statement would not create a legislative test, it would demonstrate the principles that underpin the residency rules and the Government’s policy intention to guide individuals when determining their residency status.

1.195 The Board recommends that an overarching policy statement be legislated to reflect this principle, based on the above considerations.

Recommendation 3

The Board recommends that the Government legislate to adopt a policy statement (for example, an objects clause in the ITAA 1997) that provides legislative guidance on the parameters of individual residency.

While the Board considers that access to the economic and social benefits of Australian society should be used as a basis for any statement, the Board recommends the Government commission further consultation to develop this statement.

Separate statutory tests for inbound and outbound individuals

1.196 The Board concluded, from its deliberations and consultations, that the times at which residency rules are relevant are in relation to the establishment and cessation of residency. This is clear from the way the current residency rules are applied in practice, and ATO guidance material (for example, IT 2650 and TR 98/17 applying to outbound and inbound respectively). The Board considers that this is an appropriate dichotomy that can simplify and streamline each test by eliminating unnecessary or irrelevant considerations.

1.197 Any updated residency rules should maintain the distinction between inbound individuals and outbound individuals. The Board considers that this distinction would most effectively be addressed explicitly, as it provides simplicity in its application and certainty of outcome for individuals. While the tests would be similar, they would

operate differently to reflect the relevant considerations that arise for establishing and ceasing residency.

1.198 Any analysis would likely be more onerous for outbound individuals, reflecting the current principle that residence should be adhesive; that is, it should be harder to cease residency than it is to establish. By reference to the overarching policy statement, the benefits that an individual would likely have available (ie, Government services and Australian economic activity) may linger upon leaving and it is, therefore, reasonable that residency similarly remains.

1.199 It is suggested that this more adhesive requirement could manifest in a variety of ways. For example:

- having different objective day count thresholds for inbound and outbound legislative residency tests;
- an outbound individual may be required to demonstrate fewer ties to Australia before they cease to be a resident, whereas an inbound individual may be required to demonstrate more ties in order to commence residency.

1.200 The Board recommends that two explicit residency tests be adopted for inbound individuals (establishing residency) and outbound individuals (ceasing residency) respectively.

Recommendation 4

Subject to the policy statement, the Board recommends two separate residency tests be adopted, for inbound individuals and outbound individuals respectively.

A primary bright line test

1.201 The Board recommends that the new residency test should adopt a two-step conceptual approach.

1.202 The first step should be an objective test, such as a bright line 'days count' style test. This would be more efficient than commencing with the more complex analysis of individual factors (for example, the current 'resides' test), which should instead be reserved for more difficult residency cases (through a second step). In the majority of cases, an objective test should be all that is needed to determine residency, and this should ensure that the changes do not affect the majority of individuals.

1.203 The number of days used will need to take into account the likely change in residency status that a strict counting might have (subject to grandfathering or other transitional arrangements that will require further consideration) on current and prospective residents. Further, the Board notes that there is no international uniformity

as to the relevant number of days used, but considers the following examples informative:

- New Zealand:
 - 183 day count of physical presence in New Zealand in any 12 month period for establishing residency;
 - 325 day count of physical presence out of New Zealand in a subsequent 12 month period for ceasing residency (if established only under the 183 day test).⁵²
- United Kingdom:
 - 30 and 183 day counts of physical presence in the UK for establishing residency;
 - 16, 46 and 91 day counts of physical presence in the UK for ceasing residency.⁵³

1.204 These tests, while based on a specific day count conceptual framework, all incorporate other elements to ensure the integrity of the rules; that is, the potential manipulation of the rules for tax preferred outcomes.

1.205 The Board considers that the relevant number of days in an Australian context should necessarily take into account matters of simplicity, while remaining aware of integrity and equity concerns. This may arise in an Australian context whereby an inbound individual seeks to take advantage of the tax-free threshold available for residents on assessable income up to \$18,200 without genuinely seeking to be an Australian resident. Conversely, an outbound individual may seek to ensure that gains arising from property that is not taxable Australian property do not become subject to income or capital gains tax in Australia.

1.206 The Board also notes the ability to be physically present in Australia over two income years, spending a certain number of days in Australia without satisfying the relevant 'day' test in either income year. This would be inconsistent with improving certainty using a bright line test. In some overseas countries, such as New Zealand, the test is 183 days present over any 365 day period rather than 183 days in an income

52 YD1 of the *Income Tax Act 2007* (NZ). As noted, the 325 day test only applies where the individual has established residency purely on a day count basis and is outside New Zealand for more than 325 days. It does not apply if the individual has a permanent place of abode in New Zealand.

53 These different thresholds apply in different circumstances in the 'statutory residency test' of Schedule 45 to the *Finance Act 2013* (UK).

year. The Board expects that such outcomes would be considered during the policy and law design process to reduce any potential manipulation of the new rules.

1.207 To address these concerns, it may be appropriate to set the relevant number of days for inbound and outbound individuals at levels that minimise manipulation.

1.208 The following bright line tests seek to address this balance.

Inbound individuals

1.209 While the Board has not concluded a final view on the specific number of days, the Board recommends adopting a simple bright line, similar to the New Zealand and United Kingdom inbound individuals tests. These tests are based on 183 day tests, being one day more than half a year. The Board considers this a useful starting point for consideration. This threshold can be summarised as:

- an individual is a resident that has been present in Australia for 183 days or more in a 12 month period.

1.210 This test provides certainty for individuals, while the requirement that an individual is in Australia for more than half of a 12 month period reflects the need to ensure that it is not open to overly simplistic manipulation (for example, by staying in Australia for less than half of two separate income years in one 12 month period).

Outbound individuals

1.211 Similar to the inbound individual tests, the Board notes that any outbound day test will require further consideration as to the appropriate calibration. In particular, an outbound test should consider the likelihood of the test changing the residency status of individuals, any associated revenue cost, and the potential for manipulation.

1.212 However, the Board recommends adopting a similar test to the UK that bifurcates individuals that are deemed non-residents into those that are ceasing residency and those that have never been resident.⁵⁴ In the UK, the test applies a lower number of days on those that have been resident, to balance integrity with simplicity. The Board suggests that this is an instructive basis and the relevant automatic non-resident day count tests may, subject to consultation, be:

54 The Board considers that the New Zealand approach of an overriding permanent place of abode test, in YD 1 of the *Income Tax Act 2007* (NZ), does not provide the certainty for outbound individuals the Board considers appropriate. The Board prefers a primary bright line test.

- an individual that works full-time overseas is a non-resident if they spend less than 31 days working, or 61 days total, in Australia;⁵⁵
- an individual that was previously a resident of Australia is a non-resident if they spend less than 16 days in Australia; and
- an individual that has never been a resident of Australia is a non-resident if they spend less than 46 days in Australia.

1.213 These tests largely reflect a simplified version of the UK standard. The Board considers that the simplicity offered by the Board's formulation of the rules provides a useful basis for further consultation.

1.214 The Board recommends that bright line tests be adopted as the first test in each of the inbound and outbound residency rules. This will ensure simplicity and certainty for the majority of individuals, while safeguarding integrity and equity.

Recommendation 5

Subject to the policy statement, the Board recommends that each residency test begin with a bright line test to remove the facts and circumstances based tests for the majority of individuals. The Board recommends that further consultation on these bright line tests be based on the New Zealand and United Kingdom residency rules.

Secondary objective tests

1.215 The Board considers that, should an individual not satisfy the primary test, the secondary residency test should be an objective one, based on an individual's facts and circumstances.

1.216 This secondary test would be reserved for the more difficult cases. This test could draw upon the principles of the resides test, the domicile test (in particular, the permanent place of abode test) and the 183 day tests (in particular, the usual place of abode test). While the Board considers that the factors would need to be developed through further consultation, the Board has formed a preliminary view based on its deliberations and consultations during this review.

1.217 Importantly, the Board is of the view that only one list of relevant factors should be enumerated. The current tests should be replaced by a single objective test based on a limited list of objective factors that reflects matters materially relevant to residency.

55 While the UK Statutory Residency Test uses a total day count of 91 days for this test, the Board is of the preliminary understanding that such an amount of time is not necessary in an Australian context. This may be considered further in consultation.

This will be a significant simplification and improvement on the current residency rules.

1.218 Consultees also supported this view, that the second test should involve an analysis of the individual's facts and circumstances similar to those currently required but against a more targeted, enumerated list of factors. This would involve considering a number of key factors and determining the connection or relationship to Australia thereby leading to a determination of resident or non-resident status.

1.219 The second test could incorporate some of the current factors outlined in ATO guidance materials such as TR 98/17 and IT 2650, to leverage the underlying concepts in the existing body of common law that can assist individuals in these more difficult cases. A number of suggested factors that the Board was provided during consultation included:

- citizenship or permanent residency status (or other immigration visa status and conditions);
- where an individual's family (or other significant social support network) is located or resides;
- whether an individual has readily accessible Australian accommodation (owned or rented);
- whether an individual has substantial Australian economic ties (such as employment or business interests); and
- the length of time spent in Australia over a medium term period (for example, the preceding two to three income years).

1.220 While the Board emphasises that this list is not exhaustive, and any decision on the relevant factors would require further consultation to consider their suitability and relative importance (that is, probative value), these factors identify specific issues that relate to the overarching policy statement. These factors reflect the Board's view that the combination of Government, economic and social ties should form the basis of residency policy.

1.221 Some consultees also suggested that the test be based on the OECD Model Tax Convention on Income and on Capital, Article 4 (residence) tiebreaker clauses, adopting the concepts of:

- permanent home;
- personal and economic relations (centre of vital interests);
- habitual abode; and

- nationality (that is, citizenship).

1.222 The Board observes that these factors broadly align with the Board's suggested factors above. On balance, the Board prefers to maintain relevant Australian factors. However, the Board considers that this alternative approach is worthy of further consideration.

Recommendation 6

Subject to the policy statement, the Board recommends that a secondary test based on applying the facts and circumstances of an individual against a list of key factors be adopted. The nature and composition of these factors should be determined in consultation.

Factor weighting

1.223 The current tests rely on a determination of 'weighing' different factors to arrive at a holistic decision on residency. As outlined earlier in this report, this weighting varies depending on the individual's personal circumstances, and no one single factor is decisive.

1.224 The Board observes that this broadly accords with the common methods adopted in Australia's DTAs, based on the OECD's Model Convention (outlined above) and will ultimately be relevant when determining treaty residency under the applicable DTA.

1.225 Consultees suggested that a more prescriptive weighting procedure could be legislated. That is, whether the relevant factors in the new Australian residency test should be allocated a weight so as to assist individuals to determine their residency and provide certainty.

1.226 Consultees suggested that weighting could be adopted by giving a numerical rating (points system) to different factors. For example:

- an individual could require a certain number of points to be regarded as either a resident or a non-resident; or
- in a similar manner to the UK's statutory residency test, an individual could require a number of 'ties', being a set number of significant factors that lead to a conclusion of either resident or non-resident.

1.227 The Board notes that the weighting would be different for inbound and outbound tests, reflecting the different considerations of those two tests.

1.228 Consultees suggested that weighting increases transparency and simplification and ensure individuals can consistently apply their facts and circumstances without the need for specialist advice.

1.229 The Board observes that this approach might increase the complexity of the legislation when drafting. The Board also acknowledges feedback received that this might lead to greater manipulation and arbitrary outcomes.

1.230 The Board considers that there is merit in further considering the appropriateness of legislative weighting of factors.

Observation 3

Subject to the policy statement, the Board observes that each residency test may declare a weighting for each of the relevant factors to provide greater certainty and simplicity in determining the outcome of the relevant test.

The Board considers that this warrants further consideration in policy development having regard to the appropriate balance of certainty of outcomes against potential manipulation of outcomes and increasingly complex legislation.

Resident of nowhere

1.231 The Board agrees with feedback provided by consultees that a significant integrity risk arises in the current domicile test. Where an individual becomes a non-resident (that is, ceasing to have an Australian domicile, establishing a permanent place of abode outside of Australia or otherwise ceasing residency) but has not established tax residency in another jurisdiction, the individual can become a 'resident of nowhere'. The Board considers that this integrity concern should be specifically addressed and articulated in the new residency definition so that it is clear to taxpayers.

1.232 When adopting the new outbound individual resident rules, the Board considers that, where an individual that has been an Australian resident might otherwise determine their status as a non-resident, the change in status should only be effective where the individual can demonstrate that they have established residency in another country. This will address the integrity and equity concerns of individuals being a resident of nowhere.

1.233 The new test should reflect that such individuals remain Australian residents unless and until tax residency is established in another jurisdiction.

Recommendation 7

The Board recommends that the new residency test for outbound individuals ensures that all residents remain resident unless and until tax residency is established in another jurisdiction.

Superannuation test — residency of Government officials

1.234 As noted in consultee feedback, the Superannuation test only applies to Commonwealth officials and their families where the official is a member of certain closed Government superannuation funds.

1.235 The Board considers that this test should not be adopted in any new residency definition. Should the Government intend to continue to treat Government officials (and their families) as tax residents, this could be achieved in a far simpler form. For example, an explicit government services test or regulation could provide this certainty.

Recommendation 8

The Board recommends that the new residency definition not include the Superannuation test. Should the Government continue to treat Government officials as residents, the new residency definition should include a more effective rule that reflects the Government's position, such as a specific government services rule.

FURTHER INTERACTIONS AND RECOMMENDATIONS

THE IMPACT OF NARROWING SECTION 23AG

1.236 As previously noted, the Board outlined a number of tax concessions related to inbound individuals that provide simplicity and certainty of tax outcome for specific individuals coming to work in Australia.

1.237 The Board also observed that a cognate provision for outbound individuals, section 23AG of the ITAA 1936, prior to 2009, operated to provide limited tax relief in Australia for the temporary relocation of Australian based employees to overseas employment. Ultimately, the Board found that this exemption provided significant administrative and compliance relief for employees and employers, at the limited notional cost to the Government of the differential between taxes paid in the relevant overseas jurisdiction and the relevant rate of tax paid on the income in Australia. The Board considers that this previous exemption provided practical certainty.

1.238 The amendment of section 23AG in 2009 has resulted in foreign services (broadly employment) income of an Australian resident taxpayer becoming taxable (in the vast majority of cases) in Australia with a related FITO under Division 770 of the ITAA 1997. Previously, provided certain criteria were met, this income was treated as exempt income. In contrast, a non-resident is not subject to tax on such foreign sourced (employment) income.

1.239 The distinction between whether an individual is an Australian tax resident or a non-resident for tax purposes during the period they are working overseas has therefore assumed increased importance. Importantly, there has been increased litigation during this period. Between 1930 (when the resident definition was introduced) and 2009, there were approximately 25 decisions handed down by a tribunal or court on individual residency. Since 2009 (up to the time of writing this report), there have been more than 30 cases heard relating to individual residency, with a significant number of these cases relating to circumstances in which section 23AG may have previously been thought to apply.⁵⁶

1.240 During consultation, it was submitted that narrowing section 23AG now incentivises taxpayers to argue non-resident status (where it is reasonably arguable when applying the residency rules to their fact patterns or where the individual has a higher risk appetite) during employment overseas, particularly where the tax rates are

56 The Board understands that scope of section 23AG was limited so that it would not have applied in some of the cases; for example, where workers were employed in jurisdictions with no income tax.

lower. In particular, the Board is aware of a number of low tax jurisdictions in which regional hubs now operate that would seem to exacerbate this difference.

1.241 Further, it was noted that often the salary in the foreign jurisdiction was calculated taking into account the level of local taxation applicable and that once the Australian marginal tax rates are applied (even with a FITO), the salary is no longer attractive, reducing the appeal of many global employment opportunities for Australians unless they become non-resident.

1.242 The Board understands that Treasury has undertaken a post-implementation review of the amendments to section 23AG. Further, the Board notes that not all of the recent residency litigation is related to the changes to section 23AG. However, the increase in disputation reflects the general consensus regarding the uncertainty inherent in the residency rules of which individuals and their advisers are now acutely aware.

1.243 The following two issues were raised by consultees that have emanated from the changes to section 23AG:

- double taxation of fringe benefits; and
- level of administration in complying with the taxation of employment income in two tax jurisdictions.

1.244 The Board considers that these issues are significant, and has addressed each in turn below.

Double taxation of fringe benefits for Australian residents working outside Australia

1.245 The Board understands that a significant 'double taxation' issue has arisen since the narrowing of section 23AG in relation to fringe benefits.

1.246 Prior to the 2009 amendments, provided certain criteria were met, fringe benefits associated with the foreign services were exempt from Australian fringe benefits tax (FBT) (given that the salary and wages in respect of those services were also exempt from tax). As a result of the amendments, fringe benefits associated with the foreign services are now generally subject to Australian FBT where the foreign earnings are also subject to Australian tax.⁵⁷

⁵⁷ There is a limited exemption for employment in remote overseas locations pursuant to subsection 47(7) of the *Fringe Benefits Tax Assessment Act 1986*.

1.247 Consultees noted that most other countries include fringe benefits in the assessable income of the employee. In contrast, Australia imposes FBT on the employer and there is no provision under the FBT legislation for the employer to receive a credit for the tax paid in the overseas jurisdiction by the individual on that same benefit. This leads to double taxation unless relief is provided under a DTA (albeit only five current tax treaties address this issue: Chile, Germany, New Zealand, Switzerland and the United Kingdom). Questions can also arise as to how to value the benefit for FBT purposes.

1.248 The Board agrees in principle that double tax should be alleviated where it is identified. During consultation this issue has been raised with the Treasury and the ATO.

1.249 The Board considers that this issue requires further consultation to identify the size of the problem, as well as the development of an appropriate solution. The Board considers that it may be appropriate to reduce any Australian FBT liability to the extent the benefit has been taxed overseas where it is not otherwise relieved via a Double Tax Agreement.

Practical impacts of the narrowing of the exemption for foreign employment income

1.250 With the narrowing of section 23AG, in most cases, the employee is subject to tax in two jurisdictions, with Australia providing relief pursuant to FITO for income tax paid in the overseas jurisdiction.

1.251 Where an employee is paid from an Australian employer's payroll through its Australian operations, there is now a necessity for employers to maintain payroll records in both locations. Consultation emphasised that interactions with PAYG withholding and reporting and FITO require complex calculations to determine the correct level of withholding (to accurately remit to the ATO while minimising the impact on cash-flow for employees and employers). As a consequence, payment of tax and lodgement of returns have become very resource intensive and can require specialist tax advice for a relatively common practice (being short term overseas secondment of staff). The Board understands that, given the increased number, and sophistication, of global payroll service providers, the ability to pay salary and wages of employees into multiple bank accounts (including overseas bank accounts) regardless of where they work gives rise to integrity and compliance risks where an employee works overseas but remains an Australian resident.

1.252 While the Board does not recommend the reversal of the 2009 amendment, there is significant complexity involved in complying with its narrowed scope in practice. The Board understands that Australian employers have, and continue to, apply for class rulings from the ATO to obtain certainty with respect to their obligations under relevant income tax and FBT legislation.

1.253 The Board makes this observation and recommends that this issue could be addressed by the Government as part of its regulatory reform or simplification agenda. The Board considers that further work is required prior to making any firm recommendations.

Recommendation 9

The Board recommends that the Government consider reviewing the indirect consequences arising in relation to the amendments made to section 23AG in 2009 and the impact on Australian individuals, employers, and labour mobility. In particular, the Board considers the following consequences require further consideration:

- the double taxation of fringe benefits as a consequence of the amendments;
- the administrative compliance burden placed on employers (and resultant cash flow consequences for employees); and
- the potential simplification benefits that may arise by addressing these matters.

TEMPORARY RESIDENT CONCESSIONS: AVAILABILITY FOR INDIVIDUALS WORKING IN AUSTRALIA PERMANENTLY

1.254 Temporary resident rules were introduced in 2006 as a means of facilitating Australia's growth as a regional centre by significantly reducing administrative and compliance costs to Australian businesses of employing highly mobile skilled expatriates.

1.255 Broadly, the temporary resident rules provide concessional tax treatment to certain inbound individuals. This involves an exclusion from Australian tax on 'worldwide income' that may otherwise arise where the individual commences 'residency' in Australia. This includes a tax exemption in respect of foreign income (with the exception of foreign employment income) and liability for Australian capital gains tax in accordance with non-resident rules (generally, no liability arises unless the asset constitutes 'taxable Australian property').

1.256 Temporary residents are limited in their ability to access the tax concession to the period they hold the temporary visa.

1.257 The definition of 'temporary resident' in section 995-1 of the ITAA 1997, details the following qualifying criteria:

- '(a) you hold a temporary visa granted under the *Migration Act 1958*; and
 - (b) you are not an Australian resident within the meaning of the *Social Security Act 1991*;
- and

(c) your *spouse is not an Australian resident within the meaning of the *Social Security Act 1991*.

However, you are not a temporary resident if you have been an Australian resident (within the meaning of this Act), and any of paragraphs (a), (b) and (c) are not satisfied, at any time after the commencement of this definition.'

1.258 Generally, social services are only available to Australian residents. The definition of Australian resident in the *Social Security Act 1991* appears in section 7 as follows:

'An *Australian resident* is a person who:

(a) resides in Australia; and

(b) is one of the following:

(i) an Australian citizen;

(ii) the holder of a permanent visa;

(iii) a special category visa holder who is a protected SCV holder.'

1.259 The term 'protected SCV holder' broadly refers to New Zealand citizens that arrived in Australia before 26 February 2001 (the date on which an agreement between Australia and New Zealand regarding access to social services came into effect).

1.260 The Board understands that certain visa holders (for example, New Zealand residents that arrived in Australia *after* 26 February 2001) can work in Australia indefinitely. For example, this occurs where a visa (including special visas available to New Zealand citizens) is defined as a 'temporary visa' — there is no requirement to seek permanent residency or Australian citizenship to continue to reside in Australia indefinitely (other than, as can be seen from the definition, to access social services in specific circumstances). This means that individuals entering Australia on such temporary visas qualify for concessional tax treatment under the 'temporary resident' rules for as long as they remain in Australia; that is, there is no time limit imposed.

1.261 The Board understands that the way in which the visa rules apply to New Zealand citizens is different to other countries. The, potentially unintended, advantageous tax outcomes may be seen as discriminatory (against other countries' citizens) and is therefore considered to be inequitable. The favourable treatment provided to New Zealand citizens vis-à-vis other countries do not appear to have any basis in tax policy. The Board understands that, while Australian citizens and permanent residents have analogous visa classes for living in New Zealand

indefinitely,⁵⁸ there does not appear to be an analogous tax concession – New Zealand provides a temporary (four-year) tax exemption on certain types of foreign income upon becoming a New Zealand tax resident (regardless of the individual’s previous country of residence).⁵⁹

1.262 The Board considers that it is inappropriate for any person on a temporary visa to live and work in Australia for more than four years and not to be taxed in the same manner as permanent residents. The Board is of the view that this inconsistency be removed, with a time limit (for example, a four-year cap) be put on **any** individual being classified as a temporary resident.

1.263 The Board also recommends that, should its preceding recommendations to modernise the residency rules be adopted, any individual that is concessionally taxed under the Temporary Resident rules may more appropriately be taxed at non-resident income tax rates throughout the period they qualify for the concession (such that the reforms do not lead to unintended access to the tax-free threshold).

1.264 The Board notes that the Government’s immigration review may affect this recommendation; however, should it not be currently under consideration it is the Board’s view that this issue warrants further attention.

Recommendation 10

Subject to the Government’s current immigration review, the Board recommends that:

- temporary resident tax concessions should be amended such that the concessions are not available where an individual has been in Australia for more than 4 years; and
- should the Government adopt the Board’s modernisation recommendations, temporary residents should be subject to non-resident income tax rates.

58 For more information: New Zealand Immigration Australian Resident Visa <<https://www.immigration.govt.nz/new-zealand-visas/apply-for-a-visa/about-visa/australian-resident-visa>>

59 New Zealand Inland Revenue New Zealand Tax Residence IR 292, published April 2017, p 9.

GREATER ALIGNMENT BETWEEN AUSTRALIAN TAX RESIDENCY RULES AND IMMIGRATION VISA STATUS

1.265 During the consultation process, when examining areas for simplification, there was general consensus that by more closely aligning immigration with a deemed tax outcome the Government could, in certain circumstances, achieve both increased simplicity and integrity in the taxation system. That is, where possible, the immigration status of individuals should strongly indicate the appropriate tax residency status of that individual, or in certain circumstances a tax status could be automatically ascribed.

1.266 Whilst reserving judgement to the policy rationale for either the 'temporary resident' or 'working holiday maker' regimes specifically, the Board acknowledges these as examples of the simplicity and integrity which can be achieved from aligning specific visa categories with a 'deemed' tax residency outcome (for example, the granting of a former 457 visa usually resulted in 'temporary resident' status for tax and the granting of a 417 or 462 visa results in 'working holiday maker' status for tax, regardless of whether these individuals otherwise constituted a resident according to Australia's domestic law definition).⁶⁰

1.267 During consultation there was general agreement that similar alignment could simplify tax residency analyses, allow the Government to better dictate desired economic outcomes from the granting of certain visas, avoid manipulation (as in the context of working holiday makers) and reduce compliance and red tape associated with both the immigration and tax processes.⁶¹

1.268 It is acknowledged, however, that whilst any deemed tax residency status linked to business migration visas may appear to provide a simple solution for tax purposes, this will need to be more closely considered to ensure alignment with policies associated with the promotion of foreign investment, which underlie many of the business migration programs.

1.269 For example, the Board understands that entry into Australia is permitted on certain 'Investor' visas, which generally include a condition requiring investment of a significant dollar amount into complying Australian assets (A\$5 million for four years for a Significant Investor Visa and A\$15 million for 12 months for a Premium Investor Visa). Given the conditions attaching to these investor visas may make the visa holder

60 The Board observes that a number of changes were announced on 18 April 2017 to the employer sponsored skilled migration visa programs. While the Board understands that the 457 visa has been replaced with more targeted visa requirements, the Board refers only to 'former 457' as it was on the basis of the previous regime that the Board undertook consultation. For more information, see <<https://www.border.gov.au/Trav/Work/457-abolition-replacement>>.

61 The Board notes that alignment will require close collaboration to mitigate potentially inappropriate outcomes (such as those identified in paragraphs 5.19 to 5.29).

eligible to apply for a permanent visa, consultees submitted that, in their experience, the vast majority of holders of investor visas subsequently seek permanent residency for themselves and their family. Consultees suggested that deeming residency at some point for these visa holders (for example, when the initial visa is granted) may increase simplicity and integrity.

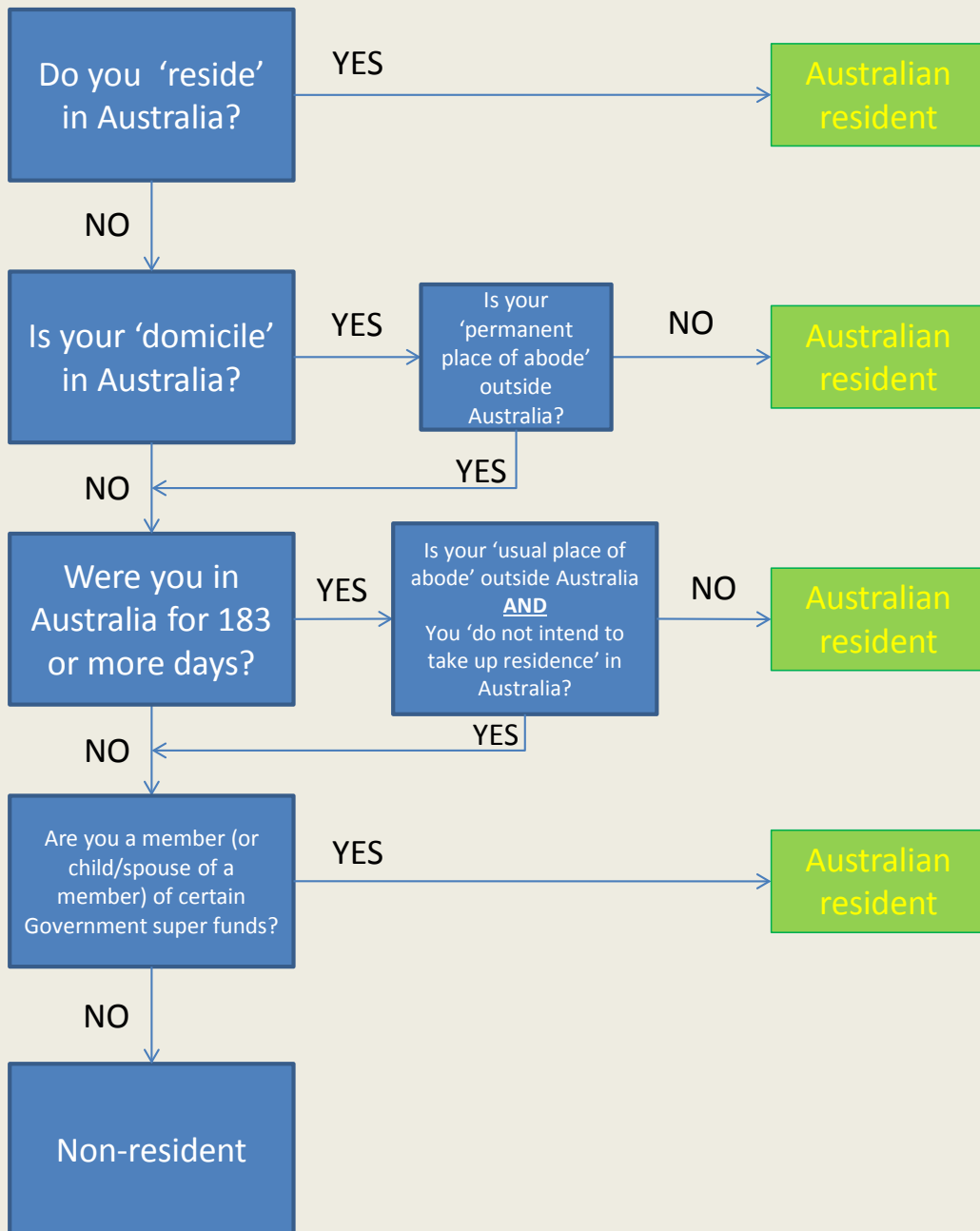
1.270 The Board notes that the Government announced in early 2017 a review of its immigration policies and visa statuses. The Board considers that this may now be an opportune time to leverage that work and commission a review as to whether there may be greater alignment of the revised visa classes and taxation.

Recommendation 11

The Board recommends that the Government consider a review in relation to the interaction and possible alignment of the individual tax residency rules and Australia's immigration visa regime. The Board considers that this may benefit from the work undertaken during the Government's current immigration review.

ANNEXURE A: AUSTRALIA'S CURRENT RESIDENCY RULES

Australian residency tests*



*application of double tax agreements (commonly Article 4) not considered

ANNEXURE B: ISSUES FOR FURTHER CONSIDERATION

1.271 During the Board's deliberations and consultations, a variety of ancillary, incidental and complementary issues were identified which warranted further consideration. While the Board has limited its recommendations to modernising the residency rules, the Board seeks to bring to the Government's attention a number of other concerns that warrant its consideration.

Issue One: Improving payments and reporting systems for visa holders

1.272 The Board understands that certain visa categories provide a link between an employer and an employee (sponsorship) that can be used to verify whether the appropriate payment and reporting of salary, wages and fringe benefits occurs. Consultation raised significant concerns that this same level of verification for payment and reporting systems is not commonly available for other visa categories where the individual has the right to work in Australia and seeks employment after arrival (such as 'student' and 'e-visitor' visas).

1.273 The Board observed that the ATO is establishing a register of 'working holiday maker' employers, and this register will assist with accurate PAYG withholding. Such a register could be expanded more broadly for other visa holders and uses to reduce the potential for exploitation.

1.274 The Board observed that exploitation of such visa holders is a concern that canvasses many policy areas (including tax and employment). In light of the establishment of the Black Economy Taskforce, the Board referred this matter to the Taskforce for its consideration.

Observation 4

The Board observes that payment and reporting systems for many visa holders remain a concern. This issue has been raised with the Black Economy Taskforce.

Issue Two — Current Replication of Visa and TFN information collection requirements should be streamlined

1.275 Consistent with the Government’s regulatory reform agenda, the information supplied to obtain a visa should be available to facilitate an application for a tax file number (TFN) *at the same time* where the person has the right to work in Australia under the visa. That is, there should be permitted sharing of information (rather than replication of information) and greater connectivity between the ATO and Immigration processes.

1.276 The TFN application process can be undertaken online or in writing. However, regardless of the process it is necessary for the applicant to meet certain identity verification requirements – which largely replicate the visa application process.

1.277 The Board has learned through consultation that many short stay visa holders visiting Australia for work purposes currently have difficulty completing the TFN application process. Unless completed while in Australia (a common difficulty given the time pressures placed on them during a short stay), it is necessary for the applicant to attend an Australian embassy, consulate, or other authorised destination in their home country. The Board understands that in many circumstances, this is resulting in the individual not applying for a TFN.

1.278 The Board recommends that the Government’s regulatory reform agenda could adopt this issue as a compelling case for further simplification and streamlining of Government processes. For example,

- the TFN application process could conceivably leverage the Immigration process completed upon entry where a TFN application is automatically lodged upon entering Australia on a visa that permits the person to work in Australia; or
- the TFN identification process (not the broader application process) could leverage the Immigration identification process completed upon entry, aligned with the ‘tell us once’ concept of Government interaction.⁶²

1.279 The Board notes that the attractiveness of streamlining processes and sharing data between Government agencies and departments should be balanced with due regard for individual privacy concerns and appropriate governance standards. A reasonable approach would necessarily consider that individual consent is required to transmit identification documents between bodies and that each body will need to consider whether it is appropriate to rely upon the processes of the other to satisfy its own security and integrity concerns.

62 Australian Public Service Information and Communications Technology Strategy 2012-2015.

1.280 The Board notes that certain information sharing policies were announced as part of the Government's reforms to immigration policy earlier in 2017.

Observation 5

Consistent with the Government's regulatory reform agenda, the Board considers that the information supplied to the Department of Immigration and Border Protection to obtain a visa, where the person has the right to work in Australia, should be available to the ATO to facilitate the automatic generation of an application for a tax file number.

Issue Three — Linkages between Tax Residency and access to Australian Government benefits by non-residents

1.281 The Board considers that access to Government infrastructure, security and services is relevant to individual tax residency policy. This linkage, being the logical connection that those who are afforded the benefit of the Government's protection should pay for the privilege when they can afford it, relates to the overarching policy statement the Board has recommended.

1.282 The lack of linkages between the tax system and other Australian citizen 'benefits' may be seen as unfair and inconsistent with the sustainability of the tax system.

1.283 Consultees raised concerns that residency for taxation purposes and access to social security (Medicare etc.) is not harmonised. It was brought to the Board's attention that Australians living overseas who are non-residents for tax purposes can, in certain circumstances, avail themselves of Australian welfare and medical benefits (eg, Medicare, the age pension, etc).

1.284 The Board observes that the conditions of access to Australian Government benefits and services do not strictly fall within the remit of taxation policy. However, the Board is of the view that the impact of the tax residency rules is not an issue of which other agencies may be fully aware.

1.285 The Board considers access to these benefits may be an unforeseen and inconsistent policy outcome that should be reviewed.

Observation 6

The Board notes that consultees raised concerns regarding the lack of harmonisation and potential for manipulation of the tax residency rules and access to other Government services. The Board observes that the Government should commission a review of how individuals that reside overseas continue to access Government services but are not subject to tax as Australian residents.

Issue Four — Improve tax compliance and ease of tax administration where an Australian resident ceases Australian residency — capital gains can be deferred upon ceasing Australian Residency — capital gains tax event I1

1.286 Foreign residents are broadly taxable in Australia only on Australian sourced income, whereas Australian residents are broadly taxable in Australia on worldwide income.

1.287 For CGT purposes, foreign residents are taxable only in relation to assets which constitute taxable Australian property (TAP) (essentially Australian real property), whereas Australian residents are taxable in relation to both TAP and non-TAP assets.

1.288 For non-TAP assets, CGT event I1 happens upon residency cessation to deem a disposal of these assets because they will cease to be taxable in Australia.⁶³ Since it is acknowledged that a negative cash-flow impact is associated with any 'deemed' disposal, a taxpayer may make the choice to defer any deemed gain or loss until ultimate disposal. Mechanically, this is achieved by deeming a non-TAP asset to constitute TAP and relying on the (now foreign resident) taxpayer to subsequently furnish their income tax return in Australia disclosing the disposal. The likelihood of this occurring was questioned during consultation, with the general view being that a revenue leakage is more likely than not to arise.⁶⁴

1.289 In addition, where the individual establishes residency in a treaty jurisdiction, a small number of tax treaties preclude Australia taxing such gains. That is, some treaties specifically prevent any ultimate disposal of a 'deemed-TAP' asset being taxable in Australia in any event. As an example, the UK treaty at Article 13 specifically provides the UK with the taxing right (over Australia) in relation to a 'deemed-TAP' asset disposed of whilst the vendor is treaty resident in the UK.

1.290 The Board acknowledges the practical reasons that make it difficult to collect tax from CGT event I1 such as the cash-flow considerations noted above, as well as the difficulties associated with collecting tax from offshore non-residents. However, it was noted that with the advent of electronic lodgement of returns, this information could now be easily collected.

1.291 Other suggestions raised by consultees to improve the collection and administration of information in this area, included:

- including 'deemed-TAP' assets in the foreign resident CGT withholding rules; or

63 CGT event I1 also happens to indirect taxable Australian real property interests. The deferral choice is also available for capital gains and capital losses arising from such interests.

64 For completeness, it is important to note that assets deemed TAP by virtue of making the deferral choice are not within the scope of the recently enacted foreign resident CGT withholding regime.

- implementing an objective threshold (eg, 6 years from deferral) upon which date a deemed disposal of a 'deemed-TAP' asset is taken to happen (unless the taxpayer has re-acquired their Australian tax residency); or
- a combination of the above measures.

Observation 7

The Board observes that while some individuals may seek to manipulate CGT event I1, the Board considers that the ATO should increase its compliance efforts to identify 'deemed-TAP' assets that should be taxable in Australia.

The Board suggests any assets which taxpayers have elected to be deferred as a 'deemed disposal' upon ceasing residency should be catalogued and reported to the ATO to use as a reference point for the tracking of any future disposal of such assets. This could be incorporated as part of the annual tax return process.