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Board of Taxation Secretariat
The Treasury – Sydney Office
Level 5, 100 Market Street
Sydney NSW 2000

30 October 2018

Dear Stephen

We are pleased to provide our comments in response to the consultation by the Board of Taxation on the definition of "resident" for individuals.

While supportive of reform and greater certainty for taxpayers, their employers and advisers, we strongly endorse a principles-based approach. To balance the objectives of fairness and revenue-neutrality would require considerable additional work on a legislative solution. As an immediate interim measure, many of the existing difficulties can be addressed through updated rulings and a revised approach to source. However we strongly support careful and detailed consultation on the design principles to provide a more appropriate legislative framework going forward. Drawing on the concepts used in double tax agreements and expounded by the OECD would also be appropriate in our view. We consider this is likely to be more cost-effective and avoid significant disruption and uncertainty through clarification of numerous new definitions and tests.

Should the proposed reforms proceed, we strongly recommend additional modelling to reflect:

- The majority of inbound taxpayers being temporary residents (at least initially) and therefore being largely unaffected by the definition of "resident".
- For globally mobile employees, the need for certainty at the commencement of their assignment. In the absence of this certainty, employer costs can be considerable.
- The potential loss of revenue when providing access to resident rates for individuals who have historically been non-residents e.g. rotational workers in the mining and oil and gas industries.
- The likelihood that significant changes in the definition may make complex cases easier to resolve but will add a great deal of complexity to many simple scenarios.

There is evidence that modernised and practical guidance released by authorities can provide more certain, simple and predictable outcomes for taxpayers and tax offices alike. HMRC6 was practical and objective guidance issued in the UK prior to the introduction of the Statutory Residence Test (SRT), which based on our UK experience, provided a more practical guide to easily defining an individual's tax residency.

Whilst we understand the Board has designed the proposed framework around providing simplicity, equity, efficiency and integrity in the Australian tax residency definition, there are certain elements within each of these objectives which are not being met in the current proposal:

- Whilst we ultimately support the concept of objective testing for Australian residency, we note that it would potentially provide an even more uncertain outlook for taxpayers and employers, thus making forward looking tax planning strategies, cost accruals and timely compliance even more difficult.

- We believe that the incorrect view of simplicity has been taken from the standpoint of experienced tax professionals and that the view of simplicity should be from the layperson's application of the rules. Providing factors without the appropriate level of definition and holistic thinking can provide more uncertain outcomes through difference in interpretation, making a simple structure more complex to apply. This was a key fall down at the time the SRT was introduced and HMRC have since added a significant layer of definitions to the tests to ensure consistent application.

- There is a fine line between the objectives of simplicity and integrity - codified objective tests can often be simply applied (where appropriately defined), however can also be proactively planned for in most cases to provide a preferred outcome for a taxpayer.

Please find our detailed comments in response to the questions raised, in the attached appendix.

If you have any queries please contact me on (08) 9429 2249 or James Palmer on (02) 8295 6994.

Yours sincerely

Tanya Ross Jones
Partner – People Advisory Services
Ernst & Young

Appendix A

Policy statement

1. ***Does the Board's proposed wording appropriately encapsulate the policy objective of ensuring that individuals with substantial ties should be residents?***

While we understand the expectation outlined in the OPC Drafting Direction that a theme statement is important to encapsulate the legislative division, the actual legislative provisions are of greater importance.

In our opinion, the Board's proposed wording does not sufficiently address the policy objectives of aligning an individual's tax position to their exposure to Australia's economic, social and governmental infrastructure.

We also believe the policy statement should highlight how the proposed rules will operate differently to the current rules. In particular, an individual's intentions cannot be taken into consideration unless they are evidenced via the particular ties factored in by the legislation.

2. ***The Board's report suggested that the 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) to help taxpayers and the ATO understand whether taxation (or its absence) in any given context is a intended outcome or the result of tax avoidance. Do you consider that this statement achieves this standard? If not, how may it more accurately do so?***

The recommended restrictions in the length of the statement outlined in the OPC Drafting Direction would restrict the amount of content which could be included in this statement. As such, it may be more appropriate to address this objective through an alternative method. The reference to "substantial" and "relevance" when talking about an individual's ties to Australia does not bring about a level of certainty or simplicity that the Board is after, they are both subjective terms which is not the intention of the proposed reform.

Bright line - inbound individuals

3. ***To what extent does a bright-line test provide balance between certainty, simplicity and integrity? Are other measures needed to provide integrity – for example, those discussed under design principle 5?***

As it is proposed currently, we believe the bright line test only considering 183 days in Australia does not achieve the balance intended by the guiding principles. This approach is too focussed on the simplicity principle and does not give sufficient weight to the certainty and integrity principles.

The proposal to use a bright line days test as currently proposed with no reference to intention would not create the level of certainty which both employers and individuals require as it would not be possible to know whether this test would be met until the day count is reached. We are not suggesting a subjective element be included in the primary test, but rather bolstering the calculation of the bright line test to evidence intention, for example, a model based on the US Federal Substantial Presence Test for tax residency which is based on a weighted average of days in the current and two preceding fiscal years. Employers will need to be adequately resourced and informed to ensure that they can meet their employer obligations and will likely have various cases where the initial assessment of tax residency is retrospectively overturned by a change in individual facts. We would recommend that the Board understand this impact in more detail, especially in light of the introduction of Single Touch Payroll, in order to ensure a smoother transition.

Any proposal involving one single bright line test, whether relating to a rolling 12 month period or each tax year, may not sufficiently address the issue of integrity as it may be open to manipulation. Careful consideration of this single bright line test is recommended, and whether a model similar to the US, per above, should be adopted in order address integrity concerns.

Other measures proposed under design principle 5 may address these issues, however they appear focused on penalising an individual for moving to a lower tax jurisdiction, even where genuine, or include added complexity to fix a section of tax avoidance that would in fact be fixed through easier means (i.e. capital gains for assets held while resident and manipulation of CGT event I1 – observation 7 from the Board's self-initiated review of the income tax residency rules for individuals). Legislation similar to that provided in design principle 5 would not achieve the design principal of integrity for individuals and would also add to complexity by representing a wholescale reform to the Australian tax system.

If taking this approach, we support aligning the bright line tests in a similar way to that of the UK SRT as outlined in Question 4 below.

4. Are there any other bright-line tests that you think should be included (whether as alternatives to a day count test, or in some form of combination)? For example, should you be a resident if:

a. Your only home is located in Australia; or b. You work full-time in Australia.

We support a multi-step bright line test for inbound individuals in a similar way to the UK SRT. This test would work together with the 183 day test in order to provide a suitable balance of certainty, integrity and simplicity and avoid uncertainty in part-year scenarios. When coupled with a similar multi-step test for outbound individuals as proposed currently, the majority of cases can then be determined using one of the bright line tests with only the highly complex cases requiring the factors tests.

We believe the additional two tests of working full time in Australia and having your only home in Australia are good indicators of Australian tax residency and broadly align with the policy aim of ensuring those with access to the privileges of the Australian economy and other benefits of physical location in Australia are taxed as a resident accordingly. However, these tests do not necessarily align to certain categories of employees who would meet one of these criteria, but not necessarily meet the overall criteria of access to the privileges of the Australian economy and other benefits of physical location in Australia (i.e. FIFO workers). For simplicity, if considering additional tests in our view it would be more appropriate to create clear distinctions based on the durability of association to Australia which would more closely be aligned to the availability of a sole home in Australia.

5. Should an individual spending 183 days or more in any 12-month period in Australia spanning two income years be considered a tax resident in both periods?

An individual should be considered resident in Australia for the period in which they have exposure to the Australian economy in line with the policy statement. As such we would agree that individuals should be considered resident for the part of the first income year in which they were physically present and then determine residency based on the outbound bright line test in the second year.

Non-recognition of part-year tax residency would increase the complexity of the individual income tax compliance due to the need to claim foreign income tax offsets, analyse the treaty residency position and ascertain Australian tax positions with reference to foreign sources of income.

We would strongly recommend the inclusion of provisions for split year treatment with a specific date triggering and / or ceasing Australian tax residency.

6. What consequences (if any) will arise for the temporary residency and working holiday maker rules if these changes were adopted? How should these issues be addressed?

The current working holiday maker rules are not impacted by tax residency determinations but solely linked to the visa held by an individual. As a result, the proposals will have little to no impact on working holiday makers.

We believe it is worth noting that the working holiday maker changes were introduced on the basis that all working holiday makers would most likely qualify as non-resident of Australia based on the “usual place of abode” criteria contained in the current 183 day test. By removing the considerations of intention from the residency tests, the ongoing relevance of the changes may be brought into question given many working holiday makers may qualify as tax resident under the bright line test.

It is our view that the proposed rule changes are unlikely to have any material impact for temporary residents as the rules are currently drafted as we understand the Board is not consulting on any changes to the temporary residency provisions. The move away from the review of an individual’s intention and usual place of adobe may result in more individuals qualifying as tax resident in this category. However with the concessions currently available for temporary residents, we don’t foresee this having a material impact on the individuals. As the Government brief was not to look into the temporary resident rules there should be no impact for these individuals from any proposed changes.

Bright line - outbound individuals

7. Are there any other bright-line tests that you think should be included? For example, should you be a non-resident if your only home is located outside of Australia?

No, we believe the multi-step bright line test proposed for outbound individuals is suitable. However, as discussed above, it’s our view that the bright line test should be based on a fiscal year rather than a rolling 12 month period, with look back elements to support intention, similar to the US Substantial Presence Test.

8. Do the proposed day-count tests appropriately balance simplicity and integrity? Is it too complex? Alternatively, are other measures needed to provide integrity – for example, those discussed under design principle 5?

In our view the model proposed for outbound individuals aligns closely with the UK SRT by considering the multi-step bright line test which offers the right balance between simplicity and integrity. Our comments on the integrity measures proposed in principle 5 remain consistent with our comments on question 3.

While the tests do favour simplicity as they are currently drafted, in order to pursue revenue neutrality in the outcomes there would need to be significant amounts of work done to ensure the opportunities for manipulation are minimised. As has been acknowledged by the Board, the permanent place of abode test is much better for ensuring integrity but with significantly more complexity.

9. Should the outbound individual test apply over a 12-month period, per income year or on some other basis? Why?

As outlined in previous questions, using a rolling 12 month period for any bright line test does not provide the level of certainty that individuals and employers require and will often lead to an individual and employer having to fix non-compliance issues associated with a retrospective change in residency. Our suggestion would be to use the income year as the measure for the bright line tests and to develop the split year tests for cases where individuals have greater exposure to the Australian economy during a certain period in the tax year.

The determination of residency should also be viewed with reference to the individual's history of tax residence in Australia which would support the integrity of the provisions.

10. How does this test interact with the limited foreign employment income tax exemption (section 23AG of the Income Tax Assessment Act 1936)?

We understand that the Board has been asked to not consult on the re-introduction of section 23AG of the Income Tax Assessment Act 1936.

The proposed residency tests would not likely have any bearing on the current limited application of 23AG. There is unlikely to be any impact as the 91 continuous days of foreign service for qualification for the income exemption would not likely trigger a non-resident position under the proposed multi-step approach as most people using this exemption will often maintain Australia as their normal home during the foreign assignment.

Factors test

11. Are the factors proposed for the secondary test the most appropriate factors?

Broadly we believe the factors capture the overall policy objectives but there are some changes which we have outlined below which will improve the level of certainty and integrity. While we acknowledge these proposals may take away some of the simplicity, this is key to achieve the objective of a conclusive result from the proposed residency tests.

We also consider there should be more certainty regarding when the Factors Test should be applied (i.e. in both an inbound and outbound context where the primary bright line days test has not been satisfied).

We agree that immigration status is an important factor which should be considered due to the certainty and simplicity which the test offers as well as offering an element of adhesive residency for those who have previously been resident of Australia. It also clearly follows the policy objectives of ensuring that those who benefit from the privileges of Australian citizenship and permanent residency are held closer to Australian tax residency. However this should be balanced with consideration of the immigration status obtained elsewhere e.g. dual citizens, those with extended work rights and permanent residence in other countries.

We also understand that the Board is trying to seek simplicity by reviewing only the factors associated with an individual's presence in Australia as the key for determining Australian tax residency, and relying on double tax agreements to provide relief where an individual may have similar ties in a foreign location. It is our view that looking at only one side of the individual's facts and circumstances will bring about an inequitable outcome. Furthermore, key overseas locations that have been the subject of a lot of the recent disputes, including Bahrain, Saudi Arabia, UAE and Hong Kong, do not have double tax agreements with Australia.

It is our view that it would be a fundamental flaw of the proposed residency tests to consider the factors as solely one-sided. We propose that the factors are built out to review an individual's global facts and circumstances to provide the most appropriate outcome for all individuals instead of relying on the double tax agreements.

As a framework, we consider the 5 factors recommended by the Board to be an appropriate starting point for the Secondary Test. However, we recommend the key terms/principles proposed as part of these 5 factors be clarified further, for example:

- Time spent in Australia – we agree with a framework which sets an increasing number of days each year over a period of years (e.g. 30 days in Year 1, 60 days in Year 2, 90 days in Year 3 etc.)
- Family – we recommend the definition of "family" should be limited to dependants, and the reference to "relevant social grouping" be removed as this extremely difficult to assess
- Australian accommodation – this should consider days of actual use and form of accommodation (i.e. it should exclude hotel accommodation (or similar accommodation) where the individual pays ordinary commercial rates)
- Economic ties – consider methods to determine the degree of ties to Australia and how to attribute wealth to locations based on actual source rather than nominal factors such as bank account location

12. Are there any key matters that should be adopted in preference to, or addition to, the listed factors?

We have responded to each suggested point below and have no other suggestions in addition to the factors listed.

For example:

a. The length of a taxpayer's stay in a single overseas country

More and more, companies are looking to mobilise their workforce in order to align their existing talent to global market opportunities. This type of employee mobilisation within an organisation can be short term or long term and also can change at any point in time based on the market conditions impacting that organisation.

While the collective duration of overseas stays is clearly relevant, we do not believe that the continuity of association to a single country should be considered as it does not take into account the globalised world where moving from one country to another in a short space of time is relatively easy, will often support an individual's career development or business opportunities and can often be driven by non-personal motivations.

b. The answers on immigration forms upon arriving or departing Australia

We do not believe this should be considered a factor as we have concerns over integrity of relying on these answers as a factor. It would be very simple for people to manipulate their number of factors in order to influence their residency position and can also be answered erroneously by individuals who can be confused by the alternative answers provided on the card.

c. Whether a taxpayer established a home (in the sense of dwelling, house or other shelter that is the fixed residence of a person, a family, or a household), outside Australia

In our opinion this should not be considered a factor in isolation but could be considered in conjunction with the Australian accommodation factor. There are a number of scenarios where an individual may not immediately cease owning or leasing a former residence which does not necessarily indicate an intention to remain resident of Australia.

If the proposed Australian accommodation factor were to be weighted based on whether the taxpayer has also established a home overseas this would more accurately reflect the closeness of their ties to Australia in the period when they are based overseas. The tests could be written in such a way as to closely define what a home is and what is considered available in order to provide certainty and to ensure there is no room for the tests to be manipulated to produce a favourable outcome.

d. The duration and continuity of a taxpayer's presence in the overseas country outside of a single income year

We have provided more context to this answer at our answer to question 12a. In our opinion the duration and continuity of a taxpayers presence overseas is important and should be considered, but it would not be fair to consider just the presence in one single country.

e. Whether a taxpayer informs government departments such as the Department of Social Security of leaving permanently and stopping social security payments (i.e. family allowance payments)

We do not believe this should be considered a factor as not everybody would qualify or receive any social security payments meaning there would not be equality in the factors.

Furthermore, people who are claiming non-residency in Australia will generally not be eligible to continue to receive these payments.

f. Whether accommodation in Australia has been effectively abandoned (i.e. the extent to which accommodation is actually available).

We do not believe this should be a factor in itself. As outlined above in our response to question 12c., there are various reasons why an individual would retain accommodation in Australia which is not rented out but also not used for a regular, settled purpose. Our proposal would be to link this test with having accommodation in the overseas location and only consider the availability of, and actual use of, the accommodation in Australia where there is not a settled home in the overseas country.

For example, the test could be structured as follows:

- Do you have a home available to you in the overseas country? Yes- no tie to Australia. No- go to next question.
- Do you have a home in Australia which is available to you and you use whenever you return to Australia? Yes- tie to Australia. No- no tie to Australia.

13. What level of "economic ties" should be necessary for the factor to be conclusively determined?

It is our opinion that economic ties is too broad a term for this factor. While we acknowledge one of the policy aim is for individuals who benefit economically from Australia to be considered tax resident accordingly, we refer back to the expected economic impacts of the proposals. By potentially penalising individuals with investments in Australia this may reduce the appeal of inward investment in Australia.

We also refer to the recent case of Harding v Commissioner of Taxation (2018) whereby the judge commented that "the factor of where a person maintains investments may, in these days, have little bearing on where a person resides. […] there has been a growing internationalisation of investment markets which has increased the ability of people in one country to make investments in businesses in other countries."

As an alternative to this test, we would propose to use a similar test to that in the UK SRT of substantive employment in Australia resulting in a tie. This would meet the requirement of people who benefit from the chance to work in Australia being potentially considered tax resident in Australia, while not potentially reducing the appeal of inbound investment in Australia.

For example:

14. Maintaining bank accounts in Australia

We do not believe maintaining a bank account in Australia should be considered a tie to Australia as it is not an indication of an intention to reside in Australia. An example of this would be an individual leaving Australia at the end of a temporary visa would be required to keep their Australian bank account open in order to claim their Departing Australia Superannuation Payment (DASP), or an Australian resident maintaining their savings in an Australian bank with whom they have built a relationship over many years.

15. Maintaining an ABN in Australia

It is our opinion that maintaining an ABN in Australia is not an indication of an intention to remain in Australia. A more suitable test would be continuing a business in Australia, similar to the substantive employment test outlined above, however we also see a risk in the application of this test where it may discourage the establishment of, or continued investment in, business in Australia.

16. Directorship of an Australian company (or other entities such as a self-managed super fund)

It is not uncommon for companies to have directors who do not live in the country in which the board meetings take place, in particular multi-national corporations. Introducing this as a factor for tax residency may potentially penalise these individuals and reduce the economic appeal of Australia as a destination to do business.

There are also specific taxing provisions in Australia's double tax treaties which define taxability of remuneration for board duties as well as corporate tax implications of having board meetings in Australia which could be adversely impacted if this is considered a factor for tax residency.

Conversely, self-managed super funds require trustees to be resident of Australia in order to maintain their qualifying status. As a result, people who maintain their status as trustee of a self-managed superannuation fund (SMSF) while working and / or living overseas are likely to already conclusively qualify as an Australian tax resident before this test is reviewed to ensure there is no risk to the SMSF.

17. The level of investment in Australia (both passive and active)

As outlined above, we believe the main impact of this factor would be to reduce the appeal of Australia for inbound investment so should not be considered a factor.

18. Compliance with any other residency requirements for the purposes of making or maintaining investments (i.e. whether a foreign investment application is required by the taxpayers).

We feel this will bring an undue amount of complexity to the rules and would be difficult to implement as tracking of compliance will be difficult.

19. What level of connection to accommodation should be required to satisfy the Australian accommodation factor?

As outlined in our previous answers above, we recommend that the Australian accommodation factor should be a tiered test which factors in whether the individual has accommodation in the overseas country:

- Do you have a home available to you in the overseas country? Yes- no tie to Australia. No- go to next question.

- Do you have a home in Australia which is available to you, and used whenever you return to Australia? Yes- tie to Australia. No- no tie to Australia.

The overseas accommodation should have a defined level of permanency in order to ensure integrity, so hotel accommodation or short term leases (e.g. less than 6 months), would not be considered accommodation.

The availability of the accommodation in Australia would also need to be defined to ensure integrity and a similar bright line test solution could be sought to ensure relative simplicity and create certainty in the answer. We would suggest that accommodation that is readily available for the individual's use and actually used by the individual for a period during the year (i.e. when back in Australia) would be considered as a factor. Consideration should be given to ensuring that individuals who maintain a home in Australia for their extended family, such as elderly parents or children who to continue to attend education, are not tied to Australia as a direct result. An added test within the accommodation factor may be considered such as where the house occupied by a child attending education in Australia, a lesser weighted tie may be triggered.

20. To what extent should a person's personal and social ties be located in Australia to satisfy the Family factor?

As currently proposed, this test does not appear to provide the certainty which is important throughout these tests. We believe it would be very difficult to design a test for family which would provide certainty without becoming overly complex or intrusive. In order to get the full picture of a person's personal and social ties you would need to define which ties are considered and this is likely to be a significant list and does not take into account the different weighting each individual would attribute to any single tie.

Furthermore, we also believe that this factor does not take into account how globalisation and the increase in connectivity is impacting "normal" family life. It is much easier in today's digital age to remain in regular contact with family even if they live in another country and the instances of people working and living in different countries to their families is on the rise.

If personal and social ties were to be considered as one of the ties, we believe there should be a comparison between the ties in both Australia and the overseas country, and only where the ties are significantly stronger in Australia than the overseas country should this be considered a factor. However, this will be difficult to design a test which provides certainty and moves away from subjectivity in the same way as the other bright line tests proposed.

21. At what level should the resident and non-resident "time spent" factor be set (i.e. how should they interact with the primary bright-line test for outbound individuals)? Should they be spread over a medium term (i.e. 2 to 3 years)?

We believe there should be a level of continuity in this test with the bright line test in order to improve the simplicity and maintain the concept of adhesive residency. In order to ensure a fair treatment, we believe it should be capped at a medium term number of years (e.g. 3 tax years) as after this length of time it is more conceivable that an individual will have fewer ties to Australia and is closely aligned to global precedent of similar tests (i.e. the Substantial Presence Test in the United States).

A similar test in the UK SRT refers to an individual having spent more than 90 days in the country in any of the previous two tax years which we believe would also be a reasonable approach and support the adhesive residency proposal.

22. What should be necessary to satisfy any of the other factors?

Across all the factors outlined above, we believe the definitions of each factor and how an individual determines whether they meet that factor is key. In all cases, we would recommend a bright line type test is applied, similarly to the UK SRT, in order to provide the certainty around each factor and to ensure that even the complex cases receive a certain outcome through the new tests.

While we acknowledge that with definitions and further tests come complexity, we feel this is essential in order to ensure the integrity of the factors test and to ensure all of the tests proposed offer certainty to the individual and to the authorities.

Weighting for inbound and outbound individuals

23. Are the outcomes fair and equitable? If no, please elaborate.

With the introduction of many new concepts and monitoring tests, there is a high likelihood that for several years at least, examples that are currently simple to resolve under existing law will in fact be more complex and time-consuming. This is in line with the UK experience. While there should ultimately be benefits in simplifying more complex scenarios, this should be balanced against the cost to revenue of allowing individuals to plan their affairs in order to achieve non-residence, which is a likely outcome of the application of bright-line tests.

It is difficult to advise on the equality of the outcome from the proposed tests in their current state as there is still a lot of work to be done on defining terms and thresholds. We believe that the current draft of proposals is too simplistic, doesn't necessarily consider the increasing globalisation of people and is far too heavily focused on the factors present in Australia whilst ignoring factors present in an overseas location which should always be considered to understand the true closeness of an individual's tie to a location. In the rapidly changing environment we live in, it is also necessary for the factors to stay relevant in order to continue to provide equitable outcomes over a sustained period of time. In this regard and in line with our proposal, we would recommend a more immediate interim approach to reform in the form of official tax office guidance whilst the details of an appropriate legislative reform is worked through. If the Board does in fact go down the path of recommending legislative reform, we would recommend a review period of 7-10 years be implemented in order to continually asses the relevance of the factors tests and add in any new factors that have become more relevant in the modern society.

The design of the bright line test is important in ensuring the outcomes are fair and equitable and ensuring individuals who meet the set criteria for being considered non-resident are not then deemed resident due to factors in Australia.

24. An individual working overseas may automatically be a non-resident, but under the secondary test would likely have otherwise been a resident. Does this interaction provide appropriate results?

In our opinion, an individual who is working overseas, in line with a set definition which is designed to ensure the work is substantial and for an extended period, should be considered as non-resident of Australia for tax purposes. This clear definition will provide certainty for both individuals and employers to know from the outset of an international move whether an individual will be considered resident and allow them to plan accordingly.

The definition of working overseas is key in ensuring appropriate results are achieved. The factors which we believe to be important in this are similar to those already considered within the existing residency rules, such as the duration of the overseas work, the travel pattern back to Australia and the nature of the work overseas i.e. the role being full time.

Where an individual does not meet the conditions of full time work overseas, they will then move to the factor test which will look to their other ties to Australia to determine residency, with the likelihood being they will remain resident unless they are suitably severing ties.

We believe that where this definition is done comprehensively and considers all possible outcomes, there should only be very limited scenarios where an individual is inappropriately deemed to be a non-resident.

25. In the UK a stepped approach to "ties" is adopted – the Board considers this adds additional complexity. Does the Board's approach balance simplicity with integrity in the absence of this tiered approach?

In our opinion the UK stepped approach to ties works well and we believe an approach similar to this test would work well in the factors test. While we acknowledge the UK tests do bring an additional level of complexity, we feel this balances against the increase in integrity and adhesive residency which this approach brings.

The current proposals may provide individuals with some scope to manipulate certain facts and circumstances in order to obtain a more beneficial residency position. By implementing a stepped approach this becomes much more difficult due to the close interaction with the other factors. It also promotes adhesive residency in the same way.

Another potential issue with the current proposals is that there is little differentiation for individuals spending very different amounts of time in Australia. Without a level of weighting there may be situations where individuals spending a small amount of time over the proposed threshold in the days factor test, say 90 days, would be treated in the same way as individuals with the same number of factors but who spend 182 days in Australia.

In this example and on face value, it would be fair to say that an individual who meets 2 factors and spent 90 days in Australia is less closely tied to Australia than an individual meeting 2 factors and spending 182 days in Australia. The proposed tiered test, such as that used in the UK, would acknowledge these differences and, where appropriate, provide different answers for such different examples.

26. Would a "points" style approach be more easily accessible and understood? Does the different approach make a material difference?

The points based approach is certainly simpler than the tiered approach, however we believe this may be to the detriment of integrity where a person can more easily plan their affairs to not meet the level of points required in any given period. As outlined above, we believe a tiered test similar to that in the UK provides more integrity and it also allows for the tests to be designed in such a way as to add more weighting to the total amount of time spent in Australia.

Tax treaties

27. Should the new residency rules include a provision to align domestic and treaty residency for dual residents, eliminating potentially inconsistent outcomes?

In our opinion this proposal would be a reasonable approach. It would meet the simplicity principle by building on a well-defined system which is already in place and one which would interact with any new system which is developed, though the tests do not necessarily provide the level of certainty that a bright line test would provide.

We would support a position whereby an individual who is considered as a DTA non-resident receives the same tax treatment as a domestic non-resident as this would reduce the complexity of certain individuals' tax affairs. This would include the income tax rates and the capital gains tax implications of becoming a tax non-resident.

Integrity rules

28. Other than the resident of nowhere phenomenon, what other arrangements that should be taken into account when designing an integrity rule for residency?

Our main proposal for integrity rules which would address this issue is to focus on the concept of source and the tracking of assets that are deemed Taxable Australian Property when an individual departs Australia. By ensuring income and gains are taxed based on their source, the residency rules and any attempt by individuals to manipulate them to their own ends will not impact the ultimate taxability of the income. This is not to take away from the importance of the residency rules in general which remain important for both individuals and employers in ensuring their obligations are met.

As discussed during the face to face consultation, the tightening of the requirement to report certain types of non-taxable income as Target Foreign Income in a tax return will help the tax office identify individuals that may be manipulating the tax residency rules for tax avoidance. This may also be measured by the implementation of an individual declaration of assets at departure, as well as any other global interests they may have (including beneficiaries of foreign trusts), in order for the tax office to be more proactive in managing this risk.

We believe that the introduction of provisions for an individual to become a tax resident in another location in order for them to cease being an Australian resident will still not completely close this gap , and add unnecessary complexity to the residency tests for the majority of individuals not sought to be caught by this rule.

29. Which of the options described best guard against short-term gaming that may allow otherwise taxable income, profits or gains to become exempt from Australian tax under either the current or proposed rules?

We have outlined the importance of utilising sourcing rules for integrity and this would also extend to the potential for short-term gaming. This would be particularly relevant for income and profits as considering the source of that income would ensure it is taxed in the correct state.

The rules in place already for capital gains would not need significant overhaul in order to improve integrity and guard against short term gaming. Our proposal for this would centre around the deemed disposal rules and either making it mandatory for a deemed disposal to occur at the date the individual ceases residency, in a similar way to Singapore treats equity granted while resident there, or to enforce reporting of all assets at the point an individual departs Australia in order to suitably track any future sale of these assets for reporting purposes. We understand the Board is already considering this proposal and would strongly recommend its introduction to overcome the view of short-term gaming.

30. Are you aware of any arrangements which primarily seek to take advantage of resident-only tax outcomes? If so, please explain.

In a number of individual cases, it can be beneficial for individuals leaving Australia to a country with a double tax treaty to continue to be considered tax resident of Australia under the domestic provisions but be considered non-resident under the treaty.

In this example, the individual benefits from the resident income tax rates for any income which remains taxable in Australia under the treaty, they do not suffer from any of the potentially negative capital gains tax implications of breaking residency (e.g. deemed disposal and the reduced CGT discount), it removes the impact of the proposed changes to the main residence exemption for non-residents and also removes the need for the individual to re-structure their personal holdings to ensure continued compliance (i.e. SMSF and personal trust considerations).

Citizen/Remittance regimes

31. Do you think that a strict citizen-based residence test or a remittance based regime would improve the income tax system and/or complement new residency rules?

We do not believe that any potential benefits of such regimes would outweigh the significant additional resources required to implement them nor would they outweigh the additional complexities of such regimes, in particular the remittance regime. Furthermore, the citizen based taxation regimes in place (i.e. the US) are overly burdensome on individuals and there is often a significant amount of resources required in order to ensure global compliance.

Superannuation test

32. Do the proposed design considerations capture the appropriate Government officials and functions? If not, what else should be considered?

We agree with the proposed design considerations for Government officials and what is defined as a Government function.

33. Do any of the international comparisons provide a clear guide for reforming the superannuation test?

The UK and New Zealand income tax systems are most closely aligned to the Australian system and the tests used in both are very similar to the proposed solution. We believe the current proposals already align closely with the UK and New Zealand rules as well as the international standards.

34. Should the residency rules continue to deem spouses and dependants of Government officials to be Australian residents?

In our opinion, spouses and dependants of Government officials should not be considered Australian tax residents automatically, instead they should be treated on their own individual facts and circumstances under the proposed residency tests.

This would be more in line with the intention of the income tax regime to apply to an individual taxpayer in their own right.

Part year residency

35. Should the new residency rules include part-year residency provisions? Should there be different part-year provisions for inbound and outbound individuals?

In our opinion the part year residency provisions are a vital part of the proposed rules. Without these there would be less integrity as the bright line tests alone could be manipulated for years of arrival and departure to create a favourable tax position. The lack of part year provisions is also likely to result in increased complexity on tax returns due to the need to understand taxability of foreign income streams and claim a Foreign Income Tax Offset (FITO) for income taxed in another country within the tax year.

We agree that there should be different provisions based on inbound and outbound individuals and our suggestion would be to link these to the bright line tests, in particular those for either working overseas or working in Australia in order to have the greatest opportunity to identify a specific day on which an individual commences or ceases tax residency. There would also need to be some acknowledgement of the treatment of working days prior to actually moving to Australia to take up employment and any integrity concerns around potential gaps between cessation of foreign employment and resumption of Australian tax residency (i.e. where the individual takes leave before returning to Australia and may receive some trailing income which may not be subject to tax in the overseas location).

36. Do the above design features provide a reasonable mechanism to determine split year income periods?

In our view the proposed mechanisms are currently weighted too heavily in favour of the simplicity principle at the detriment to the certainty and integrity principles. In order to promote certainty there would need to be a bright line type test which we believe should be closely linked to the other bright line tests as outlined above. The bright line type test would also negate the risks of individuals manipulating their date of arrival or departure date in order to get a more favourable tax outcome.

Based on our conversations with our UK colleagues, one negative opinion of the UK SRT is that the split year provisions could have been more thought through with more flexibility in determining the relevant dates for cases which would not be considered normal. In light of these comments, the bright line test for part year cases may need to be loosened to allow a greater flexibility.

We would propose separate bright line tests for inbound and outbound assignees which is designed to capture the majority of cases, such as working full time in Australia or overseas where the first day of work is the date for splitting the year. There could then be a day count test for working days either pre or post this in order to determine whether the individual has had access to the Australian economy and should be considered resident at an earlier date.

There could then be further more complex tests designed to capture the more complex cases and determine the date residency should begin or end where employment is not factor.

37. How might part-year rules interact with Australia's double tax treaties?

In the majority of cases the part year provisions would match with similar provisions in the overseas country meaning there would be fewer cases of dual residency requiring the treaty to determine residency. This would then likely mean only the complex cases would require a level of treaty analysis to determine their residency position, increasing the simplicity of the system.

Transitional rules

38. Should there be any transitional relief for any affected individuals? If so, please identify the affected type of individuals and relevant relief.

Any rule changes in which treaty non-residents are treated in the same way as domestic non-residents may have significant impacts on these individuals. There are a number of structures which rely on the tax residency of an individual to maintain the status of the structures in Australia, in particular SMSFs and trusts. We have also outlined the potential implications from a capital gains tax perspective above. In particular, we consider the integrity rules should only apply prospectively to a resident seeking to become a non-resident under the new regime.

We believe there should be either transitional rules or a grace period for impacted individuals to give them sufficient time to reorganise their structures to ensure they are not negatively impacted by the changes. This would be of significant importance for individuals with a self-managed super fund given the potential tax implications of the fund becoming non-qualifying.

We would propose that individuals whose residency position would change following implementation of these rules would be given a grace period of, for example, two tax years, to continue to be treated under the old rules. We believe this would give them sufficient time to reorganise any impacted structures or assets and at the end of this period they would use the new rules to determine residency. Any new international moves should be considered under the new rules from then on.