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

Sent via email to: taxboard@treasury.gov.au

26 October 2018

Dear Sir/Madam,

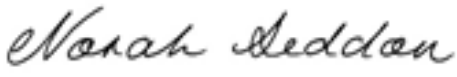
Review of the income tax residency rules for individuals – PwC's submission

We welcome the opportunity to provide comments to the Board of Taxation in relation to individual income tax residency reform.

We strongly support any reform to the rules for determining the Australian tax residence of individuals where the reform brings more certainty and simplicity for affected individuals, employers and the Australian Taxation Office (ATO) while maintaining the integrity of the system. Our comments and responses are set out in Appendix A.

PwC are happy to discuss our comments and responses with you further and we are grateful to have representatives of PwC involved in the consultation in relation to the proposed reforms.

Yours sincerely



Norah Seddon
Partner
Tax & Legal
norah.seddon@pwc.com
02 8266 5864

Judy Sullivan
Partner
Tax & Legal
judy.sullivan@pwc.com
02 8266 0197

Appendix A: Board of Taxation's Questions

Policy statement

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

Yes. The wording draws a clear link between time spent and ties to Australia when assessing whether an individual is a resident of Australia.

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 statement does not specifically reference how the residency rules address the tax policy objectives of simplicity, equity, efficiency and integrity, but arguably it should not need to. These objectives should be evident in the design of the actual residency rules themselves.

It would be difficult to add wording to this general statement which would help taxpayers and the ATO understand whether a particular outcome is intended or the result of tax avoidance, given the breadth of possible circumstances in which the residency rules will be applied.

Bright-line test

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?

If the bright-line test is clearly and reasonably defined, it would provide simplicity, and would greatly improve certainty for the majority of taxpayers.

Including integrity measures in the bright-line test should be balanced with having a test that provides simplicity and certainty. The higher the number of specific integrity measures that are included in the bright line test, the less simplicity and certainty there will be in the test. The bright-line test should focus on providing simplicity and certainty for the majority of taxpayers rather than being developed for a minority of cases where there may be integrity concerns.

We also note that simplicity and certainty is needed also by the employers of the taxpayers so that the employer can meet its obligations for resident employees. The bright-line test should allow employers to have clarity on the residency of their employees based on objective facts available to the employer.

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 are of the view that the bright-line test should be a quantitative test only for simplicity and certainty. Adding other tests involving qualitative assessments, whether as alternatives to a day

count test or in some form of combination, brings a degree of uncertainty and complexity.

Only home test

It is common for globally mobile employees and individuals to have homes in different countries, so this factor may not be determinative. It would also introduce a qualitative element to the bright-line test, being the need to consider what is a home.

Full-time work in Australia test

In the global workplace, it is very common for taxpayers to work in more than one location. Guidance would be needed to determine what "full-time work" in Australia means - this brings with it added complexity. Does full-time work in Australia mean physically working in Australia or merely working for an Australian employer regardless of location?

Again, this would introduce a qualitative element to the bright-line test which would reduce the simplicity of and certainty from the test.

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

As a preliminary comment, in order to count the 183 days, we recommend that the arrival date in Australia and the departure date from Australia are excluded for the purpose of the 183-day period count. Only a full day in Australia should be considered.

There are three common periods of measurement of the 183-day period:
- 183 days in a calendar year;
- 183 days in the Australian tax year; and
- 183 days in any 12-month period.

If the first or third options are adopted, there is a forward looking element to the test which can result in some uncertainty for taxpayers who are required to lodge their Australian tax return, prior to the 183 day requirement being satisfied.

In our view it would be preferable to calculate the 183 days threshold per Australian income tax year, as this would be the simplest to apply. While this may allow a taxpayer to be present in Australia for up to 365 days split over two income years and be considered a non-resident of Australia (subject to the outcome of the factor test), they would also be subject to non-resident tax rates for each year. In addition, Subdivision 768-R of the *Income Tax Assessment Act 1997* would operate in many circumstances to result in the same income being charged to tax.

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?

Temporary residents and working holiday makers should be no less or no more impacted than other Australian residents.

We note that the Board recommended in its August 2017 Report that the temporary resident tax concessions be limited to four years and that non-resident income tax rates should apply to temporary residents.

It is worth noting that some individuals are eligible for a visa of four years with indefinite renewal. This is on the condition that their occupation is listed on the Medium and Long-term Strategic Skills List (MLTSSL) or on the Regional Occupation List (ROL). In this context, changing the rules related to the temporary resident tax concessions would not align with immigration rules.

Putting a limit on the temporary residence concessions would also be contrary to the purpose for

introducing the temporary residence concessions in the first place. Paragraph 1.64 of the Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No. 1) Bill 2006* states that the policy objective of the temporary residence concessions is to attract internationally mobile skilled labour to Australia and to assist in the promotion of Australia as a business location, by reducing the costs to Australian business of bringing skilled persons to work in Australia. Imposing higher non-resident tax rates would also be contrary to this purpose.

We are also of the view that in relation to temporary residents, where they do not have their residency tie-broken to another country, they should be taxed on the basis that they are residents of Australia (i.e. resident tax rates should apply).

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 outside Australia?

As noted in our response to question 4 above, the concept of "home" brings a qualitative element into the test, and resulting complexity. In our view, the bright-line test should be a quantitative test based on days only.

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?

Subject to defining the actual days that form the basis of the proposed day-count tests, the tests strike an appropriate balance between simplicity and integrity. The proposed day-count tests should be simple in order to be applied consistently by taxpayers. The UK's automatic tests, for example, are significantly more complicated, and are not easy to apply in practice.

In relation to design principle 5 (resident of nowhere), introducing measures to address this point this has the potential to complicate the position for many taxpayers who go to countries which have a bright-line test for establishing residency. For example, if a taxpayer transfers to the US for 5 years, and departs Australia in September, they may not become a tax resident of the US until 1 January the following year. They would need to report their US source income for the period September to December and then claim a Foreign Income Tax Offset (FITO) in order to ensure that they are not double taxed.

In addition, the concept of residence of nowhere may be problematic if the foreign country does not adopt the concept of tax residence because the country does not impose tax on income. Currently, if a taxpayer goes indefinitely to a country that does not have the concept of tax residence because the country does not impose tax on income, they may break Australian residence from the date of their departure. We believe the position should be the same under the proposed residency rules.

In order to enhance the simplicity and certainty from the bright-line test, we recommend that flowcharts and examples be included with any proposed changes to illustrate how the proposed rules would work in practice.

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

For the same reasons given in our response to question 5 above, we recommend calculating the days count for outbound individuals per income tax year for simplicity.

Also, we would recommend that the travel dates (departure date and return date to Australia) be excluded for the purpose of the day period count. Only full days in Australia should be considered.

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

If the bright-line test for individuals who have been Australian resident, but are working full-time

overseas is set at less than 31 days working, or 61 days total in Australia, it is possible that more taxpayers will be able to break Australian tax residence, and that reliance on the section 23AG exemption will decrease.

Secondary test

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

If a taxpayer does not meet the bright-line test and so they are not automatically a non-resident of Australia, the factor test needs to be considered. If more factors are weighted towards Australia, then the taxpayer will be a resident of Australia under the factor test.

We also note that the test considers only the connections with Australia and not the taxpayer's connections with other countries. Where a taxpayer is also a resident in a country with which Australia has a treaty, the relative weighting of these connections will be considered and impact on the individual's tax residence decided upon by the application of the treaty. Where the taxpayer is also a resident of a country with which Australia does not have a treaty however, the factor test focussing solely on connections with Australia may result in taxpayers who have closer connections with the foreign country being an Australian resident.

We suggest that the factor test compare the taxpayer's connections with Australia to their connections with other countries in determining the taxpayer's tax residence.

Time spent in Australia

This is an appropriate factor to include.

Immigration status

This is not the most appropriate factor. In the case of Dempsey v FC of T 2014 ATC 10-363 , Logan J states nationality should not be relevant to determining residency:

> *"...one of the criteria which appears in the checklist is nationality. With respect, we consider that the adoption of this criterion as one indication of whether a person "resides" in Australia is apt to mislead. Nationality is pertinent to the determination of domicile, which is a separate legal concept from residence. Nationality doubtless confers a right of residence but whether or not that right is exercised in circumstances that admit of the conclusion that a person is a "resident", as opposed to a lawful visitor, is quite another thing. Further, it has been observed that a person may become a resident "completely against his will".*

In addition, this test may be complicated or redundant in the case of taxpayers who have dual citizenship or who are permanent resident in another country.

Family, Australian accommodation and economic ties

In relation to family, we recommend that the Board give consideration to whether this applies to immediate family, extended family, independent children, relatives etc. In relation to Australian accommodation, this should refer to "available" accommodation only.

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

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

This should be considered in addition to the time spent in Australia.

The answers on immigration forms upon arriving or departing Australia

As immigration forms are no longer required for people departing Australia, the weight of this factor is of less relevance. In any event, recent case law indicates that the answers given on immigration forms should not be a strong factor when considering residency.

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

This is a factor which should be considered. However, further guidance should be given on what it means to "establish a home".

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

We are of the view that this is a factor which should be considered.

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

In our view, this is a factor which should not be considered. For example, a taxpayer may not inform the relevant Department due to an administrative oversight. If they have been overpaid benefits, they will be required to repay them.

Whether accommodation in Australia has been effectively abandoned (ie, the extent to which accommodation is actually available)

We note that Australian accommodation is already a listed factor.

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

Maintaining bank accounts in Australia

Merely maintaining Australian bank accounts should not be viewed as maintaining strong economic ties to Australia. For example, a taxpayer with a small number of bank accounts would typically keep these bank accounts open in Australia to facilitate transactions (e.g. receiving Australian rental income, paying obligations in Australia). They should not be viewed as having strong economic ties to Australia because of this factor.

Maintaining an ABN in Australia

Maintaining an ABN in Australia should not necessarily be viewed as maintaining strong economic ties to Australia. For example, a taxpayer who has not cancelled their ABN, but who is no longer carrying on an enterprise in Australia, should not be viewed as having strong economic ties to Australia because of this factor. However, if the ABN is actively used by the taxpayer while carrying on business in Australia, this would be a factor.

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

This should be a factor when determining economic ties to Australia. For similar reasons, employment in Australia should also be a factor when determining economic ties to Australia.

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

This should be a factor to be considered when determining economic ties to Australia.

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

It would not be necessary for this to be a factor if the level of investment in Australia is one of the other factors.

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

In order to satisfy the Australian accommodation factor, we are of the view that:

- The taxpayer must own a home or rent a home in Australia; and
- This home must be available to them or their family.

We recommend objectivity to these tests to avoid complexity inherent in a broad definition such as "having a home available". An example of this complexity was evidenced in *Tan v Federal Commission of Taxation* [2016] AATA 1062.

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

In order to satisfy the Family factor, we would suggest that a taxpayer must have a spouse and/or dependent children (under the age of 18) located in Australia. Independent children, parents, siblings, relatives and friends should not be considered. Guidance would need to be provided in relation to separated couples.

Under this approach, it would be expected that outbound single individuals without dependent children would not have strong family ties to Australia.

16. At what level should the resident and non-resident 'time spent' factor be set (ie, how should they interact with the primary bright-line tests)? Should they be spread over a medium term (ie, 2 to 3 years)?

Similar to the UK, it would be preferable for the time spent factor to be considered over a two-year period (e.g. days over a certain number in either of the previous two years) for integrity.

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

In relation to a factor which considers the length of a taxpayer's stay in a single overseas country, this factor could be satisfied if the taxpayer were present in Australia more than any other single country.

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

In line with the general statement, *prima facie* it would be fair and equitable to base residency decisions on the ties and time spent in Australia. Ultimately, whether this results in fair and equitable outcomes in practice will depend on where the bar for each of the factors is set.

19. 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?

Whether this interaction provides appropriate results, will depend on an individual taxpayer's circumstances. We suggest that consideration is given to example situations when developing the proposed residency tests to ensure that there are no unintended outcomes from the proposed approach.

20. 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?

We are supportive of the Board's preliminary view that if a taxpayer was a resident in the preceding income year, a set number of X or more factors must be satisfied to establish residency, and that if a

taxpayer was not a resident in the preceding income year, a higher set number of Y or more factors must be satisfied to establish residency as it is simpler to apply than the UK approach.

We note that it is possible to balance integrity in the absence of the tiered approach by reference to where the bar for each of the factors is set.

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

A "points" style approach would bring added complexity in practice, and may not make a material difference to the final determination.

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

Such an approach could be considered. It would be consistent with the approach taken, for example, in the US. If a taxpayer is a dual resident of Australia and the US, but has their residency treaty tie-broken to Australia, the US treats the taxpayer as a "Non-Resident Alien" (NRA).

Integrity: resident of nowhere

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

The integrity rules for residency should effectively be built into the bright-line test and the factor test. For more complex integrity concerns, the general anti-avoidance rules contained in Part IVA should be considered rather than adding additional complexity to the residency rules.

24. 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?

None noted.

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

None noted.

26. 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 believe that a strict citizen-based residence test or a remittance based regime would bring added complexity which is inconsistent with the guiding policy principles for designing the new residency rules.

The superannuation test: options for reform

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

Yes. No further comments to add.

28. Do any of the international comparisons provide a clear guide for reforming the

superannuation test?

No comments to add.

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

No. This is not consistent with the approach taken by most countries.

Part-year residency

30. Should the new residency rules include part-year residency provisions?

Yes. The new residency rules should include part-year residency provisions.

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

We believe that the above design features provide a reasonable mechanism to determine split year income periods.

However, in relation to the end date for residency, the Board proposes that this should generally be the last day in which an individual is in Australia in an income year, where that individual was a resident for the entire previous income year. We note that if a taxpayer were to depart Australia on say 10 July (after having been a resident the entire previous income year), but returns for a short trip between 28 to 30 June the following year, it would appear to be incongruous to conclude that they would be resident for the entire year.

The US, in relation to non-US citizens, allows up to 10 days of further presence to be ignored, provided they have a closer connection to another Country. A similar requirement should be considered in order to avoid the complexities of claiming a FITO in Australia or a foreign tax credit in the US for Australian workdays or using the tie-breaker test in Australia's double tax treaties to alleviate double taxation.

Consideration could also be given to aligning the residency start and end dates with the first or last day that the taxpayer is in Australia holding a visa that gives them a right to reside in Australia. This would appropriately exclude any days on genuine business visits or holidays before or after the residence period in Australia.

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

See our response to question 31 above.

Transitional rules

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

The current Australian individual residency rules have been in place for a long time, so the proposals represent a fundamental change. This will have a significant impact on both individuals and on employers. In this context, we would recommend a long implementation period (i.e. between 18 and 24 months).

As an example of timeframe, if the new rules were announced in May of Year N, the law would receive Royal Assent in Year N+1 and the application of the new rules would apply from 1 July of

Year N+2.