The Tax Institute

22 September 2023

Assistant Secretary, Personal and Small Business Tax Branch
Personal and Indirect Tax and Charities Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: individualtaxresidency@treasury.gov.au

Dear Assistant Secretary,

Modernising individual tax residency

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the consultation paper on modernising the individual tax residency rules (**Consultation Paper**).

In the development of this submission, we have closely consulted with our Large Business and International Technical Committee, Small & Medium Enterprises Technical Committee and Taxation of Individuals Committee to prepare a considered response that represents the views of the broader membership of The Tax Institute.

While tax residency is generally relatively straightforward for the majority of taxpayers, the existing rules are complex for those at the margins. This uncertainty leads to increased compliance costs for taxpayers and more frequent disputes with the Australian Taxation Office (**ATO**).

The Tax Institute supports the development of the new framework for the individual residency rules where the reform brings certainty and simplicity for affected individuals, employers, and the ATO, while maintaining the integrity of the system. We consider it crucial that the proposed rules are appropriately designed in alignment with existing policy settings and balanced against broader priorities.

Our comments in this submission are limited to the proposed 45-day threshold, and the factor tests. We consider that the 45-day threshold is too low and should be replaced with an at least 60-day threshold. In relation to the factor test, we consider that some of the factors proposed are not appropriate tests for determining individual tax residency, and that, in any case, a weighted model rather than a strict '2 of 4' factors should be applied.

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It is also The Tax Institute's view that any reform to the individual tax residency rules would be well supported by the reinstatement of the former breadth of the foreign employment income exemption contained in section 23AG of the *Income Tax Assessment Act 1936* (**ITAA 1936**).

Our detailed response is contained in **Appendix A**. We have attached in **Appendix B** our earlier submission to the former Government, regarding the Federal Budget 2021-22 announcement of measures proposing to reform the individual residency rules (**2021 Submission**).

In our 2021 Submission, we set out in detail our concerns regards the recommendations made by the Board of Taxation in its 2019 Report titled 'Reforming Individual Tax Residency Rules – a model for modernisation' as well as a practical alternative approach which we still consider to be an appropriate option if reform of the individual tax residency rules is to proceed.

Our 2018 submission to the Board of Taxation regarding its 2018 Review of the Income Tax Residency Rules for Individuals (**2018 Submission**) is referred to in our 2021 Submission and provides further information on our views on the factor test, among other matters. Our 2018 Submission is attached in **Appendix C**.

Our comments in this submission should be read together with our 2018 Submission and 2021 Submission.

We note that our 2021 Submission endorsed the corresponding submission made by the Taxation Committee of Business Law Section of the Law Council of Australia (**Law Council of Australia**). We have had the benefit of reviewing the Law Council of Australia's draft submission in response to the Consultation Paper and we continue to share and endorse those views.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact The Tax Institute's Senior Counsel – Tax & Legal, Julie Abdalla, on (02) 8223 0058.

Yours faithfully,

Scott Treatt

General Manager,
Tax Policy and Advocacy

Marg Marshall

President

APPENDIX A

We have set out below our detailed comments and observations for your consideration.

45-day threshold

The Tax Institute recommends that the 45-day threshold be replaced with a higher threshold of at least 60 days.

We consider that the proposed 45-day threshold is too low. We acknowledge that it is proposed that individuals would be subject to the suggested factor tests where they meet the 45-day threshold. In addition, in our view, the proposed framework should provide concessions and specific policy settings to carve out certain categories of individuals such as genuine visitors to avoid inappropriate outcomes.

It is worth noting that the minimum period of stay granted under a visitor visa is currently 3 months from the date of arrival. That is, during each entry into Australia, visitors are allowed to stay for a continuous period of 90 days. Under the proposed rule, and without proper exclusions, genuine visitors could commence being an Australian resident from the 45th day of their stay. This is an anomalous outcome and may deter visitors from staying the entire period permitted under their visa. As acknowledged in our 2021 Submission, practical issues will arise with any threshold based on days. Accordingly, we recommend that flexibility should be built into the law to address unforeseen and extraordinary circumstances, such as restrictions on free movement due to lockdowns over the course of the COVID-19 pandemic. At the same time, the law should provide limited scope for flexibility in administration in those circumstances.

Factor test

As noted in our 2021 Submission, we are concerned that the four proposed factors do not resolve the complexities at hand, and we consider the two-factor threshold for achieving residency status to be inappropriate based on the current proposed four factors.

A mere 'right to reside in Australia' is not an indicator of where an individual actually lives or is settled — the key consideration for residency. It would be beneficial for this factor to be removed entirely and replaced with a more relevant consideration. Where an individual has family or friends in Australia, the individual will usually have access to Australian accommodation. Accordingly, it is too simple for an individual to meet '2 factors' without there being proper consideration of factors relevant for residency.

The relevant factors should all be easily verifiable and have flexibility and scope to account for the practical circumstances of modern life. There may be some merit in exploring a weighting system as a secondary factor-based test. If the Government is to continue with the concepts as proposed by the Board of Taxation, we strongly recommend that a weighting system is adopted, rather than a 'black and white' '2 of 4' factor test.

Interaction with Australia's double tax treaties

Australia's double tax treaties not only operate to allocate taxing rights and avoid the imposition of double taxation, they are also a demonstration of a relationship and understanding between Australia and other States. With limited exceptions, our double tax treaties take precedence over our domestic law and this is appropriate given their objectives.

The criteria under the factors test should align as closely as possible with those taken into account in the tie-breaker tests for determining individual tax residency contained in Australia's double tax treaties.

Where the 45-day threshold is applied with the factor test (particularly as currently proposed), or even when either of these tests are considered in isolation, more individuals will be required to seek professional advice on the application of the tie-breaker tests, where they otherwise would not be required to do so. This will unduly increase compliance costs for many individuals who should not naturally fall within the scope of the Australian tax residency rules.

Consistency with the tie-breaker tests to the extent possible will provide greater certainty and mitigate the need for individuals to seek professional advice on the application of multiple rules to their circumstances, particularly where they should not otherwise have cause to do so.

Foreign employment income exemption

In the 79-year period from 1930 to 2009, there were only 25 court and AAT cases on individual tax residency. However, in the 10-years from 2010 to 2020 there were 56 cases on the residency of individuals and associated issues. Most of the recent litigation on residency matters has been in relation to individuals working overseas who sought to have their foreign earnings not to be taxed following the 2009 changes which greatly restricted the availability of the exemption for foreign employment earnings under section 23AG of the ITAA 1936.

Prior to its amendment, this exemption was a relatively simple way of addressing income earned by Australian tax resident individuals during overseas service or employment. The narrowing seemed to be the catalyst for the change in behaviour that led to several taxpayers attempting to argue that they were non-residents for tax purposes.

Reinstating the former breadth of the foreign employment income exemption, and addressing prior compliance concerns in its redrafting, would:

- reduce both the number of private binding ruling applications made to the ATO, and the number cases going before the AAT and the courts;
- be completely consistent with the existing approach taken for companies in respect of foreign sourced active income; and
- encourage the international movement of people and the associated knowledge-transfer benefits that generally arise.

The outcome for the revenue in many (if not most) cases is a little different to assessing the foreign income and providing a credit but the compliance cost imposed on the individual is significant.

Alternative approach

We have suggested an alternative approach in **Appendix B** to our 2021 Submission. The proposed alternative builds on existing law and principles, and in our view, lends itself to fair and logical outcomes. In particular, our proposed approach:

- acknowledges the significant diversity in the population;

- provides significantly more expatriates with greater certainty regarding their residency status;
- builds in sufficient flexibility to allow a weighting of factors where the work and accommodation factors are not met;
- is consistent with the approach in many of Australia's double tax agreements;
- provides certainty regarding the time when residency commences and when it ceases;
- addresses the challenges of residents of nowhere by specific provision rather than increased complexity in a factor test; and
- allows for the integrity of the system to be maintained through the 'resides' test where individuals attempt to manipulate the day thresholds to their advantage.

APPENDIX B

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APPENDIX C

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