



# AUSTRALIA TO CHANGE **PERSONAL TAX RESIDENCY LAWS**

*On 11 May 2021, the Australian Government announced that it will legislate to replace Australia's existing residency rules with a new 'modernised framework', to be based on a report by the Board of Taxation in March 2019 entitled 'Reforming Individual Tax Residency Rules – A Model for Modernisation' (Report).*

The Government stated that its purpose in introducing a new framework is to make personal tax residency laws 'easier to understand and apply in practice, deliver greater certainty, and lower compliance costs for globally mobile individuals'.

A key reform will be the introduction of a so called 'bright line' 183-day test, and other secondary tests which will depend on a combination of physical presence and other 'objective criteria'.

The secondary tests may also include an apparently stringent '45-day rule' for commencing and ceasing residency, but that has not yet been confirmed by the Government.

The changes will be effective from the first day of the tax year following the date that the enabling legislation receives Royal Assent.

The earliest possible effective date would therefore be 1 July 2022, but because the legislative process

will be lengthy the more likely commencement date would be 1 July 2023.

At the time of writing there has been no exposure draft legislation circulated.

## **AUSTRALIA'S CURRENT RULES**

Australia's general residency framework has been unchanged for decades, excepting the introduction of temporary resident rules<sup>1</sup>.

The governing provision is the definition of 'resident' in Section 6(1) of the Income Tax Assessment Act 1936, which provides for four tests, usually known as the Primary Test, the Domicile Test, the 183 Day Test and the Superannuation Test.

There is a fourth test known as the Superannuation Test, which is rarely applicable these days. It mostly applies to Commonwealth employees. Under that test a person is a resident of Australia if they, or their spouse, is a member of certain Commonwealth Government superannuation funds.

### **The Primary Test**

The primary test, being a common law test is beguilingly simple.

A person is a resident of Australia if they reside here, with the word 'reside' taking its ordinary meaning. A

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<sup>1</sup> Australia introduced the concept of 'temporary residency' rules in 2006.

person resides if they 'dwell' in or at a particular place and that dwelling must be for a considerable (though unspecified) period, being of such length that the person is seen to dwell there permanently<sup>2</sup>.

Physical presence has always been a key part of the common law concept of residence as has a person's intention to reside in a place<sup>3</sup>. In Taxation Ruling 98/17<sup>4</sup> the Australian Taxation Office states:

*"on entering this country, individuals may demonstrate that 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 is consistent with residing here. Intention is to be determined objectively, having regard to all relevant facts and circumstances."*

### **The Domicile Test**

Under the Domicile Test, a person is a resident if their domicile is in Australia, unless the Commissioner is satisfied that they have a permanent place of abode outside Australia.

This test has some unusual aspects.

Firstly, the requirement for the Commissioner to be satisfied of certain matters flies in the face of modern tax administration and current practice, because the Commissioner rarely turns his attention to the circumstance of individual taxpayers.

In most cases the Commissioner simply accepts the taxpayer's own assessment that they are non-resident without any further enquiry.

Unless an audit was being undertaken the Commissioner would rarely be in receipt of information that would enable him to demonstrate that he could be satisfied that a taxpayer has a 'permanent place of abode' outside Australia.

Secondly the precise meaning of the how the phrase 'permanent place of abode' should be interpreted was thought to be settled in the late 70's in *Applegate* and *Jenkins* has been modified very

recently by the Australian Federal Court in *Harding*<sup>5</sup>.

The new shade of meaning is that the use of the word 'place' in the expression permanent place of abode is a reference to a particular country, not a particular residential unit within a country so that the character of a person's unit of accommodation should not be determinative.

### **The 183 Day Test**

The existing 183-day test defines a person to be a resident if they have been in Australia, continuously or intermittently, during more than one-half of the year of income. This applies unless the Commissioner is satisfied that the person's usual place of abode is outside Australia, and that the person does not intend to take up residence (the 183-Day test).

The precise meaning of the various components of the 183-day test, it must be said, have also recently been clarified by the Federal Court in *Addy*<sup>6</sup>.

Many taxpayers have assumed incorrectly that this test entitles them to claim non-residency if they have been in Australia for less than 183 days.

That view is erroneous because a person can clearly be in Australia for less than 183 days and still be tax resident because of the application of the Primary Test or the Domicile Test to their situation.

### **The Superannuation Test**

Under this test a person is a resident of Australia if they, or their spouse, are a member of certain Commonwealth Government superannuation funds and as such the test normally applies to government employees.

### **AN OUTDATED FRAMEWORK?**

The Board of Taxation believes that the Australia's existing residency tests have evolved into an increasingly complex area of tax law.

In its Report, the Board of Taxation noted that at the time its report there were over 25 cases before the Federal Court and the Administrative Appeals Tribunal (AAT), though that is probably coincidental<sup>7</sup>.

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2 Federal Commissioner of Taxation v Miller (1946) 73 CLR 93,99-100 (Latham CJ)

3 Per Wilcox J in Hafza v Director-General of Social Security

4 Taxation Ruling TR 98/17 Income tax: Residency status of individuals entering Australia

5 Harding v FCT [2018] FCA 837

6 FCT v Addy [2020] FCAFC 135

7 The AAT, a lower-level forum, hears most residency disputes, including many in which the outcome is unsurprising to most tax professionals.

However, increasing global mobility over the last 30 years has no doubt given rise to a greater number of situations in where determining a taxpayer's residency based on Australia's existing framework is difficult.

Often is it unclear whether a person who is in Australia is simply visiting or has commenced 'residing' because all the particular facts and circumstances must be called upon to form a view.

That is particularly so for returning Australian citizens<sup>8</sup> and in many situations it is clear that the taxpayer has become a resident of Australia, but the difficulties are in establishing when.

Indeed, many practitioners will have had client situations which could be described as 'creeping returns', characterised by the return to Australia of some but not all family members, with the main income earning spouse still living and working overseas.

The current difficulties are best summarised, somewhat remarkably, by an observation of Justice Rich in 1946 when in *Miller*<sup>9</sup> he noted that

*"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."*

## THE BOARDS RECOMMENDATIONS

In its Report, the Board of Taxation framed its recommendations as flowing from the following guiding principles.

1. Making physical presence in Australia the primary measure of residency
2. Focusing on Australian connections.
3. Adopting objective criteria only.

In summary the Boards recommendations were that Australia should introduce a re-designed residency framework as follows;

- 183-day physical presence test

- A commencing residency test
- A ceasing residency test

## 183 DAY PHYSICAL PRESENT TEST

The 183 Day test is the only test that the Government has categorically indicated that it will implement, though the exact design of the test is not confirmed.

The Board's recommendation was that:

*"An individual who spends 183 days or more in Australia in the current income year will be an Australian tax resident"*<sup>10</sup>

As would be expected, the 183 Day test is a blunt day counting exercise with any part of a day in Australia to be treated as one day.

There was some discussion from the Board that consideration should be given to permitting a taxpayer to apply to the Commissioner to have certain days exempt from this test to take into account, for example, critical illness of a family member, significant national disasters, or comparable events<sup>11</sup>.

Importantly if a person commences residency in a particular year, they will only be resident from the day they 'commence residency', rather than the full year, even if they are in Australia for 183 days or more during the tax year.

## COMMENCING TAX RESIDENCY TEST

The Commencing Residency test is a test designed to apply to an individual who is in Australia for less than 183 days, who in the Board's opinion should still be considered resident.

The proposal is that *'An individual will be an Australian tax resident where the individual is present in Australia for 45 days or more in an income year and satisfies two more factors.'*

There are four factors proposed by the Board being:

- The right to reside in Australia (i.e citizenship or permanent residency)
- Australian accommodation
- Australian family
- Australian economic connections.

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<sup>8</sup> Since March 2020 over 450,000 Australian's have returned to Australian to shelter from the pandemic some only temporarily

<sup>9</sup> FCT v Miller [1946] HCA 23

<sup>10</sup> Page 30 of the Report

<sup>11</sup> The Report was written prior to the outbreak of the Covid19 pandemic so one is not sure it would be a comparable event

The right to reside permanently in Australia is apparently a straightforward test.

The concept of 'Australian accommodation' is an expansive one. An individual would be taken to satisfy that factor if the person has an 'arrangement to access accommodation' at any time during the income year.

It seems that the concept of 'Australian family' will be limited to spouse or children under the age of 18<sup>12</sup>.

Lastly the Board considers that the concept of 'Australian economic connections' should have three limbs, each which require more clarity.

- i. employment located in Australia
- ii. active participation in the carrying on of a business in Australia
- iii. interests in Australia assets

### **CEASING TAX RESIDENCY TEST**

The Board has also proposed a two-pronged ceasing residency test which would treat a taxpayer as only ceasing residency if they spend less than 45 days in Australia for the current year and less than 45 days in each of the preceding 2 years.

This would apparently be qualified by another test which would permit an individual to cease residency immediately, if they are moving overseas to take up an employment overseas in the following situation:

- They are Australian residents for three previous consecutive income years.
- Their overseas employment is mandated to be for a period of more than two years at the time the employment commences.
- They have accommodation available continuously in the place of employment for the duration of their employment.
- They return to Australia for less than 45 days in each income year that they continue to their overseas employment after the year in which they depart.

### **BETTER SOLUTION?**

In the authors view, although some amendments should be made to simplify and clarify the law, the proposed Commencing Residency and Ceasing Residency tests, which use 'factors' extracted from the common law, need to be further development. The Government is encouraged to consult widely and extensively on draft legislation.

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<sup>12</sup> Paragraph 7.32 of the Report