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

Email: individualtaxresidency@treasury.gov.au

Dear Sir/Madam,

Modernising Individual tax residency consultation paper

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 173,000 members in over 100 countries and regions. We make this submission in response to the **Modernising individual tax residency** consultation paper on behalf of our members and in the broader public interest.

We make the following comments and questions for your consideration which we believe would further improve the efficacy of the new framework:

45-day threshold

1. *How many days in an income year should an individual with strong connections to Australia be able to spend in Australia before they are considered a tax resident?*

Prima facie, we submit it is incorrect to determine tax residency based on a set number of days. Although the period of physical presence or length of time in Australia is an important factor when considering whether someone is a tax resident, it is not a determinative factor on its own. The substantial body of case law on individual tax residency confirms it is necessary to examine the facts and circumstances of each case to arrive at the correct tax residency position, even if they have strong connections to Australia.

For example, where individuals live and work overseas but have their spouse and children living in Australia, under existing law, such individuals do not sever their Australian tax residency (see ***Iyengar's Case***[1] and Example 7 of Taxation Ruling TR 2023/1). However, under the proposed 45-day threshold test (see response to 9. below), if these individuals spend less than 45 days here, they will be considered as non-residents of Australia for tax purposes, on the basis they were tax non-residents in the previous income year. We believe this to not be the correct outcome.

Furthermore, we note that some individuals have been declaring themselves as tax non-residents of Australia, while their spouses and dependent children live in Australia and are tax residents here. The lack of **tax information exchange agreements** between Australia and many foreign jurisdictions means it is difficult for the Australian Taxation Office (ATO) to detect such outbound individuals with strong family connections to Australia. As such, these individuals can continue to 'maintain' their non-tax resident status by staying here for less than 45 days under the new framework.

[1] *Iyengar v FC of T* [2011] AATA 856, 30 November 2011

Therefore, we do not support determining tax residency based on the number of days an individual spent in Australia, especially where such an individual has strong connections with Australia.

Furthermore, the existing Commonwealth superannuation test applies to not just the taxpayer, it also applies to their spouse and children under 16 years. The proposed replacement 'Government Officials Test' should maintain the same application to the spouse and children of the taxpayer.

Despite the concerns raised above, if the government wants to include a test for residency based on a set number of days, we submit that 60 days is a more reasonable length of time to spend in Australia before an individual is considered a tax resident, than 45 days. This is provided their initial non-tax resident status is correct (see 2. below). The reason is the day count positions in the UK and New Zealand referred to in the consultation paper are both in respect of ceasing an individual's tax residency, not commencing residency.

2. *Do you consider that days spent in Australia under certain circumstances should be disregarded for the purposes of the 45-day count? If so, why should days be excluded in some circumstances and not others. Who would decide?*

As discussed above, our view is that the days spent in Australia are an inappropriate basis for determining tax residency. This is especially true for Australian nationals who return from overseas for temporary visits when they live and work overseas, but only if they are tax residents overseas. As raised in response to Q1., we do not support determining tax residency based on the number of days an individual spent in Australia while their family live in Australia and are tax residents.

On the other hand, Australians living overseas can stay here for more than 45 days when they return for holidays or visits and spend time with their extended family and friends. This could possibly be due to a family emergency or disruptions to their return for reasons outside of their control. They may also work here remotely from their normal overseas workplace. In these circumstances, we do not believe that such individuals should be considered tax residents of Australia simply because they have spent more than 45 days here.

Furthermore, even if such individuals are treated as tax residents based on the 45-day count, where a **double tax agreement** (DTA) exists between Australia and a foreign jurisdiction, then under the DTA tie-breaker provisions, with the tax treaty overriding domestic tax law, such individuals would be considered treaty tax residents of the foreign jurisdiction and treaty non-tax residents of Australia. Generally, income arising outside of Australia in these circumstances will be exempt from income tax. In addition, Australian tax may be limited under the treaty to a "treaty rate" on Australian source income, such as 10 per cent for interest and royalties, and 15 per cent for dividends income. This is much lower than Australia's non-resident tax rate. However, this tax outcome is not available for foreign jurisdictions with which Australia does not have a DTA. We believe this disparity in tax treatment between DTA jurisdictions and non-DTA jurisdictions is inequitable.

Please see examples 1 and 2 below which illustrate the difference in tax payable in a DTA jurisdiction (Singapore) and a non-DTA jurisdiction (Hong Kong).

Example 1 – Anna of Singapore, Singapore-Australia DTA:

Anna, an Australian national left Australia for work in Singapore five years ago and returned to Australia to visit her extended family during summer and spent 50 days here. She has $2 million in a fixed-term deposit In Australia and earned 5 per cent interest totaling $100,000 for the year.

Under the 45 days test, Anna is treated as a tax resident of Australia, but under the Singapore-Australia DTA tiebreaker provisions, she is a treaty tax resident of Singapore and a treaty non-tax resident of Australia. As such, the Australian resident tax rates and rebates apply on the basis that she is a resident of Australia under domestic law. Consequently, while Anna is a treaty resident in Singapore, she will only be subject to Australian tax on Australian income, in the same way as a non-tax resident, but resident tax rates and rebates apply. In general, income outside of Australia will be exempt from Australian tax. Furthermore, the treaty provides limitations on the extent of tax payable in Australia. Therefore, the interest income will be limited to a 'treaty tax rate' on Australian source income, which is 10 per cent or tax of $10,000. Where the interest income is taxable in Singapore also on remittance, as Anna is a tax resident of Singapore, a foreign tax credit should be available for the Australian tax paid.

Example 2 – Bella of Hong Kong, no DTA between Hong Kong and Australia:

Bella, an Australian national left Australia for work in Hong Kong five years ago and returned to Australia to visit her extended family during summer and spent 50 days here. She has $2 million in a fixed-term deposit in Australia and earned 5 per cent interest totaling $100,000 for the year.

Under the 45-day test, Bella is treated as a tax resident of Australia. As there is no DTA between Hong Kong and Australia, the Australian resident tax rates and rebates apply on the basis that she is a resident of Australia. Consequently, while Bella is a tax resident in Hong Kong, she will also be subject to Australian tax on worldwide income in Australia, in the same way as an Australian tax resident, and resident tax rates and rebates apply. In general, income outside of Australia will not be exempt from Australian tax. Therefore, the interest income will be taxed at resident tax rates or tax of $24,967 (2024 resident rates). As Bella is a tax resident of Hong Kong, interest income not derived from investing the funds of a business/real estate is exempt from taxation in Hong Kong.

As to the question of who should decide tax residency, the onus generally rests with the taxpayer to determine and prove their tax residency (as Australia uses a self-assessment tax system). However, given the concerns we raised in Q1. on individuals declaring themselves as tax non-residents of Australia when they live and work overseas and their spouse and children live in Australia, it is necessary for the ATO to make that assessment based on taxpayers providing evidence, including evidence of their tax residency declared in a foreign jurisdiction. We therefore suggest that the individual tax return could be updated with additional questions to ensure the ATO has sufficient information from taxpayers to determine/validate their tax residency. The questions could include:

- Whether the taxpayer has a spouse and/or dependent children living in Australia
- Whether the taxpayer is a tax resident of another jurisdiction when they claim to be a tax non-resident of Australia
- Whether the taxpayer or their spouse, or the taxpayer who is under 16 have either parent who is a 'Government Official'.

Factor tests

3. *Could any of the four factors be defined differently to better achieve the design goals whilst remaining objective and identifiable?*

In relation to the Australian economic interests, it would assist evaluation if a monetary amount were specified in the phrase "a bank account with an Australian bank with significant cash deposits". The reason is a 'significant cash deposits' is a relative term. It means different things to different people.

Apart from an interest in a family trust, we suggest it is important to include interest in a:

- partnership or joint venture
- private company
- self-managed superannuation fund or a specified amount in a retail or industry superannuation fund.

We believe the type of Australian assets should not be exhaustive under the Australian economic interests factor test, this is to align with existing case law.

4. *Are there other factors better suited to identifying individuals strongly connected to Australia in an objective, simple and certain way?*

No response to this question at this stage.

5. *How would any additional factors affect the proposed Factor Test, in particular the operation of the two-out-of-four aspect of the rule?*

No response to this question at this stage.

Commencing residency

6. *Does having three points of connection (i.e. being physical present in Australia for more than 45 days in an income year, together with two factors) strike the right level of connection to commence residency*?

Other than the issues we noted in response to questions 1 and 2, we agree that having three points of connection strikes the right level of connection to commence residency.

Ceasing short-term residency

7. *Does maintaining two points of connection to Australia (i.e. meeting two factors) strike the right level of connection to maintain residency in income years during which an individual is physically present for less than 45 days?*

No response at this stage, other than to suggest that the question could be rephrased as follows:

Does maintaining two points of connection to Australia (i.e. being physically present in Australia for less than 45 days in an income year and meeting less than two factors) strike the right level of connection to maintain residency in income years during which an individual is physically present for less than 45 days?

8. *If not, how should the Ceasing Short-Term Residency Rule operate to strike the appropriate balance between adhesive residency, certainty and simplicity?*

No response at this stage.

Ceasing long-term residency

9. *Does the Ceasing Long-Term Residency Rule strike an appropriate balance between increasing adhesiveness of residency for individuals with enduring ties to Australia while also providing a clear pathway to non-residency?*

As discussed in our response to Q1., where individuals leave Australia to work overseas but their spouse and children remain in Australia, under existing law, such individuals do not sever their Australian tax residency (see ***Iyengar's Case*** and Taxation Ruling TR 2023/1). However, under the proposed Ceasing Long-Term Residency Rule, such individuals could cease their Australian tax residency from the day following departure provided the stipulated conditions are satisfied (including less than 45 days in Australia). We do not support this outcome as it fails to consider these individuals' family ties in Australia.

Temporary residents

10. Is it appropriate to only treat a 'temporary resident' as a long-term resident if they have been a tax resident for six or more consecutive years? (Note that other individuals will be treated as long-term residents if they have been a tax resident for three or more consecutive income years.)

The introduction of the temporary resident rules was designed to attract internationally mobile skilled labour to Australia and to reduce the costs to Australian businesses of bringing skilled overseas workers onshore. An individual classified as a temporary resident can obtain the benefit of a number of taxation concessions.

As to whether it is appropriate to treat a 'temporary resident' as a long-term resident if they have been a resident for six or more consecutive years, our view is that the tax concession should not continue after temporary tax residents have been in Australia for three or more consecutive income years.

Given issues with the immigration and visa systems, such as the potential misuse by some foreign nationals, including students[2] and employers[3], with foreign individuals entering Australia and working and staying long term via temporary visas[4] and the inability to identify genuine temporary residents who do not intend to reside here permanently, we should not provide a six-year tax benefit to temporary visa holders. Tax concessions should be temporary for temporary residents and should align with other individuals who will be treated as long-term residents instead. That is, they are long-term residents if they have been tax residents for three or more consecutive income years. We believe this position may assist in improving the integrity of Australia's tax and visa systems.

Overseas employment rule

11. The Overseas Employment Rule allows individuals with enduring connections to Australia to immediately cease being a tax resident, thereby reducing the tax and compliance burden for those individuals and their employers. Do the settings strike the appropriate balance between facilitating the skill development of Australians through international experience while maintaining sufficient integrity?

As discussed in our response to Q9., we reiterate our concerns about the ability of some individuals to cease their Australian tax residency under the Overseas Employment Rule where these individuals have spouses and children living in Australia. We believe the better outcome in this situation should be that such individuals maintain their Australian tax residency even if they satisfy the conditions (including less than 45 days in Australia) under the Overseas Employment Rule.

12. The effect of the Overseas Employment Rule is to cause the individual to become a non-resident (and provide certainty for employees and their employers) rather than to exempt the overseas employment income. Is this the appropriate outcome?

We agree this is the appropriate outcome provided the Overseas Employment Rule achieves the best outcome - please refer to our concerns raised in response to Q9.

Other matters

13. There will be a need for transitional rules when moving from the existing residency rules to the new framework. How would you suggest these transitional rules operate? For example, how should the Overseas Employment Rule apply to individuals who are already partway through their overseas employment at the time the new residency rules come into effect?

To avoid complications and to provide certainty, individuals should determine their tax residency based on the existing rules at the time when they embarked on their assignment or employment, provided they have applied the

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[2] Hon Clare O'Neil, *Action to end rorts in international education*, Minister for Home Affairs, Joint media release, 26 August 2023

[3] Sanmati Verma, *Australia can't blame criminals and fraudsters for migration crisis*, The Age, 8 November 2022

[4] Ibid, "There are around two million temporary and bridging visa holders currently in the country, some staying for decades."

tax residency rules correctly. The proposed new framework should not have retrospective application when the new rules are enacted.

14. Do you have any other insights or observations to make about the framework?

The framework should consider the inclusion of a specific anti-avoidance rule for taxpayers who purport to cease Australian tax residency but where they have strong family ties in Australia. Such a rule should also cover where the individual does not take up tax residency in another jurisdiction. In these cases, the anti-avoidance rule should deem that they do not sever their Australian tax residency.

The inclusion of an anti-avoidance rule should lead to an improvement in the integrity of individual tax residency rules, reducing the incidences of taxpayers taking the position that they are not tax residents of Australia when they have immediate family in Australia. It should also address incidences where they are not a tax resident of any jurisdiction, i.e. when they self-determine they have ceased their Australian tax residency, and provide (possibly selective) facts that fit their non-tax residency positions in both jurisdictions. To support the ATO in such situations, we recommend Australia increase the number of tax information exchange agreements it enters into. Such agreements increase the probability of the ATO detecting such behaviour.

If you have any queries, contact Bill Leung, Tax Technical Advisor on (03) 9606 9779 or **bill.leung@cpaaustralia.com.au**.

Yours sincerely,

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