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

***By Email:*** *taxboard@treasury.gov.au*

Dear Secretariat

**REVIEW OF THE INCOME TAX RESIDENCY RULES FOR INDIVIDUALS**

1. Thank you for the opportunity to provide comments on the Board of Taxation's ("**the Board**") Review of the Income Tax Residency Rules for Individuals Consultation Guide ("**Consultation Guide**") dealing with the proposals for the modernisation and simplification of Australia's residency rules for individuals for income tax purposes ("**Residency Rules"**).

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many taxpayers that would be impacted by the proposed changes to the Residency Rules.

3. Our submission contains high-level comments in response to certain proposals contained in the Consultation Guide, rather than providing answers to the specific questions posed therein.

**POLICY OF THE PROVISIONS**

4. We note the Board's overarching views regarding the Residency Rules are that they should be simple to apply, provide individuals with certainty regarding their residence status, be revenue-neutral and contain measures to preserve the integrity of the rules. We agree that these are important policy positions that should be taken into account when designing the governing rules. We therefore provide our comments with this context in mind.

5. As an observation, we believe that the formulation of the new rules are not likely to significantly change the residency status for the majority of Australian taxpaying residents. Accordingly, for those taxpayers that are on the fringe of being an Australian tax resident, one of the key objectives of the new rules will be to provide certainty and simplicity for both taxpayers and the administrators.

6. We do not believe that the new rules regarding tax residency should be drafted with a bias in favour or against a taxpayer being an Australian tax resident. We note that there are benefits from being an Australian tax resident (e.g. tax-free threshold, CGT discount) and costs associated with being an Australian tax resident (e.g. tax on income from worldwide sources, CGT on non-TAP assets) and therefore there will be revenue impacts on either side depending on the relevant facts and circumstances.

7. In our view, certainty and simplicity for taxpayers should be a priority within the overall policy context. We therefore support clear and concise rules for all taxpayers. Should integrity rules be required for a small sub-set of individuals, it will be important that such rules are limited to the small sub-set (rather than all taxpayers) in order to ensure that the final recommendations provide simple and clear provisions without the added level of complexity for all taxpayers.

**BRIGHT-LINE TEST**

**General comments**

8. We support the proposal for a primary test to be a bright-line test that will allow the vast majority of individuals to determine with certainty whether or not they are a resident or non-resident. We believe that a bright-line test should be based on the individual's physical presence in Australia (i.e. a days count test) rather their immigration or citizenship status.

9. In summary, we support the proposal that a bright line test be provided for determining both residency and non-residency. That is:

   9.1. residency (inbound test) – if an individual is present for 183 days or more during a 12-month period, they are deemed to be resident of Australia; and

   9.2. non-residency (outbound test) – if an individual is present for less than 30 days during a 12-month period, they are deemed to be non-resident.

10. To the extent that an individual does not satisfy either bright line test, then that individual would be required to apply a secondary test.

11. This physical presence basis is more consistent with the present 'resides' test and any broader policy of granting the Commonwealth additional taxing rights (as well as providing the individual with certain tax concessions) for those who benefit from or contribute to the Australian economy or society. Additionally, a primary test based on physical presence in Australia is consistent with rules adopted in other similar OECD jurisdictions such as the United Kingdom, United States and New Zealand.

**Inbound test**

12. We believe that the appropriate number of days to strike the right balance for a bright-line test is half the number of days in a given period and that this period should be a 12-month period given the annual income tax compliance obligations. Therefore, a 183-day test should be appropriate in this regard.

13. Additionally, we support a test similar to the New Zealand model which tests any 12-month period rather than arbitrarily testing from every 1 July. As individuals may establish the necessary connection with Australia at any time, it would not make sense for individuals who first arrive in Australia after 1 January to not be able to satisfy a bright-line test in relation to that first income year. This would be particularly so for students who arrive after January to commence their studies and workers who commence new roles where recruitment targets for start dates early in the calendar year.

14. Such a test would effectively be a 12-month rolling window which is backwards looking. We make some additional comments below in relation to part-year residency and other administrative issues.

15. We highlight that the 183-day test may extend the scope of the Residency Rules in circumstances which may not be appropriate (e.g. visiting professors, those on extended holidays). While the temporary resident rules and Australia's double tax agreements may work to alleviate any unfair outcomes, these are not a complete panacea. Any proposed modernisation of the Residency Rules should be road-tested for their application to various classes of individuals to identify any anomalous outcomes before a 183-day test for inbound individuals is adopted.

**Outbound test**

16. We acknowledge the Board's comments regarding the principle that residency is 'adhesive' whereby it is more difficult to cease rather than establish residency and agree that an individual should only be able to satisfy any bright-line test to be automatically treated as a non-resident if they have only spent a limited amount of time in Australia during a certain period. As per our comments above, any such testing period should be a rolling 12-month period.

17. However, we note some concerns with the Board's preferred model which contains tests for three categories of individuals:

    17.1. Previously a resident;

    17.2. Never previously a resident; and

    17.3. Working full-time overseas.

18. We understand that this is based on the UK model where the number of days is 16 and 46 in respect of the first two categories above respectively. We suggest that 16 days is too few as would exclude far too many individuals visiting Australia temporarily. Given Australia's remoteness to the rest of the world (in comparison to the UK), many people who choose to travel long distances to Australia will commonly

spend more than 16 days in the country (e.g. former residents visiting family over the Christmas and New Year period).

19. We submit that a maximum of 30 days is a more appropriate bright-line test for non-residency to provide certainty to many individuals visiting Australia temporarily. Our choice of 30 days is that it exceeds a 4-week period (whereby 4 weeks is often the amount of annual leave afforded to individuals on an annual basis).

20. Further, we suggest that categorising individuals based on either previously or never previously being a resident is both impractical and can lead to inappropriate outcomes. Such a distinction would require the individual and/or the ATO to test residency over the individual's entire life in order to decide which test to apply.

21. We agree there is merit in having a higher day count threshold (e.g. such as 60 days) for the outbound test where the individual has never been a resident of Australia or has not been a resident of Australia for a long period of time (say four to six years). We would be concerned if this required one to look back indefinitely. That is, an individual who permanently departed Australia and established a permanent home overseas, perhaps 30 years ago, should not apply a different set of rules to those that were never residents. In our view there should be a certain period of non-residency after which the 'adhesiveness' of former residency no longer sticks. For example, take the case of one individual who may have last been an Australian resident 30 years ago and has not returned since. The mere fact of their being a resident in the distant past should not make it more difficult to establish non-residency than an individual who has never been a resident.

22. We acknowledge that any bright-line test to allow an individual to cease residency by mere absence from Australia alone for 12 months (or just under 12 months) may result in different outcomes for Australian domiciled individuals when compared to the current rules. For instance, an individual may work overseas on secondment with an intention to always return to Australia where they may have a family and permanent home. If that individual's overseas income is used to largely support their family in Australia, they may still be said to be substantially benefitting from Australian society. Such individuals could arguably still be regarded as a resident of Australia under the current domicile test.

23. However, we still would submit that the 12-month rule would be an appropriate testing period and would not be susceptible to people gaming the system other than in the most extreme circumstances due to the following reasons.

    23.1. For the vast majority of taxpayers, with a connection with Australia, spending less than 30 days in a 12-month period would be an enormous lifestyle commitment from both an emotional and financial perspective.

    23.2. Where a taxpayer is absent for a period in excess of 12 months, it is more likely that a tax treaty would apply to allocate taxing rights to the foreign country in such cases.

    23.3. Impending amendments may result in taxpayers that become non-residents losing their CGT main residence exemption. For many taxpayers this could

result in a significant unanticipated tax impost which would operate as an extreme disincentive for becoming a non-resident.

23.4. We highlight that the rules would be more difficult to apply in a timely manner for the majority of individuals if this period were to be increased (e.g. by testing for presence over a 24-month period).

24. Lastly, we believe an overseas work test may be difficult to apply (e.g. definition of "work") and may lead to some unusual outcomes where family members who otherwise live together may have a different status merely because one works full-time and one does not. Furthermore, including a test based on full-time work or full-time equivalence may result in inadvertent outcomes for members of a family that are unable to work full-time due to other family commitments (i.e. which may lead to gender discrimination in practice).

**SECONDARY TEST**

25. We acknowledge that the current facts and circumstances test is practically very challenging to apply for taxpayers, advisors and the ATO alike and that inconsistent caselaw makes the Residency Rules especially difficult in arriving at a conclusion with any degree of certainty. We note that any secondary test that is based on a qualitative analysis, without a prescriptive methodology, would likely result in similar disputes as under the present rules in relation to individuals who may be on the borderline of residency.

26. The Consultation Guide suggests a secondary factor-based test that individuals will be required to apply if they do not satisfy either primary or secondary bright-line tests. We believe there is merit in adopting a test requiring a number of points based on a short list of objective factors with the appropriate weight or 'points' being allocated to each factor (e.g. a 100-point based test).

27. For example, one of those factors may be the time spent in Australia. If the 183-day test is failed by one day, this factor alone could be almost enough to make the person a resident (i.e. as all that would have been needed to pass the bright-line test would have been presence in Australia for one extra day). If there were a 100-point based test and if this factor were to be assigned (say) 75 points out of 100, the individual would be allocated 74.59 points based on their presence in Australia during the period (i.e. 182/183 x 75 points)).

28. If a points-based system were adopted, then we broadly agree that the Board could examine the types of factors outlined in the Consultation Guide in such a system. Existing definitions of dependant child and spouse could be adopted but there may be circularity in determining whether an individual's spouse is resident of Australia as their residency status may also depend on the test individual's residency status (unless this was based on satisfying the bright-line test).

29. We also note inherent problems in defining" home" or "available home". Such issues have often been the point of dispute between individuals and the ATO when applying the current rules. That being said, we believe it is possible to adopt a domestic definition of a home for the purposes of the tax residency provisions. For example, the term could be based on the individual's objectively ascertainable legal rights (e.g.

exclusive rights of use and enjoyment under a freehold or leasehold interest in residential premises). This may not capture those in the earlier stages of life where they rely on accommodation provided by parents or those in later stages of life where they rely on accommodation provided by their children. Potentially this could be addressed by only including homes of relatives (using the same definition above) where the person is a dependent of that relative. We note that any definition of a "home" would not be perfect and therefore appropriate consultation and testing would be recommended. That being said, we believe it would be possible to craft an appropriate definition of home to assist in the relevant analysis of this factor.

30. We do not believe that items such as Australian bank accounts or investment in Australian assets should be a factor that carries much weight, if any, given the mobility of capital and the global nature of many people's affairs in the present day.

31. We acknowledge that it would be simpler for the ATO and for Australian advisors if the factors comprising the secondary test were to be based on Australian rather than foreign circumstances. That is, if a points-based system were to be based on definitive yes/no answer – rather than a qualitative weighting of relevant circumstances – it is likely that the factors would need to consider Australian factors if it were to be simple to apply.

32. We reiterate our comments in paragraph 14 above and that the Board road-test the application of a secondary test to various classes of taxpayers to identify if such a proposal would result in any unintended or unfair outcomes.

**Interaction with tax treaties**

33. We note that the OECD and UN model tax treaties (under Article 4) contain tie-breaker rules based on internationally accepted concepts such as "permanent home" and "habitual abode". Given that there are a large number of inbound and outbound individuals that reside in Australia from non-treaty jurisdictions (e.g. Hong Kong, UAE), we do not believe relying on treaty concepts is appropriate for determining Australia's domestic Residency Rules. Further, this would mean that the test would be one based on facts and circumstances and present the same challenges as the existing Residency Rules.

**PART-YEAR RESIDENCY**

34. Further to our comments above that any bright-line test should be based on a rolling 12-month period rather than the income year, it follows that an individual should be able to become or cease to be a resident at any time in an income year (i.e. in such cases there would be part-year residency).

35. If an individual would be deemed to be a resident for an entire income year despite only first arriving in Australia part-way through the year, this would unfairly bring to tax any foreign source income or gains (or inappropriately provide tax concessions where such amounts are Australian sourced) derived before that individual's arrival, particularly where that individual had not considered moving to Australia on 1 July of that income year. Likewise, those who depart permanently part-way through the year should not continue to be taxed like a resident where events occur after that date but before 30 June.

36. We suggest that the commencement date should be the first date of presence in Australia that would fall within a 12-month period in which a 183-day primary inbound test would be satisfied. Further, we suggest that an end date should be the last date in a 12-month period where in which the relevant outbound test would be satisfied. We note that the end date suggested in the Consultation Guide relies on the individual being a resident for the entire previous income year and comment that this may not be able to be applied where the person was not a resident for the entire previous income year (e.g. first arrival in July with permanent departure 23 months later sometime in June).

37. These tests would be the most objective and simple to apply but we note that short-term presence in Australia prior to the "real" initial arrival or after the "real" final departure would cause that date and any intervening period to be treated as a period of residency (e.g. a holiday in Australia with a permanent immigration occurring 5-6 months later). We suggest that such anomalies may be unavoidable under a bright-line test without additional complexity. That is, separating out such periods to adjust the commencement and end dates would require an inquiry into the facts and circumstances surrounding the reasons for presence in Australia on these other dates and therefore could undermine the guiding principles of certainty and simplicity. Finally we note that, where applicable, Australia's double tax agreements would go some way towards dealing with this issue.

**INTEGRITY ISSUES**

38. We refer to the Board's concerns around manipulation of the Australian system by certain individuals who intentionally order their affairs to become "residents of nowhere" and escape tax on income from foreign sources. We understand that Board has raised these concerns particularly with respect to certain high-wealth individuals. However, we believe that this integrity concern is not likely to impact ordinary taxpayers as most individuals will require a physical presence in a particular jurisdiction for employment and business purposes.

39. We note that including complex rules in the definition of "resident" to combat such behaviour will undermine the principal of simplicity and certainty as this would require every individual to consider whether such rules apply to them and increase compliance costs by requiring all departing individuals to provide evidence of establishing residency elsewhere.

40. Furthermore, we suggest that the current rule in CGT event I1 would already address the vast majority of integrity concerns relating to departing individuals. Any difficulties with enforcement and collection of taxes from non-residents would not be made easier by any additional integrity rule in respect of the definition of resident.

41. However, if this is a real concern for the Board and if an integrity rule is to be introduced, we recommend that the Board only recommend a specific anti-avoidance rule targeted at certain taxpayers, where that rule does not need to be considered by the majority of individual taxpayers. For example, there could be a *de minimis* threshold that needs to be satisfied before any individual would have to consider the application of a specific integrity rule (e.g. similar to the Significant Global Entity rule applied to non-individuals). We believe this targeted rule would be more appropriate

in the circumstances, given our comments in the paragraphs above and the limited integrity concerns for ordinary taxpayers.

**OTHER MATTERS**

**Transitional Rules**

42. We suggest that any transitional rules allow a sufficient period of time for individuals to understand the rules prior to their operation and consider whether the new rules may cause their residency status to change (e.g. where presently not residing in Australia but domiciled in Australia with no permanent place of abode overseas).

43. For example, following its amendment, CGT event I1 contained a transitional rule for individuals that allowed them to continue to apply the former exemption for short term Australian residents who were in Australia at the time the amendment received royal assent. We suggest that the Board consider adopting similar transitional rules that allow individuals to preserve their residency status under the current rules for a period of time if the new rules, in and of themselves, would have the effect of changing that individual's residency status.

**Implications for Third Parties**

44. In most cases, the necessity to look backwards over 12 months to determine residency may not be too problematic for the purposes of self-assessing an individual's income tax liability for the income year. However, third parties may need to determine an individual's residency status at earlier points in time. These include:

    44.1. Employers who will be required to withhold amounts from salary and wages at the appropriate tax rates;

    44.2. The ATO when asked to provide a residency certificate to the individual under the CGT withholding regime (or for other purposes); and

    44.3. Related entities where the individual's residency status may affect whether they are a foreign controlled Australian entity subject to the thin-capitalisation rules or other Australian shareholders of foreign companies that may be subject to attribution if the residency of the individual determines whether or not that company is a controlled foreign company.

45. We suggest that it will be difficult for all individuals to have certainty regarding their residency status around the time that they first arrive or last depart from Australia if this needs to be determined at that time. We also note that these issues currently exist in the current law for inbound and outbound residents.

46. We suggest that any such concerns could potentially be dealt with by appropriate administrative practice by the ATO that allows for individuals to make an honest self-assessment based on their circumstances and intention at the time with protection against penalties and interest if this assessment ultimately turns out to be incorrect.

47. It would therefore be useful for the Board to acknowledge these administrative difficulties and make certain recommendations for dealing with this (either legislatively or administratively).

48. Also, we suggest that it would be useful to establish processes for those obtaining visas or becoming citizens to also apply for a TFN rather than merely passing along information about that individual to the ATO. This could reduce duplication of red-tape that may require the individual to establish their identity again and would allow for better enforcement of the tax laws in respect of those who enter Australia.

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We would be happy to discuss any aspect of our comments with you. Please contact Denise Honey on (03) 8610 5401 or Alexis Kokkinos on (03) 8610 5170

Yours sincerely

D J HONEY
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