Residency in a global pandemic: advising the returning Australian

by Matthew Marcarian, CTA, Principal, CST Tax Advisors

Principles of tax residency can be notoriously difficult to apply in practice, sometimes even in quite simple cases. The recent decision in *FCT v Addy* demonstrates that. In *Addy*, the Full Federal Court unanimously reversed the decision of the single bench in relation to whether a taxpayer was a resident according to ordinary concepts and how the 183-day test should apply. During the COVID-19 pandemic, Australians living overseas have returned in droves, often temporarily, without necessarily considering the tax implications. Many are waiting out the pandemic in Australia. What does this mean for their income tax residence and how might practitioners advise on the complex issues that can arise? Given the inherent uncertainty in how tax residency laws apply, even in simple cases, the Commissioner should issue a practice statement clarifying how he would look to apply Australia's tax residency laws in a global pandemic.

Introduction

The extraordinary events of 2020 have seen hundreds of thousands of Australians[1] return to Australia, some permanently but many to wait out the COVID-19 pandemic.

When the Department of Foreign Affairs and Trade announced in March 2020 that Australians who wanted to return to Australia should do so immediately,[2] thousands of Australians living abroad took notice.

The action taken by one Australian expatriate family known to the author was typical. Almost immediately following the announcement, they locked up their home in a neighbouring country, made arrangements with their employers, and scrambled to catch a flight to Australia, happy to endure the 14-day quarantine directive announced by Prime Minister Scott Morrison on 19 March.[3]

For many Australians who live overseas, the decision to return to Australia will have been taken with only short notice given to family members, overseas landlords, employers and schools. The time normally available to plan for the issues that can arise with an international move may not have been available. In such circumstances, the potential income tax implications of returning to Australia are unlikely to have been of immediate concern. However, now that the 2021 tax year has commenced, returning Australians are likely to seek guidance from their advisers so that they can deal appropriately with their income tax obligations.

This article deals with the residency issues that practitioners will face with regard to clients who are in this predicament.

Will the client become a resident?

Usually, if a client becomes a resident of Australia, their income tax position will change significantly. If a change of residency is unplanned, a whole gamut of potential complications arises.

Depending on the circumstances of a client, ascertaining when a client becomes a resident can be one of the more difficult exercises in international tax. It is a task which requires careful consideration of the client's circumstances and a considerable degree of professional judgment. As Rich J said in *FCT v Miller*:[4]

> "In many cases, including most of those which become subjects of litigation … the question whether a person is a resident of a place … depends not upon the applicability of some definite rule of law, but upon the view taken by a tribunal of whether he comes within a field which is very loosely defined. The question is ordinarily one of degree, and therefore fact."

For the returning Australian, the three main tests[5] of residency are the common law test, the domicile test and the 183-day test.

The common law test, also known as the "resides test", is beguilingly simple. A person is a resident of Australia if they reside here, with the word "reside" taking its ordinary meaning.[6]

Under the domicile test, a person is a resident of Australia if their domicile[7] is in Australia unless the Commissioner is satisfied that they have a permanent place of abode outside Australia.[8]

As fundamental as the "resides test" is to determining residency, the domicile test is often just as relevant. It is not well appreciated, but for an Australian domiciled individual, whether or not they actually return to Australia will be a moot point if it becomes clear that they no longer have a "permanent place of abode" overseas.

Of course, it is usually the case that one follows the other closely, that a person will give up their overseas permanent place of abode as part of returning to Australia.

In everyday tax practice, one usually treats the returning Australian as becoming a resident on the day of their return to Australia. Rarely does the enquiry extend to determining when the client left or gave up their overseas residence. That is usually a common-sense approach, but there is danger in assuming that it is always the correct one.

While a global sojourn prior to returning to Australia is not a likely path in the middle of a pandemic, it is nonetheless a possibility that practitioners should be aware of. "Know your client" rings as true today as it ever did.

There are other types of "returns" to Australia which are not so straightforward. Many practitioners will have had client situations which could be described as "creeping returns". This is often characterised by the return to Australia of some but not all family members, with the main "income-earning" spouse still living and working overseas.

Such split family situations present challenging problems for advisers not only in relation to residency per se, but also in relation to the consequential treatment of international assets, companies or trusts that may be owned or controlled by members of the family.

The issues with residency have become even more complicated than usual because of the COVID-19 pandemic. This year, more than ever, the 183-day test will come into sharp focus and this is discussed later in the article.

For its part, the Australian Taxation Office has provided some limited guidance to Australian expatriates who find themselves back in Australia because of the pandemic. In answer to the question of "whether a person's tax residency will change as a result of returning to Australia due to COVID-19", the ATO's position is that, if a person is in Australia temporarily, for some weeks or months, because of COVID-19, they will not become an Australian resident for tax purposes as long as the person "usually lives overseas permanently" and intends to return there as soon as they are able.[9]

The ATO acknowledges that tax residency issues may be more complicated if a person ends up staying in Australia for a lengthy period and does not plan to return to their country of residency when able.

An inconvenient truth?

The difficulty for some returning Australians will be that, despite the well-documented ban on Australians travelling overseas, Australian citizens who live abroad (and can demonstrate that) have not been prohibited from returning to their place of residence.[10]

Although safety and health concerns may have compelled many Australians to return to Australia, it does not follow that they would not be considered a tax resident here.

Almost 100 years ago, Lord Buckmaster was of the view in *Inland Revenue Commissioners v Lysaght*[11] that, simply because circumstances necessitated that a person live in a place, they were not any less of a resident:

> "A man might well be compelled to reside here completely against his will; the exigencies of business often forbid the choice of residence and though a man may make his home elsewhere and stay in this country only because business compels him, yet none the less, if the periods for which and the conditions under which he stays are such that they may be regarded as constituting residence, it is open to the Commissioners to find that in fact he does so reside …"

However, having the intention to reside is an important factor. Therefore, if a choice to remain in Australia is made, either because of convenience (a desire to avoiding quarantine directives on both ends of an international flight) or because of health fears,[12] the issue is that such a choice might be interpreted as evidence of an intention to reside in Australia, even if only for a time.

In *Miller*, Latham CJ considered the residency of a man who spent nine months in the territories of Papua and New Guinea because he was required to do so as a result of commitments he made as part of the war effort:[13]

> "It has been contended that the respondent [Mr Miller] was not resident in the Territories because he did not voluntarily choose the Territories as a place of residence. He went there because he was directed to go there under his contract of employment. It appears to me that the same thing might be said of many millions of people in the world who reside in a particular place only because they have to do their work at or near a place. But, if voluntary choice is to be regarded as an important element in determining residence, I see no reason why it should not be said that the respondent, in entering into an agreement to serve in such places as might be specified, voluntarily ordered his life so as to reside from time to time in those places as required by the exigencies of his duties."

At the end of the day, when advising a client in relation to residency, it will be critical to get to the nub of the person's individual circumstances.

A person's intention will inevitably be important when it comes to considering residency. However, it must be borne in mind that residency has to be assessed annually (if only to prepare a tax return) and an intention to return overseas at some point is quite a different thing to not having the intention to reside in Australia.

The Australian courts have dealt with the significance of intention in some notable cases. In *Hafza v Director-General of Social Security*,[14] Wilcox J indicated that:

> "As a general concept residence includes two elements: physical presence in a particular place and the intention to treat that place as a home; at least for the time being, not necessarily forever."

The facts in *Hafza* were of an "outbound" family who intended to return to Australia after three months, but who ended up staying in Lebanon for almost four years before returning. It might be that many Australians will find themselves in Australia intending to return to their overseas residences but who may not do so for some years.

Recently, in *Harding v FCT*,[15] Derrington J said:

> "Necessarily the question of where a person resides is a question of fact (and, perhaps, of degree *per* Dixon J in *Miller* at 103), the conclusion of which is reached by a consideration of all of the person's circumstances. Those circumstances will be directed to ascertaining whether a person has a physical presence or retains a 'presence' in one location whilst at the same time maintaining an intention to reside there. The consideration also involves identifying the person's 'habits and conduct within the period', however, that will include a consideration of the events occurring prior to and subsequent to the relevant period as illuminating the relevance of the events in the relevant period."

At this time of unprecedented crisis, the most appropriate advice to give an Australian expatriate who has returned to Australia because of the COVID-19 pandemic, but who ordinarily lives overseas, is that their intention to remain in Australia *temporarily* is important.

In TR 98/17, the ATO's views in this area are made relatively clear in the following passages:

> "17. When an individual arrives in Australia not intending to reside here permanently, all the facts about his or her presence must be considered in determining residency status.

…

27. On entering this country, individuals may demonstrate they do not intend to reside in Australia, e.g., they may be visitors on holiday. When a change in their behaviour indicates an intention to reside here, e.g., they decide to migrate here, they are regarded as residents from the time their behaviour that is consistent with residing here commences. Intention is to be determined objectively, having regard to all relevant facts and circumstances. (See Example 5 at paragraphs 84 to 89.)

28. On the other hand, an intention to leave Australia after a brief stay is of little significance if the individual does not, or is unable to, depart: Case 104 10 TBRD 299."

The difficulty is that the longer the crisis continues, the greater the possibility that a person's stay in Australia, although initially thought to be temporary, might begin to exhibit a degree of habit and routine, with familial and financial connections that are consistent with residing here.

Indeed, the situation of a returning Australian is not "on all fours" with a foreigner who might have entered Australia temporarily. This is because a returning Australian will usually have strong family ties with Australia, a wider social network, and will often have retained financial connections while they were away. More fundamentally, they are likely to treat Australia as home.

The relevant issue for practitioners is to explain to clients that there may be a tipping point when the person's self-declared intention not to live in Australia becomes at odds with how actual events transpire. That issue is identified in recent comments by Logan J in *Pike v FCT*:[16]

> "The intention of a person in relation to residence is always relevant, but not determinative. Intention is but one factor to be considered in the context of the whole of the circumstances of a given case."

Inevitably during this crisis, there will be Australians who have returned to Australia not intending to stay, but who will end up becoming residents for tax purposes. Identifying the "turning point" will not always be easy, but there will usually be signs of a change of intention.

Such indicators might include the person resigning from an overseas job, giving up an overseas residence, or simply telling friends and family that they have decided to stay in Australia. Other indicators might be the enrolment of children in Australian schools or moving from temporary accommodation into a more permanent family home. If these indicia become relevant to the proper administration of the client's tax affairs, they should be clearly documented.

In practice, it would also be important to ask the client to confirm their intentions as this will help practitioners to ensure that, when preparing returns, they do not inadvertently assume that the client has become a resident at an earlier time than may be the case.

However, there is a warning for practitioners in the *Harding* case in the following comments by Derrington J:[17]

> "However, the objective manifestation of a person's intention is often a more accurate indicator of their state of mind at a particular time in the past than is an assertion about that alleged prior intent. A person's present belief about what their intention may have been in the past will necessarily be affected by their sub-conscious and the context in which they are called upon to identify that past intention. That is especially so when, at the relevant time, the person did not then consider what their then intention may have been."

His Honour's statements are prophetic as there would be many Australians who have returned to Australia during the pandemic but who may not necessarily have considered in much detail what their intentions were at the time of their return. They are likely to have simply returned to Australia in a crisis, doing nothing more than seeking the safety of Australian shores, but leaving overseas homes intact and employment arrangements on hold.

No doubt these are difficult times for clients and advisers alike. However, the inconvenient truth for those Australians who are not able to return to their overseas homes, or who choose not to return, is that they are likely to have become a resident of Australia when they formed the intention to stay. This may be the case even if they return to resume their lives overseas next year or the year after.

Ultimately, it will be the practitioner's duty to provide independent and objective advice.

183-day test

Practitioners should ensure that they do not overlook the 183-day test, particularly in relation to the 2021 income tax year. While this test has always been important, the way that tax practitioners think about this test may need to change, especially following the decision of the Full Federal Court in *FCT v Addy*[18] which was handed down on 6 August 2020.

The decision in that case has been timely because it contains several statements about the 183-day test and how it operates.

In *Addy*, the Commissioner argued that the 183-day test should not apply unless the Commissioner had formed the view that the person intended to reside in Australia and did not have a usual place of abode overseas. However, the court unanimously rejected that approach. Steward J explained how the court viewed the application of the 183-day test, at para 299, when he said:

> "… the purpose of the test is to supplement the test of residency in ordinary concepts in a practical way. It permits a conclusion to be reached about residency by the simple expedient of the taxpayer being physically in Australia during more than one-half of a year of income. It would seriously undermine the utility of this test if it also required, *in every case,* the Commissioner to form a view about the taxpayer's usual of abode and intentions about residency."

His Honour further noted at para 313:

> "By its terms, and as already mentioned, that test results in a person being a resident of Australia if they satisfy the objective requirement of being actually in Australia for more than the stipulated period 'unless' the Commissioner is 'satisfied' that the taxpayer's usual place of abode is not in Australia and the person does not intend to take up residence in Australia."

And further at para 314:

> "… the valid existence of a state of satisfaction concerning the matters required by the carve out to the 183 day test is a necessary precondition to an assessment issued to a taxpayer on the basis that she or he is a non-resident, where that taxpayer has actually been in Australia for more than one-half of the year of income."

This suggests that, even if a person finds themselves in Australia on a *temporary* basis with no intention to reside here, if they have been in Australia for more than 183 days in an income year, they will be a resident of Australia, unless the Commissioner is *demonstrably* satisfied that the person's usual place of abode is outside Australia and that they did not intend to reside here ("the exclusionary provisos").

By way of example, it will be safe to assume that there will be people who will have returned to Australia, without intending to reside here and without giving up their permanent place of abode overseas, but who do not leave Australia again until after 31 December 2020.

Irrespective of the how their time in Australia would be viewed under the "resides test", they will have stayed longer than the 183 days (measured from 1 July 2020) and consequently they will automatically be considered a resident for that time.

If they do not wish to be treated as a resident for that period, it would seem that, after *Addy*, best practice would be to provide the Commissioner with all of the facts about that person's situation so he has the opportunity to consider, and then be satisfied, about the exclusionary provisos.

In practice, it is difficult for a taxpayer to know whether the Commissioner is satisfied, let alone whether the taxpayer's disclosures have been considered. However, assuming such disclosures are made in a return and an assessment issues on the basis that the taxpayer is a non-resident, the Commissioner will ordinarily have only two years to issue an amended assessment.

Dual resident clients?

For some clients, it may be that the COVID-19 pandemic has essentially caused them to become "dual residents", meaning that they are a resident of Australia under our domestic laws while they remain a tax resident of a foreign country.

In such cases, it may be that relief from double taxation is available because the client can claim a foreign income tax offset in respect of the income that has become taxable here.

It is true, of course, that many Australians working abroad are taxed on their employment income at lower rates than would apply if they were a resident of Australia. In such cases, even after claiming a foreign income tax offset, they may still be exposed to significant additional Australian tax.

In other cases, if a client is a "dual resident", they may be able to obtain relief under a double tax agreement (DTA). Much will depend on the person's circumstances and, of course, on whether Australia has a DTA with the country that the Australian may have returned from. Treaty relief may apply to shelter foreign employment income from Australian tax in certain cases.

For some Australians, particularly those who derive most of their income from foreign employment, becoming a resident of Australia may not be as problematic as it might first appear. The analysis must be done.

Tie-breaker provisions

Most of Australia's DTAs provide "tie-breaker" rules that apply where a person is a dual resident.

The most common tie-breaker provisions are constructed on the basis that the dual resident will be treated as a resident only of the country where the person has either a permanent home or, failing that, a habitual abode.

If the "tie" cannot be broken using those tests, either because the person has a permanent home or a habitual abode in both countries or in neither, the person will often be deemed to be a resident only in the country where they have closer "economic and personal relations".[19] Some of Australia's treaties instruct that citizenship is to be a factor when determining that question.

It is important to note that the deeming of residency under a tie-breaker test will only be for the purpose of the taxation of the income and gains dealt with under a particular treaty. If a client is deemed under a tie-breaker provision to be a resident of another country, they will still be a resident of Australia for all other domestic tax purposes.

In *Pike*, a dual Australian and Thai resident was found to be a resident of Thailand for the purposes of the Australia–Thailand DTA because of the application of the tie-breaker test.[20] That finding meant that Mr Pike's employment income was only subject to tax in Thailand. However, Mr Pike would still have been assessable as a resident of Australia generally and would still have been required to lodge an income tax return as a resident.

> *"The issues with residency have become even more complicated than usual because of the COVID-19 pandemic."*

Implications of becoming a resident of Australia

At the end of the day, if a client has become an Australian resident, whether because of the COVID-19 pandemic or otherwise, the day they became a resident must be nominated in their personal income tax return for the year of their return. That residency date is critical to the proper tax assessment of the client, not only for the year of their return, but also for later years where, for example, the client owns CGT assets at the time of their return.

Cost base setting

For clients who return to Australia with CGT assets which are not taxable Australian property (examples would include foreign real estate, shares, business interests, foreign currency deposits, and collectibles), the date of the return is important because of the cost base setting rule in s 855-45 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97). That section provides that an individual is taken to have acquired the relevant CGT asset on the day they became a resident of Australia, for the market value on that day.

Given how changeable financial markets have been during 2020, not only in respect of equity values, but also in respect of the value of the Australian dollar, whether a client becomes a resident in March, April or May 2020 might have materially different CGT outcomes. When markets are moving quickly (in either direction), the deemed acquisition rule in s 855-45 ITAA97 could work to a client's advantage or disadvantage.

For a CGT asset purchased for a lower value than the market value on the day of residency, there is a benefit in that "pre-residency gains" are not brought into the Australian tax system. However, for a client who owns an asset which was purchased for a higher value than its market value on the day they become a resident, the cost base setting rule will work against them. Essentially, they will be exposed to CGT even if all that happens is that the asset is sold at its original cost price. Paying CGT when there is no economic gain is an unhappy prospect.

Other implications arising from an unplanned return to Australia

If a client becomes a resident of Australia without having had sufficient time to plan, the risk is that they may be caught out dealing with tax liabilities that they did not foresee.

There can be a minefield of returning tax issues, some of which are more basic than others, including:

- employment income is assessable in Australia when received, even if it relates to work performed prior to becoming a resident;
- withholding tax can apply if foreign bank loans remain on foot;[21]
- dealings with foreign currency balances post-residency can trigger penal outcomes under the forex realisation events;[22]
- foreign companies owned by the returning Australian may become a resident;[23]
- certain equity interests held in foreign companies may attract the operation of Australia's controlled foreign company rules;[24]
- the transferor trust rules may apply;[25]
- loans from private companies incorporated overseas can be deemed to be dividends either because of Div 7A ITAA36[26] or s 47A ITAA36;[27] and
- distributions from foreign trusts, including overseas savings plans which do not qualify as "foreign superannuation funds" (such as US 401K plans), may be taxable because of the operation of s 99B ITAA36.[28]

An opportunity for assistance

Given the significant number of Australians who have returned under the duress of the COVID-19 pandemic, it is hoped that the Commissioner will issue a practice statement addressing how he would assess returning Australians, particularly those who have kept homes overseas and who leave Australia again sometime during the 2021 income year.

Following the developments in *Addy*, understanding how the Commissioner would propose to handle assessments where the 183-day test is at issue will also be important, given the numbers of Australians who have had to return due to the pandemic.

Bright-line guidance, if only for one year, would provide certainty to Australians about the choices that they may wish to make going forward. Otherwise, arbitrary outcomes are likely to arise due to the difficulties with assessing the residency of individuals with complex cases.

Without such guidance, a great variety of approaches might be taken by taxpayers, tax agents, assessing officers and tribunals alike.

Given that we are living through extraordinary times, the certainty of a practice statement is not only needed but would be fair and equitable to Australian expatriates. This is particularly so following the raft of tax changes that have been legislated over the past decade which have increased the incidence of tax on the Australian expatriate population.[29]

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References

1 See Senator the Hon. Marise Payne, "Australians returning from overseas", media release, 9 May 2020 (available at www.foreignminister.gov.au/minister/marise-payne/media-release/australians-returning-overseas), where it is reported that over 300,000 Australians have returned to Australia since March 2020. It has also been reported by ABC News that over 25,000 people entered Australia during June 2020, mostly citizens or permanent residents (see www.abc.net.au/news/2020-07-15/australians-overseas-coronavirus-support-dfat-government-borders/12454226).

2 ABC News, *Australians who want to return from overseas warned to do so ASAP ahead of possible COVID-19 border closures*, 17 March 2020. Available at www.abc.net.au/news/2020-03-17/coronavirus-australians-should-return-home-from-overseas/12065050.

3 Prime Minister of Australia the Hon. Scott Morrison, "Border restrictions", media release, 19 March 2020. Available at www.pm.gov.au/media/border-restrictions.

4 *FCT v Miller* [1946] HCA 23.

5 The meaning of "resident" is defined in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36). Although there are four tests, for brevity, the superannuation test is excluded from the analysis.

6 According to Viscount Cave LC in *Levene v Inland Revenue Commissioners* [1928] UKHL 1, and endorsed by Latham CJ in *FCT v Miller*: "… the word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning to 'dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'."

7 A person's domicile is essentially the country that an individual identifies as their permanent home, often arising because of their birth. Most Australian expatriates will be Australian domiciled individuals, with Australia being their domicile of origin and therefore the domicile test will apply to them.

8 In *Harding v FCT* [2019] FCAFC 29, the Full Federal Court concluded that the words "permanent place" require the identification of a country in which the taxpayer is living permanently, not a particular form of accommodation (see specifically the joint judgment of Davies and Steward JJ at [40]).

9 Australian Taxation Office, *COVID-19 frequently asked questions*. Available at www.ato.gov.au/general/covid-19/covid-19-frequently-asked-questions/individuals-frequently-asked-questions/#Nonresidentstemporarilyin Australiaasares.

10 According to the Department of Home Affairs, there is a ban on Australians travelling overseas unless they are ordinarily resident in another country. A person will be considered ordinarily resident in another country if international movement records show that they have spent more

time outside Australia than in Australia for the last 12 to 24 months. See https://covid19.homeaffairs.gov.au/leaving-australia.

11 *Inland Revenue Commissioners v Lysaght* [1928] AC 234 at 248.

12 On 17 March 2020, an ABC News article reported that DFAT advice read: "Consider whether you have access to health care and support systems if you get sick while overseas. If you decide to return to Australia, do so as soon as possible." Available at www.abc.net.au/news/2020-03-17/coronavirus-australians-should-return-home-from-overseas/12065050.

13 *FCT v Miller* [1946] HCA 23.

14 *Hafza v Director-General of Social Security* [1985] FCA 164.

15 *Harding v FCT* [2018] FCA 837 at [35].

16 *Pike v FCT* [2019] FCA 2185 at [59].

17 *Harding v FCT* [2018] FCA 837 at [43].

18 *FCT v Addy* [2020] FCAFC 135.

19 The OECD, in its commentary on the *Model Tax Convention on Income and Capital 2017*, introduces a concept of "centre of vital interests" as an aid to analysis without necessarily explaining what the concept means.

20 See, for example, art 4(3) of the Australia–Thailand DTA.

21 Relief from withholding tax is available under certain treaties if the borrowing is from a financial institution. For example, see art 11(3)(b) of the Australia–US DTA which exempts United States financial institutions from withholding tax if they have dealt wholly independently with the payer.

22 The rules in Div 775 ITAA97.

23 Under s 6(1) ITAA36, a foreign company may be treated as a resident of Australia if it carries on a business in Australia and if either its central management and control is in Australia or its voting power is controlled by shareholders who are residents of Australia.

24 The controlled foreign company rules contained in Pt X ITAA36.

25 Div 6AAA of Pt III ITAA36.

26 Div 7A of Pt III ITAA36.

27 S 47A ITAA36 deems certain distributions from a controlled foreign company of an unlisted country to be a dividend.

28 Under s 99B ITAA36, where an amount, being property of a trust estate, is applied for the benefit of a beneficiary who was a resident at any time during the year of income, the amount is included in the assessable income of the Australian resident unless exceptions apply.

29 Those changes include: the removal of the exemption of foreign employment income where there was a continuous period of foreign service of greater than 90 days; the removal of the 50% CGT concession for foreign residents; and, only recently, the introduction of inequitable amendments to Australia's CGT laws in Subdiv 118-B ITAA97 to prevent foreign residents from claiming the CGT exemption for their former main residence if sold.