Tax & Super Australia

Taxpayers Australia Ltd T/A
Tax & Super Australia
ABN: 96 075 950 284

Board of Taxation Secretariat

The Treasury – Sydney Office

2 November 2018

Subject: Submission regarding review of tax residency rules for individuals

Further to your request for interested parties to contribute to consultation on the above, Tax & Super Australia, on behalf of its members, welcomes the opportunity to comment in relation to the Board's review, and appreciate the Board granting an extension of time to submit.

A summary about our organisation is contained in Appendix 1. Our members, who are mostly registered tax agents, have over an extended period voiced their concerns about the difficulties of correctly interpreting and applying certain extremely complex tax legislation including the question as to whether a taxpayer is a resident of Australia for tax purposes.

Our submission has been driven by the priorities and concerns of our members, while being premised on an overarching objective of achieving a suitable balance of fairness, efficiency and simplicity in the administration of the taxation system. We acknowledge that the Board's consultation guide contains 33 discussion questions – however, rather than address each single question, we have broadly commented on select issues based on our understanding of our stakeholder concerns.

We agree with the Board that individual tax residency rules can be uncertain and subjective, thus imposing an inappropriate high compliance burden on some taxpayers.

We are also in favour of the Board's recommendation to replace the current rules with an improved and simplified residency test.

We support the Board's preferred approach of a primary "days count" bright line test that automatically determines the residency status for most individuals and a secondary test, where warranted, that considers an individual's circumstances which leverages some existing case laws as well as some of the laws used in the international space.

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Discussion:

Currently the ATO provides an online tool to assist taxpayers in determining their residency status for tax purposes. Our members have found that when using this tool, including for those who do not necessarily have particularly complicated tax affairs, the decision tool can result in being unable to determine residency status based on the information provided. This highlights that the set of factors the ATO uses to determine residency are unable to provide a concise result.

In some cases when using the ATO online tool, it is considered that a reasonably arguable position could be taken either way based on the current ATO guidance and case law available. To obtain certainty in these situations, would then require applying for a private binding ruling. This would result in obtaining the ATO's interpretation of the factors to be considered to determine residency. To then pursue a reasonable differing view would require a costly and time-consuming process of objecting, and if unsuccessful, determining whether to continue on appealing or requesting a review of the decision through the appropriate channels. Taxpayers in this situation deserve more certainty from the tax system, from the outset regarding their residency status.

Our suggestion:

We already have a 183-day test included in subsection 6(1) of the ITAA 1936 and this could arguably be enough to provide the simplicity and certainty being sought for taxpayers who meet "de minimus" thresholds, where their situation doesn't warrant the complexity of complying with the rule, "usual place of abode is outside Australia".

Currently there is *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures no. 2) Bill 2018* before the Senate, which includes removing entitlement to the capital gains tax main residence exemption for foreign residents. The future administering of this law, if passed, will be dependent on a taxpayer's residency status. Referring to the Institute of Chartered Accountants in Australia and New Zealand's comments on the exposure draft for this bill, dated 18 August 2017, it stated that **"**Determining whether an individual is a resident or a foreign resident at a point in time as required by the ED is not clear cut despite the simplicity of the examples in the EM"**.** While uncertainty continues to exist, this will result in ongoing complexities of administration. Simplified individual residency test rules would assist in more efficient administration of current and proposed future tax laws, such as the abovementioned bill, if passed.

Members of our organisation find that when tax laws apply a "de minimis" rule or threshold applicable (i.e., say for those where the income in question exceeds a certain dollar threshold), can assist in simplifying the administration of tax laws, particularly in situations that do not warrant complexity.

It may be that such "de minimis" rules or thresholds could be introduced where the current complexities don't pose any significant risk on Government revenue. For example, IT 2650 "Income tax – permanent place of abode outside Australia" provides guidance for determining whether individuals who leave Australia temporarily to live overseas cease to be Australian residents for income tax purposes during their overseas stay.

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Paragraph 25 indicates: "As a broad rule of thumb, a period of about 2 years or more would generally be regarded by the ATO as a substantial period for the purposes of a taxpayer's stay in another country. It must be stressed, however, that the duration of the taxpayer's actual or intended stay outside of Australia is not, of itself, conclusive and needs to be considered with all the factors in paragraph 23 above".

At paragraph 5 of the ruling, when referring to those factors, it states "…it is **not possible** to provide conclusive rules for determining the residency status of individuals leaving Australia temporarily. The weight to be given to each factor will vary with individual circumstances of each case and no single factor is conclusive". Not having conclusive rules provides uncertainty, complexities and subjective interpretations.
While the ruling indicates that it is not possible to provide conclusive rules, "bright line" tests such as recommended by the Board of Taxation would make it possible to have conclusive rules, which would assist in providing certainty and simplifying tax compliance, particularly in situations not warranting complexity, where maybe thresholds could be applied.

The 2-year rule of thumb, mentioned in IT 2650, could become a "bright line" acceptable time frame for a taxpayer to be regarded as a non-resident, if certain threshold requirements are met (i.e. a "de minimis" rule, for taxpayers whose situation doesn't warrant the complexities of the current laws and costs of seeking further guidance).

The recent progress of legislation that resulted in the passing of the "*Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Act 2018*" could be looked at as guidance for any proposed law or guidance changes to the individual residency tests. Previous determinations on both the "carrying on a business" (for the above legislation) and the residency rules suggested turning to case law, however this can be extremely difficult for guidance when different weightings are given to different factors depending on each individual circumstance.

As with the decision making when passing of the *Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Act 2018* and removing the subjective "carrying on a business test", it may be that a "bright line test" for determining individual residency status can also provide a more concise method for taxpayers to obtain certainty regarding their residency status, particularly in situations where the circumstances do not warrant the complexities of reviewing case law to determine the position.

We do wish to comment on the subsequent effect that the narrowing of eligibility to section 23AG of the ITAA 1936 has had since its amendments 2009. Your report of August 2017 (on page 58) indicated the Board "considers that this previous exemption provided practical certainty". Also, on page 60, it indicated that "while the Board does not recommend the reversal of the 2009 amendment, there is significant complexity involved in complying with its narrowed scope in practice".

Our members have found that wholesale tax changes can sometimes result in further complexities down the track, rather than achieving the result of simplifying previous rules. While the residency rules we currently have in place require more certainty and simplifying for taxpayers, could it be that some "tweaking" may achieve the desired result, rather than "wholesale" changes being made.

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Suggestions in this regard include:

- Reinstating section 23AG in its original format prior to the 2009 amendment.

- "Tweaking" subsection 6(1)(ii) of the ITAA 1936, which currently includes reference to a taxpayer who has actually been in Australia more than one-half of the year of income (retain this), however modify the reference to "usual place of abode" to allow for thresholds (ie. that the "usual place of abode" test applies to taxpayers with a reasonable income threshold level that may warrant additional complexity to apply to their tax affairs). Above that threshold, the "usual place of abode" reference could continue to apply, with the requirement of complying with the current laws pertaining to residency.

We also wish to touch on the "factor weighting" reference on page 55 of your report, where you indicate a more prescriptive weighting procedure could be legislated where an individual could require a certain number of points to be regarded as either a resident or a non-resident, particularly as you have indicated that this has merit.

Suggestions in this regard, include:

- IT 2650 "Residency – permanent place of abode outside Australia" paragraph 5, factors to be considered (there are 6 factors). Could a weighting number or percentage be given to each factor, where if a taxpayer's individual circumstances result in a "weighting "number over say 50%, it is more likely and reasonably arguable (and accepted by the ATO), that the taxpayer's residency status has been reasonably determined by this "bright line" test.

- Again, these tests and thresholds could apply for taxpayers where their situation doesn't warrant applying the more complex incumbent residency rules. Ideally, the ATO online decision tool could then provide a certain result for those with non-complex affairs that meet a certain threshold test. You could say it is similar to the way that tax rules have been introduced in the past, distinguishing between small business entities and larger entities, and the simplified tax rules and concessions available where certain thresholds are met.

Some member feedback received indicates that while tax agents may feel they can comfortably provide the required advice on tax residency, the public find it hard to comprehend, for example, when working overseas, and being considered a resident of Australia for tax purposes and having to pay tax on income not derived in Australia. There appears to be high levels of incomprehension and confusion in the community on this issue, as they grapple with the current residency tax rules. (From your report, it appears that maybe section 23AG, prior to the narrowing of this law in 2009, assisted in alleviating this confusion.)

One member raised the point that in completing the 2018 individual tax return for a client, at item 20 "Foreign source income and foreign assets or property", was the question, "During the year did you own, or have an interest in, assets located outside Australia which had a total value of AUD $50,000 or more?" Uncertainty exists as to why this question is asked. If this is a figure to assist the ATO in identifying audit risk, could this figure be used as a "bright line" test for taxpayers when determining their residency status?

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One further point we wish to add is to underline the fact that individual residency rules need to be simplified. A recent case (*Harding V FC of T*, 8 June 2018), where at paragraph 7 of the case summary, the judge noted: "As is often the case in matters of this nature, the facts are not greatly in dispute save, perhaps, for the subjective intention of the taxpayer concerning issues relevant to his residency or place of abode". At paragraph 26 the judge went on to say: "There is no straightforward answer to the construction of the domicile test. Although I have reached a conclusion, as I must, it can be accepted that reasonable persons may differ as to the correct interpretation". When this is a conclusion reached at such a high level, it could be reasonably put forward that change in this regard is required.

We believe that our members require more certainty in determining individuals' residency status for tax purposes and we support changes in this regard that are fair, efficient and simple to administer.

We trust that the views contained in our submission are of value and that it will assist the Board of Taxation in its consultation process on the design of new residency rules.

On behalf of our members, we would be pleased to assist if any future opportunities arise for us to consult on this issue.

Should you have any further questions or require any clarification, please contact:

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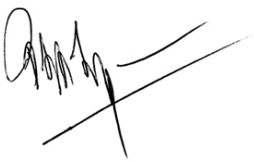
Yours Sincerely,



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APPENDIX 1:

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About Tax & Super Australia

Taxpayers Australia Limited trading as Tax & Super Australia is a not-for-profit organisation committed to a fairer and more transparent taxation system for every Australian taxpayer.

Our aim is to provide taxation practitioners, superannuation professionals, small businesses and individuals with up-to-date, informative and above all understandable information about Australian taxation.

As a community benefit organisation, Tax & Super Australia is independent and unaffiliated with any political or commercial groups, advertising or sponsoring organisations. We are a member-based organisation, and our loyalty is dedicated to our members.

Tax & Super Australia has been a trusted source of tax knowledge and expertise since 1919 – we are one of the original, if not the first, of such associations in the world.

Our membership and subscriber base comprise tax and superannuation professionals as well as individuals and small businesses. Our plain English approach means that information is not obscured by confusing jargon or heavy technical and overly academic language, while still ensuring that tax issues are comprehensively clarified.

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