



Australian Government

The Board of Taxation

REFORMING INDIVIDUAL TAX RESIDENCY RULES – A MODEL FOR MODERNISATION

the **board** of **taxation**
www.taxboard.gov.au

A Report to the Treasurer

MARCH 2019

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FOREWORD

Board of Taxation: Review of Income Tax Residency Rules for Individuals

In May 2016, the Board of Taxation (the Board) commenced a self-initiated review of individual tax residency. In August 2017 the Board presented its findings to Government in *'Review of the Income Tax Residency Rules for Individuals'* (the 2017 Report).

Following extensive consultation and research, the Board concluded that the current individual tax residency rules are no longer appropriate and require modernisation and simplification.

In particular, the current rules do not reflect global work practices, and impose an inappropriate compliance burden on many taxpayers in all but the simplest of cases – this has led to increased uncertainty and disputes. In addition, the Board identified a number of integrity concerns that arise due to the way in which the current rules operate.

The Board recommended that the Government replace the current rules with an improved and simplified residency test based on a 'two-step' model – a simple bright-line test followed by a more detailed analysis in more complex cases. While stakeholders overwhelmingly supported the Board's conclusion, further consultation was necessary to develop the framework for a new definition of individual residency.

Government response and terms of reference

The Government responded to the Board's 2017 Report in May 2018. Before taking a position on the Board's 2017 Report, the then Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, asked the Board to undertake further consultation as outlined in the 2017 Report.

The terms of reference provided by the Minister in May 2018 requested the Board to consult on its key recommendations in the 2017 Report, including how Australia could draw on residency tests in other countries. The Government expressed its support for the Board undertaking this consultation to ensure the new residency definition can be appropriately designed and targeted. As part of this process, it was also requested that the Board address the concerns raised in its report on the 'resident of nowhere' phenomenon and the deficiencies of the superannuation rule.

Consultation

In accordance with the Government's response, the Board undertook consultation in late 2018.

The Board established a working group comprised of three Board members: Rosheen Garnon (Chair), Craig Yaxley and Dr Mark Pizzacalla. The working group met on numerous occasions,

carried out consultation and prepared this Report outlining the Board's proposed new individual residency rules (assisted by the Board's Secretariat).

The Board's consultation took place in late 2018. The Board released *Review of the Income Tax Residency Rules for Individuals: Consultation Guide* in September 2018 (2018 Consultation Guide), outlining a series of design principles aimed at developing new residency rules, with a particular focus on the following:

- options for a two-step model for individual tax residency;
- integrity risks to circumvent existing residency rules (e.g. 'residents of nowhere'); and
- options to replace the 'superannuation test'.

Over 40 individuals attended roundtable consultations and the Board received numerous written submissions. The Board would like to thank all of those who so readily contributed their insights and time to assist the Board in conducting this review.

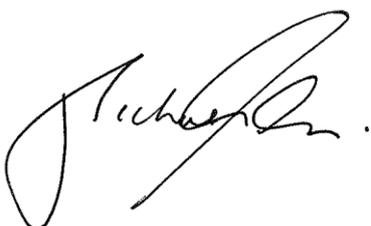
Both the Department of the Treasury (the Treasury) and the Australian Taxation Office (ATO) provided significant assistance to the Board, attended working group meetings and participated in consultation. The Board expresses its appreciation for the contributions of those officials.

Consultation-based Proposal: Reforming the Individual Residency Rules

It is with great pleasure that we submit this Report to the Treasurer on behalf of the Board.

The Board believes that, if implemented, the Board's proposed new residency rules will greatly improve the operation of the individual income tax system by modernising and simplifying a fundamental component of that system.

The ex-officio members of the Board – Secretary of the Treasury, Philip Gaetjens, the Commissioner of Taxation, Chris Jordan AO, and the First Parliamentary Counsel, Peter Quiggin PSM – reserved their final views for advice to Government.



Michael Andrew AO
Chair, Board of Taxation



Rosheen Garnon
Chair of the Board's Working Group

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GLOSSARY

The following abbreviations and acronyms are used throughout this report.

Abbreviation	Definition
ATO	The Australian Taxation Office
CGT	Capital Gains Tax
Commissioner	Commissioner of Taxation
The Board	The Board of Taxation
2017 Report	<i>Review of the Income Tax Residency Rules for Individuals</i> , Board of Taxation report, August 2017
2018 Consultation Guide	<i>Review of the Income Tax Residency Rules for Individuals: Consultation Guide</i> , September 2018

EXECUTIVE SUMMARY

As set out in the Board's 2017 report *Review of the Income Tax Residency Rules for Individuals*, the individual tax residency rules are no longer appropriate for the 21st century.

During the course of the Board's investigations from 2016 to 2019, it has become clear that the individual tax residency rules must be reformed. They no longer reflect global work practices given the increasing frequency and nature of interactions with the rules, increasing compliance burden, and increasing number of disputes. While this report was being finalised, another residency decision was handed down by the Federal Court in 2019 with significant media and industry attention, with support for reform of these rules restated across industry. The decision which reversed the decision at first instance, demonstrated the ongoing uncertainty for taxpayers and the ATO.

In accordance with the Government's terms of reference, the Board has developed a model to replace the existing residency rules with modern, simple and certain rules that are appropriately designed and targeted to align with existing policy settings. The Board consulted on the design of these rules, receiving numerous written submissions and held roundtable consultations across the country. The Board acknowledges and thanks all participants in its consultation process.

In this report, the Board sets out a model for simplifying and modernising the current individual tax residency rules.

The Board has designed these proposed rules by focusing on the guiding principles of adhesive residency, certainty, simplicity and integrity. From its consultation and further investigations, the Board has developed the proposed rules to re-focus tax residency in three critical ways:

- Making physical presence the primary measure of residency – moving Australia to closer alignment with international practice;
- Focusing on Australian connections – providing that two individuals with identical physical presence and other connections to Australia should be treated the same; and
- Adopting only objective criteria – removing any requirement to test intention or undertake broad, holistic examinations to promote simplicity, consistency and certainty.

The Board considers that, by following its guiding principles and adopting these changes, the proposed rules lead to more certain outcomes for individual taxpayers. Inconsistent outcomes that currently arise due to different approaches to the holistic analysis required will also be eliminated, improving the equity in the system. Importantly, the Board has maintained existing outcomes (in a streamlined and simplified way) where appropriate in order to minimise disruption and revenue implications.

The Board's proposed rules

The Board's proposed residency rules adopt a two-step approach. The first step for all individuals is the 183 Day Test – where an individual who spends 183 days or more in Australia is a tax resident. This primary test is a key simplification of the existing rules, provides certainty and aligns with international practice.

The proposed rules then apply more targeted, objective rules depending on each individual's circumstances. These secondary rules set out clear criteria as to when an individual who is in Australia for less than 183 days in an income year commences or ceases residency. In accordance with the adherence principle, the longer an individual is a tax resident, the more difficult it is to cease residency.

These secondary rules adopt a day-count test together with a new Factor Test – four objective factors which the Board, through consultation, has concluded best demonstrate an individual's connection to Australia.

The Board also recommends that the uncertainty for Australians undertaking expatriate employment opportunities be resolved by implementing a rule that broadly codifies a streamlined version of the existing practice for work assignments of longer than two years. The proposed rules also replace the outdated superannuation test with an Overseas Government Officials Test which treats all individuals deployed on foreign government service as residents in accordance with international norms and practice.

The Board considers that these rules reduce the ability for the 'resident of nowhere' phenomenon sufficiently that a specific rule is not warranted. The Board has also identified opportunities to eliminate manipulation and improve compliance both within the proposed rules and administratively, such as aligning domestic law and tax treaty outcomes.

The road to reform

The proposed rules address heightened uncertainty, reduce compliance costs and protect Australia's tax base by reducing opportunities for manipulation. The Board recognises that any reform must be balanced against broader priorities and any potential revenue consequences must be considered against other needs within the Australian budget. However, residency is a foundational concept upon which every individual must determine their tax affairs.

The Board has received overwhelming support from the community about the need for reform in line with the approach set out in this report. The Board worked closely with the ATO, the Treasury and consulted with the Office of Parliamentary Counsel on the design of the rules to ensure that, to the extent possible the proposed rules reflect a workable, consensus-based approach to modernising this fundamental part of the tax system.

Given the current state of affairs, the Board considers that the case for prioritising this reform is compelling, and that these proposed rules provide a roadmap to modernisation.

CHAPTER 1: MODERNISING INDIVIDUAL TAX RESIDENCY

KEY POINTS

- Residency status is a foundational concept in the income tax system. The existing rules are no longer appropriate for the 21st century.
- As requested by the Government, the Board has designed and developed a framework for new tax residency rules. The proposed rules seek to provide a modern, simple and more targeted approach, allowing individuals to quickly and easily determine their residency status and understand their tax obligations.
- The Board's proposed rules adopt a two-step approach. For each individual, a primary bright-line test should apply – a 183 day physical presence test.
- Taking into account further information, a secondary test should apply to individuals who are not in Australia for 183 days:
 - A commencing residency test for individuals who were not residents in the preceding income year to determine whether they commence residency.
 - A ceasing residency test for individuals who were residents in the preceding income year to determine whether they cease residency.
- The Board has designed the proposed rules by focusing on the guiding principles of adhesive residency as well as certainty, simplicity and integrity.

Framing questions: an introductory overview

- 1.1 Australia's income tax system is built on the foundational concepts of residence and source. Individual residency status is the first step in determining how the income tax laws apply. Much of the tax law applies differently to residents and non-residents, (for example, which types of income and capital gains are assessable and which rates of tax apply) and as such, it is of fundamental importance to the system that individuals know their residency status when interacting with the income tax system.¹

¹ Some of these differences are set out in **Annexure A**. This list is not exhaustive – it simply provides an illustration of the significance of residency status.

- 1.2 As outlined in the Board's 2017 Report, the rules that govern an individual's residence for income tax purposes no longer apply effectively to modern work and living practices, such as increased global travel and technological advancements. This creates uncertainty for individuals when seeking to understand their tax affairs.
- 1.3 At the request of the Government, the Board has conducted this review to consider how to modernise the income tax residency rules for individuals. The Board's proposed model is outlined in this report.
- 1.4 In order to design modernised and simplified residency rules, the Board needed to address a number of critical framing questions. These framing questions are:
 - (a) What principles should guide the Board's approach?
 - (b) Who is most affected by the existing uncertainty?
 - (c) Are there opportunities to update policy settings?
 - (d) Should residency be a connection to Australia or based on global connections?
 - (e) Does the proposed model lend itself to principles-based drafting?
 - (f) Are there any special cases that need to be addressed in the policy design stage?
- 1.5 The Board's responses to these questions are briefly set out below. These responses inform the design of the proposed residency rules outlined in this report.

What principles should guide the Board's approach?

- 1.6 In the Board's 2018 Consultation Guide, four key guiding policy principles were set out for designing new individual tax residency rules.
 - (a) **Adhesive residency:** it should be harder to cease residency than it is to establish it. Generally, once sufficient time is spent in Australia, and connections are made, then it is appropriate that this level of engagement with and benefit from Australian society must be scaled back to a large extent before residency ceases. This is a feature that will be maintained from the existing rules (e.g. the domicile test) and reflects common international practice.
 - (b) **Certainty:** the new rules should be designed to be straightforward and provide clear and consistent outcomes for the majority - there should be virtually no impact from this change in the majority of cases. However, unlike the current rules there will be clear thresholds for confirming when residency starts and ends.
 - (c) **Simplicity:** to remove uncertainty and complexity through clear, reasonable rules for determining residency for individuals with more complicated fact patterns.

This should balance the time spent in, and other connections with Australia but in a way that removes the perceived subjectivity of the current rules.

- (d) **Integrity:** the rules should not make it easier for individuals that have close ties to Australia to be able to manipulate the system and not pay their fair share of tax in Australia.

- 1.7 These principles have guided the Board's design and targeting of the proposed rules set out in this report. This aims to achieve equity by applying equally to all individuals, while also improving economic efficiency by removing uncertainty and removing distortions. The development of the Board's proposed rules balances these principles and reflects the compromises and trade-offs necessary.
- 1.8 For example, a test based purely on time spent in Australia could be easily manipulated through simply achieving the relevant number of days over/under a threshold depending on the tax profile of any given year. This will need to be balanced against the aim of providing simple, clear rules.

Who is most affected by the existing uncertainty?

- 1.9 As the individual residency rules will necessarily apply to all individuals who interact with the income tax system, the Board's primary focus was to provide a clear, simple standard for the vast majority of the population. This reflects that most individuals each year will not need to interact with the residency rules and there will be no change in their treatment.
- 1.10 However, as the Board has made clear, the existing residency tests have evolved into an increasingly complex area of tax law. While based on concise principles, the law does not assist individuals other than those with the simplest affairs in determining their residency status. Judicial uncertainty continues to grow – as of March 2019, there were over 25 cases before the Federal Court and Administrative Appeals Tribunal dealing with the residency status of individual taxpayers.
- 1.11 The Board considers that there is a dual focus for modernising the residency rules:
 - (a) Ensuring that the changes do not inappropriately affect the broader population;
 - (b) Simplifying, clarifying and streamlining the rules for individuals with more complex affairs (such as those who travel overseas more frequently).
- 1.12 In order to achieve this balance, the Board considered the existing practice instructive – the existing rules apply differently for individuals arriving and departing Australia (i.e. inbound and outbound individuals). Adopting this framework, more targeted rules can be created to address the more complex aspects of such individuals' affairs.
- 1.13 This decision has informed the design of the Board's proposed rules – individuals with more complex affairs, being those that travel overseas, move to Australia, or depart

Australia, face much greater difficulty in applying the existing rules. As such, the Board's proposed approach departs from the existing approach of a single definition and instead followed the way in which the rules apply in practice, by setting out separate tests for the most problematic areas – commencing and ceasing residency.

Are there opportunities to update policy settings?

- 1.14 The Board considered the extent to which the existing residency rules should simply be codified in a more structured way, or to take the opportunity to reconsider key policy settings in light of global work, life and travel arrangements and deficiencies in the existing rules that lead to integrity concerns.
- 1.15 The Board concluded that the residency policy settings should be updated to provide significant improvements in line with the guiding principles – in particular, the opportunity to simplify the rules. This simplification and modernisation will improve certainty, reduce compliance costs and increase the integrity and sustainability of the income tax system.
- 1.16 As detailed in this report, the following settings are proposed to be updated:
- (a) A clear, concise test based on physical presence should be adopted, providing certainty for the vast majority of individuals.
 - (b) The number of factual considerations should be reduced to four clear objective criteria, to be adopted in the 'Factor Test'.
 - (c) Existing integrity risks for high wealth individuals (e.g. 'residents of nowhere') resulting in the avoidance of tax in Australia will be addressed through redesigned rules.
 - (d) The 'superannuation test' should be updated to reflect that Government officials posted overseas should maintain treatment as an Australian tax resident.
- 1.17 The Board also considered how an individual's connection to Australia should be tested – this is set out separately below.

Should residency be a connection to Australia or based on global connections?

- 1.18 The Board also considered whether to depart from the existing rules that test an individual's connection to Australia as compared to any other country. This setting (relevant for the 'resides', 'permanent place of abode' and 'usual place of abode' tests), is comparative in effectively testing whether an individual's connection to Australia is stronger than their connection to other countries. While this still led to dual residency outcomes, it required analysis of overseas affairs that led to significant compliance costs, administrative costs for the ATO and is the focus of an increasing number of disputes and litigation.

- 1.19 In the Board's view, it is opportune to reconsider the appropriateness of this setting. During consultation, many consultees strongly supported recalibrating the residency rules to focus solely on an individual's connection to Australia. The mood was summarised as 'two individuals with identical connections to Australia should have the same residency status'.
- 1.20 The Board agrees with this statement. As such, the proposed rules focus on an individual's connection to Australia and disregard overseas connections (save for specific circumstances that the Board considers warrant departing from this overarching principle).
- 1.21 As such, the proposed rules do not have regard for days overseas, family overseas, foreign accommodation, economic or financial interests.
- 1.22 This will provide significant simplification benefits. The simpler standard greatly improves the accessibility of the rules for individuals, employers, and tax practitioners, thereby reducing compliance and administration costs.
- 1.23 The Board acknowledges that some consultees prefer an international comparative approach and that the Board's approach may lead to inappropriate outcomes. The Board reflected on this feedback and ultimately concluded that such concerns can be managed during implementation.
- 1.24 Further, the framework of the proposed rules is different, and this feedback can be reconsidered with the new rules in mind. While dual residency will still be possible, under the Board's proposed rules the residency status of an individual is no longer subject to Australian interpretations of practices in the country to which an individual has moved (where the individual cannot control foreign standards of work, accommodation, culture etc.). It is the Board's view that the benefits of the Board's approach outweigh any potential costs.
- 1.25 Two individuals with the same connection to Australia should, to the extent possible, have consistent residency outcomes. Where an individual has competing claims of residency in other countries, this will be resolved under the proposed double tax treaty alignment provisions or the existing foreign income tax offset rules. Australian residency rules should test an individual's connection to Australia and their access to the privileges of Australia's economy and society.

Does the proposed model lend itself to principles-based drafting?

- 1.26 A principles-based drafting approach is recommended for enacting the Board's modernised and simplified residency rules.
- 1.27 In order to provide greater assistance to the Government, the Board has reflected on the way in which a principles-based approach may be implemented in the policy and law design process in consultation with officials at the Treasury, and the ATO as well as

drafters in the Office of Parliamentary Counsel. The Board has also set out what it considers to be the overarching principles in the proposed policy statement.

- 1.28 Nonetheless, during consultation most consultees supported the proposed rules being designed in accordance with the Board's guiding principles – most particularly, simplicity and certainty.
- 1.29 Under the guiding principles, the Board designed the proposed rules in this report to rely on a mixture of principled tests and bright-line tests. This mixture is a result of the Board's exhaustive analysis and consultation between 2016 and 2019.
- (a) For example, the Board focuses on physical presence as the primary consideration for residing in Australia. This lends itself more readily to a bright-line approach, where the principle will be quite clear and certain (albeit not principles-based as that term is more commonly used).
- 1.30 The Board considers that this approach is appropriate given the way in which the existing rules (which set out broad principles) are now sufficiently uncertain to warrant legislative intervention and reformulation. Were the Board's proposed rules to replace the existing principles with a new set of principles that themselves require ongoing judicial clarification, the simplification benefits and compliance cost reductions would be adversely impacted.
- 1.31 The Board sought when preparing this report to identify what it considers to be the principles upon which each element is based (being both principles that lend themselves to bright-line drafting or broader principles-based drafting). This approach should be clear throughout the following chapters.
- 1.32 The Board notes that some clarifications, add-ons, and exceptions may be needed to elaborate in the drafting and implementation process. Where the Board has identified such issues in this report, observations are made on whether (and the extent to which) the Board considers departure from the broader principles is necessary. As an overarching aim, the Board sought to minimise the existence of and scope of any exceptions and exemptions, aiming for consistent, certain outcomes and simplified law.

Are there any special cases that need to be addressed in the policy design stage?

- 1.33 During its 2017 Report and consultation, the Board considered how the residency rules operate for Australian expatriates and inbound workers. As set out earlier, the Board considers that these individuals are most affected by the existing rules and as such separate tests should be adopted to provide more nuanced and targeted outcomes.
- 1.34 The Board focused during consultation on clarifying the residency status of individuals that leave Australia to work overseas, as the existing rules are most uncertain for this class of individuals. The Board considers these individuals warranted specific consideration in designing revised rules. The Board sought feedback on whether to

recommend a specific test based solely on working overseas, tested separately each income year.

- 1.35 Generally, there was minimal support for this approach. Feedback focused on the increased complexity and uncertainty about how such a rule would work. However, there was significant support for removing the uncertainty in the existing rules (but not fundamentally changing the treatment) of Australian expatriates working overseas.
- 1.36 The Board reflected on and ultimately adopted this feedback; in particular, that the suggested employment test departs from the existing rules not just to eliminate uncertainty but through setting a new standard.
- 1.37 The Board concluded that a better approach is to simplify and streamline the way in which the existing rules treat such individuals. The existing 'rule of thumb' for overseas stays in the ATO's Taxation Ruling IT 2650 is commonly used to conclude whether individuals have become non-residents from departure if the intended absence is two years or more (albeit as part of a holistic factual analysis).
- 1.38 The Board considers that there would be significant benefits in codifying a simplified version of this rule of thumb. Codifying this rule would vastly improve the ability for individuals to comply with the law and reduce compliance costs for individuals and their employers. The Board identified key conditions, based on the existing rules and common law, to be met for the codified rule of thumb to apply. The proposed 'overseas employment rule' is outlined later in this report.
- 1.39 The Board also received strong feedback throughout consultation that focusing on physical presence to determine residence (i.e., the 183 Day Test) may affect the residency status for certain individuals who arrive in Australia such as short-term tourists, relocating working professionals, students and visiting academic staff that stay for more than 183 days in an income year.
- 1.40 The Board considered whether it is appropriate to also provide specific rules to address these concerns – for example, that exclude them from the 183 Day Test. While this is considered in more detail elsewhere in this report, the Board is generally comfortable with the interaction between the proposed rules and the more specific tax rules that govern most of these individuals (for example, the temporary resident rules, the working holiday maker rules and the seasonal labour mobility program). However, the Board strongly supports this interaction being monitored throughout implementation.
- 1.41 At this stage, the Board does not find it necessary to provide different treatment for these individuals coming to Australia. The Board considers that the proposed rules will provide greater simplicity and certainty.

The Board's recommended model

- 1.42 During consultation, the Board considered different models to modernise individual tax residency policy. These models explored different policy settings for individuals that live in Australia, as well as those that arrive and depart over time.
- 1.43 In particular, the Board considered whether to adopt a single standard for all individuals, or to separate out simple scenarios from the more complex (such as when individuals commence and cease residency) and set the policy parameters accordingly.
- 1.44 The Board sees merit in both approaches. A single definition provides simplicity in drafting without quarantining the more complex aspects of residency policy. On the other hand, separate tests for commencing and ceasing residency target the complex scenarios with more nuanced and detailed settings may make policy settings appear more complex. From the Board's consultation and analysis:
- (a) Generally, consultation demonstrated strong support for separate tests as the benefits were considered significant, so long as the risks are managed.
 - (b) When analysing which approach is consistent with current practice, as outlined in the Board's report it was concluded that the current rules are applied separately to inbound and outbound individuals (albeit within one legislative definition, which leads to heightened uncertainty and confusion). Practically, there is consistency with a separate test approach, where improved, revised rules will provide greater clarity as to when different features of the rules apply.
- 1.45 On balance, the Board prefers the separate test approach for the targeting and nuance it can provide. The Board prefers the following separate tests:
- (a) **A physical presence test** – a 183-day test for individuals to reside in Australia.
 - (b) **A commencing residency test** – for any individual that is not in Australia for 183 days to determine whether they have otherwise commenced residency.
 - (c) **A ceasing residency test** – for any individual that is not in Australia for 183 days to determine whether they have ceased residency.
- 1.46 In accordance with the Board's 2018 Consultation Guide, the residency test is a two-step test, with a primary bright line test (physical presence test) and a secondary test based on the individual's prior year residency status (commencing/ceasing residency tests) that takes into account further information.
- 1.47 These tests are largely modular. That is, there are common rules that underpin each test that ensure consistency of treatment (for example, by using the Factor Test in each the commencing and ceasing residency tests as relevant).

1.48 As mentioned previously, Australia's income tax system is built on foundation concepts of residence and source. The Board considers that the recommended model for individual residency rules complements the source of income concepts.

Expected benefits of the Board's recommended model

1.49 The Board is of the view that its recommended model for reform of the individual residency rules will:

- **Address the high level of uncertainty** for taxpayers, employers, advisors and the administrators that exist under the current rules. This uncertainty is demonstrated by the large number of cases currently before the courts and the increasing number of private ruling requests.
- **Simplify the rules which will significantly reduce compliance costs** for a range of people; in particular for businesses with mobile workforces. Businesses will be able to more easily ascertain the residence status of their employees; particularly employees who are being seconded offshore. Businesses will be able to manage their payroll systems more effectively. This will be of particular importance as employers will soon be required to provide information on payments to expatriate/inpatriate employees under single touch payroll.
- Lead to a **more efficient taxation system** through more **consistent and predictable outcomes** for the vast majority of taxpayers.
- **Protect Australia's tax base** by reducing opportunities for manipulation.

1.50 The following chapters detail the Board's recommended model on this basis.

1.51 The Board has also annexed further explanatory information developed during the Board's deliberative process:

- (a) **Annexure A** – this annexure contains comparison tables and potential impacts of the proposed changes:
 - (1) Table 1 – a comparison of the existing residency rules and key recommended changes;
 - (2) Table 2 – a comparison of certain resident and non-resident tax outcomes;
 - (3) Table 3 – the Board's observations on the potential impacts of the proposed rules,
- (b) **Annexure B** – this annexure contains a brief overview and some commentary of other models that were considered as part of the Board's work;
- (c) **Annexure C** – a list of the Board's recommendations.

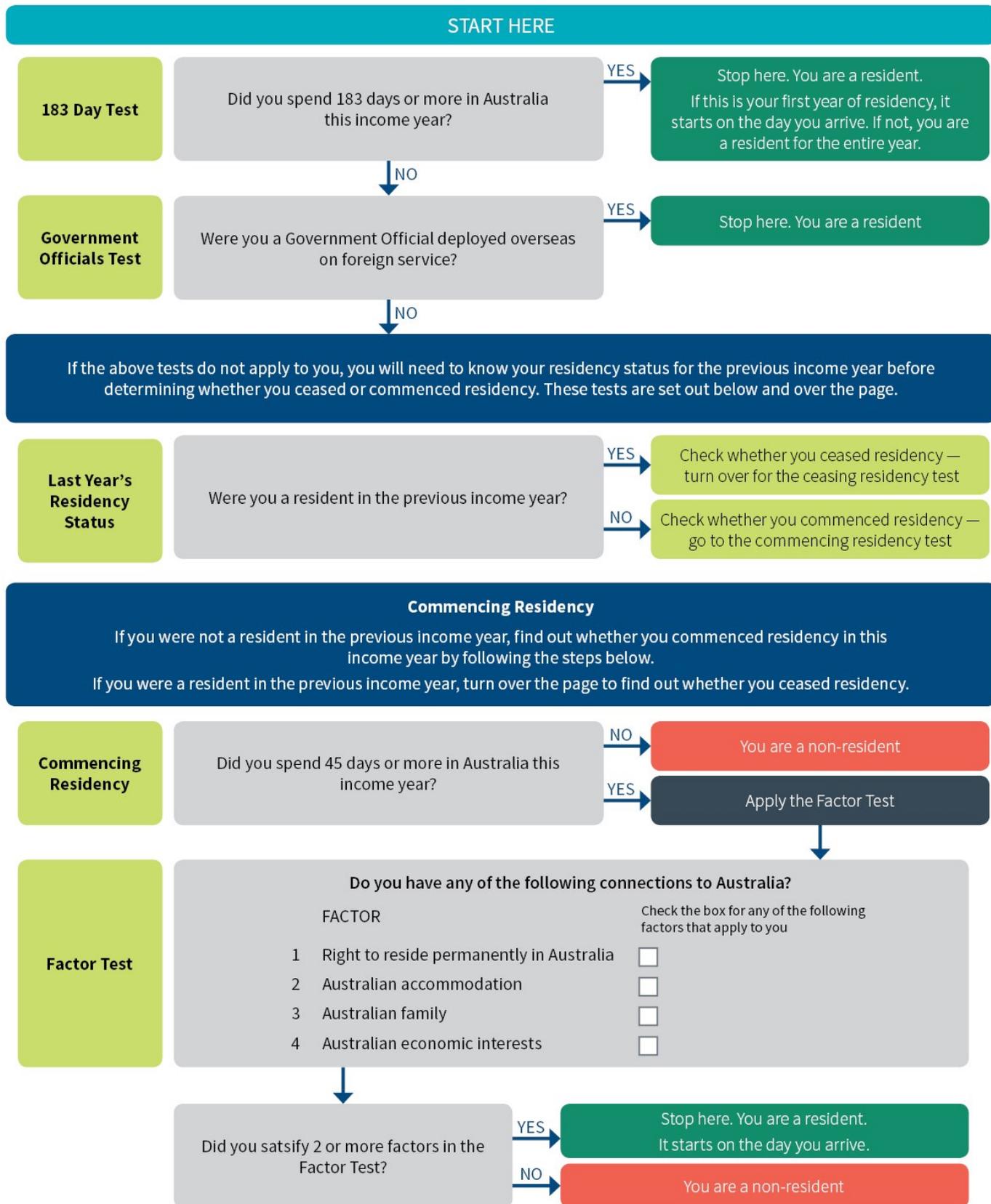
1.52 The Board has also prepared a flowchart of its preferred model on the following two pages.

Recommendation

RECOMMENDATION 1

The Board recommends that the Government replace the income tax residency rules for individuals with modernised residency rules as set out in this report.

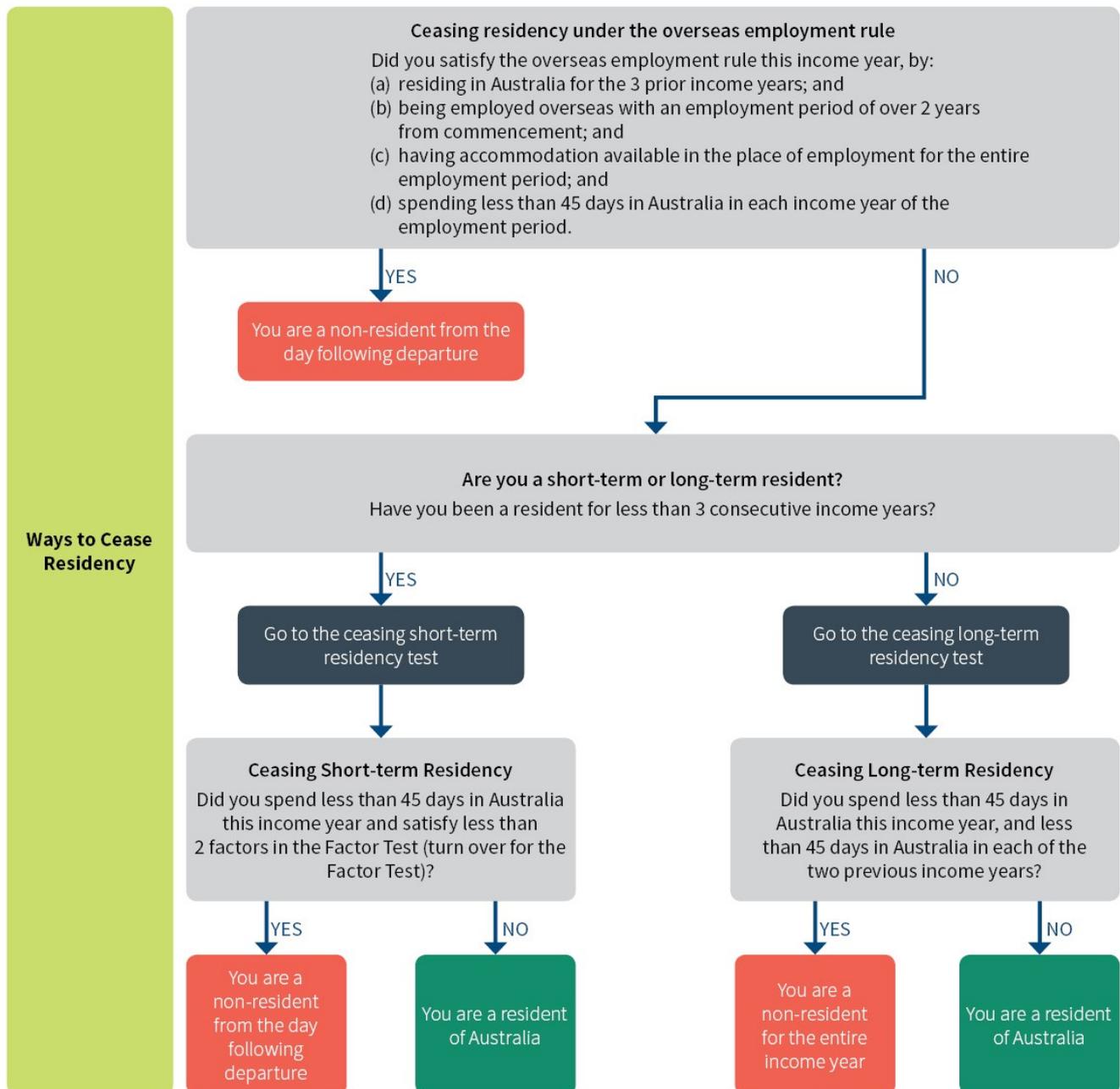
Board of Tax: Residency Rules Flowchart



Ceasing Residency

If you were a resident in the previous income year, find out whether you ceased residency in this income year by following the steps below.

If you were not a resident in the previous income year, turn over the page to find out whether you commenced residency.



Additional notes on the flowchart

Note: There are rules that assist individuals determine the date on which residency begins and ends. When residency status changes mid-year, an individual will have a resident and non-resident period, and will be taxed accordingly.

Note: If Australia has a double tax treaty with another country, the Australian Government has agreed that you will only be a tax resident of one country at any given time. There are special rules that ensure that Australia's tax laws apply to you in accordance with these international agreements (eg, if you are a resident under this test, you may become a non-resident). These rules are not included in this flowchart.

CHAPTER 2: POLICY STATEMENT: WHAT IS RESIDENCY?

KEY POINTS

- An individual's contribution to the income tax system should reflect their exposure to Australian society over time – an individual's connection to Australia underpins their residency status.
- The Board reflected on the key issues of 'what residency is' and 'who should be resident'. The Board recommends a policy statement be adopted as an objects clause clarifying the intent of the proposed residency rules.
- For income tax purposes, residing should primarily be determined by where an individual stays during a specified time period – where they live and work.
- By prioritising physical presence, the policy statement will explain what residing means in this context and remove tension that currently exists when considering individual intention.
- The statement should also reflect the additional ways for an individual to be a resident where a shorter stay in Australia is complemented by certain factors.

Statement of individual residency policy

- 2.1 In the Board's 2017 Report, the Board posed the policy question 'who should be an Australian resident?' and concluded it was a matter worthy of further consideration in modernising the residency rules.
- 2.2 The Board recommended that, in line with consultee feedback, there should be an overarching policy statement of individual residency adopted (akin to an objects clause as used in the *Income Tax Assessment Act 1997*). This is necessary to inform the scope, design and intent of Government policy and provide legislative guidance on the parameters of individual residency.
- 2.3 The Board consulted on the basis that residency reflects an individual's exposure to Australian society's economic, social and governmental infrastructure. Exposure to such benefits, through time spent in Australia and certain other ties to Australian society, should ultimately lead to the obligations of paying tax in Australia as a resident.
- 2.4 In the Board's report, the following matters were also identified:

- access to the privileges of Australian citizenship (or similar) - government infrastructure, security, medical and other services the Government provides to the individual;
- access to the Australian economy - the ability to access Australia's resources such as the capital market, a steadfast banking system, natural resources and the labour market; and
- other benefits of physical location in Australia - property (home) ownership and proximity to Australian goods, services and consumers.

2.5 The Board also considered that a policy statement should encapsulate the way in which the residency rules address tax policy objectives and the Board's guiding principles.

Consultation

2.6 The Board consulted on the following statement:

"Whether you are an Australian resident for tax purposes is based on both your time spent in Australia and the nature and quality of your ties to Australian society. The more substantial your ties to Australia, the more likely you will be a resident. This Division determines your residency status by considering the relevance of your ties and calculating your time spent."

2.7 The Board received limited feedback during consultation on the formulation of a policy statement. Stakeholders were generally supportive of adopting a policy statement and that the statement appears to strike a reasonable balance between the guiding principles. However, some stakeholders found it problematic to provide meaningful comments on a policy statement in the absence of the underlying proposed rules, as the statement should ultimately align with the way in which the law is designed that gives effect to it.

2.8 Stakeholders also observed that the statement did not specifically address all of the matters proposed in the Board's 2017 Report (e.g., the way in which the proposed rules depart from the existing rules or how they fulfil tax policy principles). However, it was generally considered that a longer statement would not provide any greater policy clarity as the outcomes under the proposed rules should complement the statement. It was suggested that a combination of a policy statement and flowchart would provide a suitable level of clarity.

What is residency?

- 2.9 Following consultation, the Board reflected on the feedback received and deliberated on setting out *what residency is* (and represents), in addition to *who will be a resident* (the focus of the policy statement in the 2018 Consultation Guide).
- 2.10 What residency means, under the current definition of resident, is inherently uncertain, being more than just where an individual ‘resides’ (for example, it is extended under the ‘domicile’ test). The concept of residing has become more uncertain over time, developing at common law from where an individual eats, sleeps and works into a more complex balance of physical presence and intention. This no longer explains, clearly and objectively, what residency is.
- 2.11 The Board considers that residing, for income tax purposes, must be clarified in the policy statement. In the Board’s view, residing is primarily where an individual stays during a specified time period – being where they eat, sleep and work. This is largely consistent with its ordinary meaning; however, by prioritising physical presence, the policy statement can simplify what residing means in this context, removing the tension that exists by considering an individual’s intention (through value laden terms such as ‘dwell’, ‘live’ and ‘continuity of association’ as developed in common law). These concepts should only be considered, in a simplified and streamlined way, as secondary considerations of residency.
- 2.12 As such, and as the Board's report makes clear, it is important that an individual's contribution to the income tax system also reflects exposure to Australian society's economic, social and governmental infrastructure over a period of time. While the statement should not create any direct link between an individual’s use of infrastructure and the amount of tax payable, it should emphasise that an individual’s connection to Australia underpins their residency status. In this way, an individual, who does not reside (through the length of their stay in Australia), may still be determined to be a resident if their stay in Australia is complemented by a connection (by way of factors).
- 2.13 The Board considers that these two matters (residency based on residing in Australia or connections to Australia) should be encapsulated in the policy statement.
- 2.14 Following consultation and deliberation, the Board recommends that a policy statement should be provided in the form of an objects clause (rather than a separate legislative test), with the underlying rules providing the mechanism to determine residency status.
- 2.15 The Board also agrees with feedback that a flowchart accompany the policy statement. The flowchart prepared for the purposes of this report may provide some assistance during implementation in this regard.

Recommendation

RECOMMENDATION 2

The Board recommends the following policy statement be adopted as an objects clause in the income tax law.

"Income tax laws apply differently to you depending on whether you are an Australian resident or not. For income tax purposes, whether you are an Australian resident is based on your time spent in Australia and the nature and quality of your ties to Australia.

These rules determine whether you are an Australian resident. This is primarily based on your physical presence in Australia. You may also be an Australian resident where you satisfy certain factors which reflect a level of connection to Australia that outweighs a lack of physical presence."

This statement should be accompanied by a flowchart of how the proposed rules operate (which may be based on the flowchart in the Board's report).

CHAPTER 3: THE 183-DAY TEST

KEY POINTS

- Residency policy should be modernised by providing that residing in Australia is primarily determined by the duration of physical presence in Australia.
- An individual who spends 183 days or more in Australia during an income year should be treated as residing in Australia for income tax purposes. This will be tested on an income-year basis.
- This simple bright-line test should be the primary test of residency. This is a key departure from the existing rules by prioritising physical presence and subordinating more complex and resource intensive analysis.
- A 183 day standard will ensure that the overwhelming majority of individuals in Australia – currently tax residents – will not need to consider the residency rules.
- A vastly smaller population of arriving and departing individuals will need to consider further tests where the 183 day standard is not met.
- The Board’s proposed rules also remove inconsistent outcomes that currently arise due to the interaction between domestic tax rules and double tax treaties.

Understanding the residency of most individuals

- 3.1 According to Taxation Statistics 2015-16, 13,374,182 individuals lodged tax returns as tax residents.² By contrast, approximately 133,919 non-resident returns were lodged.
- 3.2 These statistics support the Board’s view (in its 2017 Report and 2018 Consultation Guide) that the overwhelming majority of individuals in Australia are currently tax residents and have no need to consider the residency rules – these individuals live and do business in Australia and thus reside in Australia. However, it is unlikely that many individuals appreciate how the tax law arrives at this outcome and the potential for complexity as their circumstances change. For example, there is complexity and heightened uncertainty in the existing rules for arriving and departing individuals to determine their residency status.

² Taxation Statistics 2015-16, Australian Taxation Office , <<https://data.gov.au/dataset/ds-dga-d170213c-4391-4d10-ac24-b0c11768da3f/distribution/dist-dga-c9817dcf-5c43-4a70-8c14-0b94e7b496c4/details?q=>>

3.3 It is the Board's view that the majority of individuals should not be required to engage with the residency rules to any great extent in the proposed rules. To do so, the Board proposes that residency policy be modernised by providing that residing in Australia is primarily determined by the duration of physical presence in Australia. That is, to 'reside' for income tax purposes is primarily based on the length of physical presence in Australia as set out in the Board's proposed policy statement.

3.4 The Board recommends that the physical presence test be a simple bright line in accordance with the following principle:

An individual, who spends 183 days or more in Australia in the current income year, resides in Australia for income tax purposes.

3.5 This test provides simple, certain instructions for the vast majority of individuals. Any individual that spends less than 183 days in Australia will then need to determine whether they commence or cease residency by other means. These further standards will apply to a vastly smaller population of individuals (however, the Board supports further analysis during implementation to confirm this outcome). The Board considers providing outcomes that are simple and certain for the majority of resident taxpayers to be appropriate and a key simplification outcome.

3.6 The 183 Day Test is expanded on further below.

Key changes from the existing residency policy

3.7 Under the existing residency rules, most individuals will reside in Australia in accordance with the 'resides' test.

3.8 However, as outlined in detail in the Board's 2017 Report on individual tax residency, this test, which relies on both common law and statutory definition for interpretation, is increasingly uncertain and ill-suited to the dual purpose of determining the residency status of most individuals and sustaining claims of residency for complex cases of outbound individuals.³ In deliberating on a revised standard, the Board and consultees rejected maintaining this test as the primary test of residency. A similar analysis was undertaken for the rejected concept of domicile, an antiquated common law concept.

3.9 Individuals may also reside in Australia under the existing 183 day standard, which was intended to simplify the expected great difficulties of the residency test when enacted in 1930.⁴ As the existing rule includes a day count standard as well as requirements of

³ More recent decisions, *Harding v Commissioner of Taxation* [2018] FCA 837 and on appeal *Harding v Commissioner of Taxation* [2019] FCAFC 29, lend further weight to the uncertainty and undesirability of this test.

⁴ See page 21 of the Board's 2017 Report.

intention to reside and place of 'abode', the Board previously concluded that this rule does not apply in many circumstances due to the way the 'resides' test has been interpreted.

- 3.10 The Board's proposed primary test removes the uncertainty that applies within all of these tests and instead maintains the 183 day standard as a primary test. This provides significant simplification benefits and improved certainty for individuals, with flexibility and detail added only where it is needed most – in determining whether individuals with more complex affairs commence or cease residency.
- 3.11 As previously noted in the Board's 2017 Report, achieving residency status for income tax purposes changes both the categories of income on which an individual is taxed, and the tax rates imposed. Key examples include residents being able to access the tax-free threshold and taxed on worldwide income (as well as paying the medicare levy), while non-residents are taxed only on Australian sourced income with no access to the tax-free threshold, although certain (potentially lower) withholding tax rates may apply. The Board has prepared a table to illustrate some of these outcomes in **Annexure A**.
- 3.12 Ultimately, the Board considers that there will be trade-offs in determining whether any individual taxpayer is better off being a resident or non-resident, as well as how changes in the treatment of classes of individuals will impact tax receipts. Important examples of the latter are temporary residents and working holiday makers (explored further below).
- 3.13 The Board has reviewed these important considerations and concluded that the better policy setting for individual residency is to provide a clear standard each income year based on physical presence. Generally, physical presence in Australia for the majority of an income year provides access to Australian social, economic and infrastructure benefits for which individuals should be taxed accordingly – that is, as residents. It also provides consistency between Australian tax residency and many other countries, as 183 days is a widely used international standard.
- 3.14 In accordance with this view, the Board recommends modifying the existing residency policy to remove subjective, uncertain considerations and instead adopting a primary 183-day standard based solely on physical presence.

Clarifying the 183-day standard

- 3.15 The consultation carried out by the Board in late 2018 canvassed whether a bright-line test should be adopted to determine residency. The Board indicated its preference for a 183-day standard that would apply for individuals to establish or maintain residency.
- 3.16 Consultees overwhelmingly supported this proposal, noting significant simplification benefits as well as providing consistency with standards adopted overseas for tax residency purposes.

- 3.17 A number of important considerations have been considered in order to ensure this recommendation provides improved policy outcomes from the existing settings.
- 3.18 Of those considerations, the following merit inclusion in this report:
- (a) What makes up a day of physical presence;
 - (b) Whether any special circumstances arise;
 - (c) How the 183-day standard relates to the income/financial year.

Defining a 'day' of physical presence

- 3.19 A number of consultees sought clarification on what a 'day' would mean for these purposes. In written submissions, a number of suggestions were provided. Those suggesting that presence on any part of a day be counted noted the difference between Australia as a relatively geographically isolated country and other jurisdictions (e.g., the United Kingdom statutory residency test) where there are exceptions for certain transitory visits. Others suggested excluding any part day presence.
- 3.20 The Board prefers that any presence in Australia on a given day counts as a day for these purposes. The Board considers that this will provide simplicity and certainty, as well as limit any opportunity for manipulation.
- 3.21 As such, the proposed test will include days in which an individual spends part of the day in Australia as one day of presence in Australia for these purposes (and for the purposes of the commencing and ceasing residency tests).

Whether special circumstances arise?

- 3.22 A number of consultees raised concerns regarding extraordinary circumstances and the ability to change residency outcomes where the individual's circumstances may appear at odds with the policy settings.
- 3.23 The Board is cognisant of this issue and considers that, while a simple, certain test provides an improved standard, there may be circumstances that warrant flexibility. In order to provide some flexibility, the Board suggests that some options for flexibility in extraordinary circumstances be considered further during implementation.
- 3.24 For example, the Board suggests that an ability to apply to the Commissioner to have certain days disregarded for the purposes of the 183 Day Test, subject to certain conditions to provide clarity and integrity, should be considered. A number of examples are provided below to illustrate how such a test might operate; however, there may be other mechanisms identified that provide more suitable flexibility.
- 3.25 Any application-based exemption should not imbue broad discretion on the tax administrator (i.e., the Commissioner of Taxation (Commissioner)). Such a broad

discretion would both undermine the certainty the proposed rules seek to provide and impose significant administrative burdens on the ATO and increased costs on taxpayers.

- 3.26 It is expected that conditions may include where the physical presence in Australia is due to circumstances outside of the individual's control – such as critical illness of a family member, significant national disasters or other comparable events.
- 3.27 The Board does not envisage events such as temporary plane delays or missed connections, errors in implementing physical presence advice from tax advisers, gaol sentences etc. as justifying departure from the 183 day standard.

EXAMPLE 1

Charlotte frequently visits Australia on business. She arrives in Australia on 30 May 2019 for a 10 day business trip. Up to and including this visit, she has been in Australia for a total of 170 days. When Charlotte is due to return home on 9 June 2019, all air travel into and out of her home country is suspended due to the eruption of a volcano near her home country. She is unable to return home until 24 June 2019 when air travel resumes into her home country, with the result that she has spent a total of 185 days in Australia during the 2019 income year.

Charlotte can apply to the Commissioner to disregard the additional 15 days she spent in Australia due to the volcano eruption for the purposes of the 183 day test. Charlotte would then need to consider the secondary tests to determine if she was a resident during the income year.

EXAMPLE 2

Oliver and Noah are visiting Australia on a four month holiday. They are involved in a serious car accident which results in Oliver being hospitalised in Australia for three months before he is able to return home. Noah remains in Australia for the duration of Oliver's hospitalisation, with the result that both spend more than 183 days in Australia during an income year.

Oliver and Noah can both apply to the Commissioner to have the three month stay as a result of Oliver's hospitalisation disregarded for the purposes of the 183 day test.

EXAMPLE 3

Ava was in Australia from 1 to 26 July 2018 then moved to the United States with her partner. Due to a serious illness in her immediate family, she returned to Australia for three weeks in May 2019. As a result, Ava spent a total of 47 days in Australia during the 2019 income year.

Ava can apply to the Commissioner to have her 21 day stay in May disregarded for the purposes of the 183 day test. She would then need to consider the ceasing residency test to determine if she was a resident for part of the income year.

- 3.28 The Board does not consider that this same relief would be necessary for individuals to add additional days to their physical presence in Australia. The Board's suggestion only seeks to provide relief where an individual would not otherwise be a resident, save for the bright-line nature of the 183 day test. That is, it is expected to most commonly apply to those who would be unlikely to otherwise satisfy the commencing residency test.
- (a) If an individual fails the 183 day test, they must determine which of the other tests to apply. Any individual that would seek leave to include extra days of presence should otherwise maintain or commence residency under the commencing residency test. If not, the Board does not consider it appropriate to inflate such an individual's connection to Australia for residency to be established. Limiting claims to disregarding days on which an individual was actually present in Australia will simplify assurance and verification of presence.
- 3.29 The Board supports further consideration only for the 183 Day Test – it is unnecessary to consider for the 45-day standard in the ceasing and commencing residency tests, outlined in later chapters. These tests are designed to assess an individual's connection to Australia (including both physical presence and other factors), in the context of ceasing and commencing residency. In such circumstances, the existence of such a rule would create additional stress in the rules and give disproportionate influence to the relief mechanism – the context is materially different to the 183 Day Test.
- 3.30 Any mechanism should be targeted so that it does not affect the broader structure of the rules – the Board does not support a broader exception or exemption that reduces certainty. The Board currently prefers the application option outlined above, but the design should be explored in implementation, guided by the appropriate balance of certainty, simplicity, integrity and flexibility.
- 3.31 The Board notes that the imposing of any additional discretion upon the Commissioner (and review at the Administrative Appeals Tribunal) comes with resulting administrative burden and therefore the Board acknowledges that this will need to be carefully weighed as part of any proposal.

12-month testing period for day count

- 3.32 The Board consulted on whether some form of ‘rolling’ 12-month period or an income year would be an appropriate test period for the 183-day test.
- 3.33 Some consultees considered that a rolling period may create uncertainty and complexity, or lead to different outcomes simply because individuals arrive in Australia in the second half of the income year. Others queried whether a rolling period addresses manipulation issues, and whether it comes at the expense of simplicity.
- 3.34 In particular, the Board heard during consultation that a rolling 12-month period would necessarily mean that individuals (and their employers for pay-as-you-go withholding purposes) may not be able to conclusively determine a person’s residency status in an income year. If, due to a number of days in a subsequent year, an individual’s residency status for the prior year were to change, then this would lead to significant compliance costs and uncertainty. While efforts could be made to address these issues, a level of uncertainty is unavoidable.
- 3.35 Conversely, by limiting the 183-day count to an income year basis, individuals will have certainty regarding both the test period and number of days over which it will be tested. This can be determined at the end of an income year or earlier (i.e., on the 183rd day). Regarding concerns that an individual may manipulate the 183 day standard to straddle two income years, the inclusion of a commencing residency test, which applies to individuals who spend 45 days or more in Australia in an income year and includes the Factor Test, operates to resolve issues of manipulation and determine whether a sufficient connection has been established.
- 3.36 The Board concluded that the income year is the most appropriate setting. A rolling 12-month period is not the most appropriate setting as, while providing some integrity, it undermines the simplicity and certainty guiding the Board’s approach as well as imposing a greater burden on individual taxpayers, employers and the ATO.
- 3.37 This approach provides certainty, simplicity and aligns with the broader income tax framework. The Board recommends adopting the income year approach.
- 3.38 For completeness, the Board’s recommended part-year residency rules will provide clarity around the relevant start and end of periods of residency. The proposed part-year rules clarify the treatment for individuals who arrive at different times within an income year – a number of brief examples are set out below.

EXAMPLE 4

Isla was an Australian resident in 2018. In the 2019 year, she spent a total of 340 days in Australia. Isla is an Australia resident for the whole of the 2019 income year under the 183 day test.

EXAMPLE 5

Harvey was a non-resident in 2018. He arrived in Australia on 15 August 2018 and stayed in Australia for the remainder of the 2019 income year (a total of 320 days). Harvey is an Australian resident on and from 15 August 2018 under the 183 day test.

EXAMPLE 6

Luca was a non-resident in 2018. He arrived in Australia on 20 July 2018, and departed on 12 November 2019. Luca returned to Australia on 8 March 2019 and stayed in Australia for the remainder of the 2019 income year (a total of 231 days). Luca is an Australian resident on and from 20 July 2018 under the 183 day test.

Recommendation

RECOMMENDATION 3

The Board recommends a 183 Day Test as the primary rule for individual tax residency, in line with the following principle:

An individual who spends 183 days or more in Australia in the current income year will be an Australian tax resident.

This test will apply on an income-year basis and any part of a day spent in Australia counts towards this test.

CHAPTER 4: COMMENCING TAX RESIDENCY

KEY POINTS

- If an individual spends less than 183 days in Australia, the Board's proposed residency rules apply separate tests for determining whether an individual has commenced or ceased residency. This maintains a distinction that exists when applying the current rules in practice.
- The commencing residency test only applies to individuals who were not resident in the previous income year.
- The test will only be satisfied if an individual is physically present in Australia for 45 days or more in the current income year and two clear, objective factors demonstrate a connection to Australia under the Factor Test.
- The minimum presence of 45 days is largely consistent with international comparisons, anecdotal evidence, and the limited data available. Below this threshold, individuals should not have to apply the Factor Test.
- This test provides significant simplification and streamlining from the existing rules, focusing on certainty of outcomes.

Commencing residency in Australia

- 4.1 Under the Board's recommended model, an individual who spends 183 days in Australia in an income year will be an Australian tax resident.
- 4.2 As outlined in the Board's 2017 Report, the existing residency rules apply differently for inbound and outbound individuals. Historically, it has been most difficult to apply the residency rules in these cases – that is, when does an individual start and end being a tax resident?
- 4.3 The Board considers that this distinction, starting and ending, is a useful way to separate out the more complex cases from the simple. As such, the Board's proposed residency rules maintain this distinction from the existing rules but, through significant simplification and streamlining, provide certainty of outcomes.

- 4.4 The Board’s model also maintains the adhesive residency principle (where it is harder to cease residency than commence).⁵ This is consistent with broader global practice and the policy settings behind the existing residency rules.
- 4.5 In order to achieve these aims, the Board’s model includes specific rules to determine when an individual starts residency. That is, it sets out clear rules for individuals, who are not residents, to determine if and when they commence residency. The day-count standard is not the only way in which an individual can commence Australian residency.
- (a) As outlined in the Board’s 2018 Consultation Guide, were an individual only to become a resident via a day-count test the residency rules would be overly simplistic and open to inappropriate manipulation.
 - (b) The Board considers that a day-count test, complemented by other, more adhesive mechanisms that provide integrity, strikes an appropriate balance for determining when an individual commences residency.
- 4.6 The Board’s commencing residency test is outlined below.

The Commencing Residency Test

- 4.7 As outlined in the Board’s 2018 Consultation Guide, the Board’s preferred approach is to adopt a separate test for individuals that were not previously Australian tax residents. By doing so, these individuals can determine whether they have commenced residency in Australia by virtue of their presence and connections in an income year.
- 4.8 The commencing residency test will determine the circumstances in which an individual establishes residency. It will therefore be framed such that an individual only obtains residency if they satisfy certain requirements (and remains non-resident if they do not satisfy the requirements).
- 4.9 The commencing residency test is based on the following principle:
- 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 or more factors.*
- 4.10 Importantly, the commencing residency test only applies where an individual is physically present in Australia for 45 days or more in the current income year. The Board considers that this is an appropriate threshold before individuals should be required to consider the Factor Test.

⁵ For more information, see Chapter 1 Modernising individual tax residency.

- 4.11 The Board's consideration in coming to the 45-day standard is set out below.
- (a) The Board agreed with concerns raised that individuals that have not spent time in Australia should not be caught, as it would be impractical for individuals, and difficult for administrators, were the test to apply.
 - (b) The ceasing residency test provides an individual will use the same standard (i.e., ceasing to reside based on spending less than 45 days in Australia over a period of time). The Board considers that the physical presence threshold under the commencing residency test should be aligned to this standard.
- 4.12 In the commencing and ceasing residency tests the Board has adopted a single year approach (that is, the tests are based on an individual's residency status in the preceding year). For these purposes, the Board considers that testing can be limited to a single income year as there is broad alignment between the commencing and ceasing tests (in particular, the common 45-day standard).
- 4.13 The Board recommends that any individual, not resident in the preceding income year, becomes resident by satisfying the commencing residency test.
- 4.14 For completeness, the Board's recommended part-year residency rules will provide clarity around the relevant start and end of periods of residency. Within the part-year rules, additional rules are provided to ensure that there is appropriate treatment for individuals who arrive at different times within an income year – a brief example is set out below that illustrates the Board's views. More information is included in the part-year residency chapter.

EXAMPLE 7

Zoe is migrating to Australia with her immediate family under a permanent residence visa which issued on 15 January 2019. She travelled to Australia for 3 weeks from 2 February 2019 to 22 February 2019 and purchased a house for herself and her family to live in on 20 February 2019. Zoe migrated to Australia with her immediate family on 18 April 2019, and stayed in Australia for the remainder of the 2019 income year. She was in Australia for a total of 95 days in the 2019 income year.

As Zoe did not satisfy the 183 day test, and was not a resident in the previous income year, she needs to apply the commencing residency test. Assuming Zoe satisfied the factor test, she is a resident on and from 2 February 2019 under the commencing residency test (being her first day of physical presence in Australia in that income year).

Key changes from the existing rules

4.15 The Board's commencing residency test maintains the broad framework of the existing rules, by testing both physical presence in Australia and considering other factors connecting an individual to Australia. The Board's recommended rules depart from the existing rules in specific ways, which are summarised below:

- (a) **Individuals migrating to Australia and intention:** under the current rules, individuals determine residency when migrating largely based on their intention (and other connections holistically). The Board's proposed rules eliminate intention from the commencing residency test, providing far greater certainty of outcomes and clear guidance for individuals considering migrating to Australia.
- (b) **Facts and circumstances – simplification into factors:** the Board's proposed rules use Australia-focused factors to determine Australian residency (rather than globally comparative factors), a key departure from the existing rules that received strong support during consultation. In the context of commencing residency, departing from the holistic analysis required (set out in the Board's 2017 Report) and instead identifying a number of clear, objective factors that show a connection has been established to Australia is a key simplification. This is elaborated on later in this Report.

Adopting a 45 day standard

4.16 In the Board's 2017 Report and 2018 Consultation Guide, a number of options were considered as the minimum physical presence requirement for an individual to commence or maintain residency. This included a variety of day count thresholds as well as whether any physical presence was needed at all.

4.17 Based on analysis and consultation, the Board has concluded that some level of physical connection is necessary for individuals to commence residency in an income year. The Board found compelling the significant administrative difficulties (as well potential compliance costs) that would arise should all individuals who spend less than 183 days in Australia (down to those spending no time in Australia), must determine how the Factor Test applies to their circumstances. This outcome would be undesirable and likely unworkable.

- 4.18 In order to set an appropriate day count, the Board considered a variety of data sources and international comparisons. Available migration statistics provide insights into common tourist and other visitor stays in Australia, where the median stay was 11 days in 2018.⁶ Further, the general trends within overseas arrivals and departures data for short-term visitor arrivals (and residents returning) indicate that the vast majority of those arriving intend to stay in Australia for less than 2 months.⁷
- 4.19 Internationally, there are different approaches. As set out in the Board's 2017 Report, the New Zealand tax residency rules include a standard of 325 days or more outside of New Zealand (i.e., 40 days in New Zealand) to become non-resident, whereas the United Kingdom applies a number of tests including a standard of 45 days or less in the United Kingdom for certain individuals to become non-residents.⁸
- 4.20 The Board considers these sources to be instructive, while not conclusive. It was concluded that setting this day count would benefit from further data analysis. This would provide some further certainty around overseas arrivals and departures trends to assist calibrating the test to minimise the number of genuine visitors captured, while not being set inappropriately high giving rise to excessive manipulation.
- 4.21 Nonetheless, the Board expects a behavioural response – this is by design, to allow individuals to plan their affairs accordingly. As such, it will be impossible to definitively conclude, based on historical data, where this test should be set, and anecdotal evidence will also be informative. Based on its consultations, it should be longer than the common 4-week annual leave period.
- 4.22 At this point in time, the Board prefers an approach that is largely consistent with international comparisons, anecdotal evidence, and the limited data available. The Board recommends that a 45 day standard be adopted subject to further analysis as outlined above.

⁶ 3401.0 Overseas Arrivals and Departures, Australian Bureau of Statistics, December 2018, <<https://www.abs.gov.au/ausstats/abs@.nsf/products/961B6B53B87C130ACA2574030010BD05>>:

The median duration of stay in Australia was 11 days. Short-term visitors who travelled to Australia for education had the longest median duration of stay (123 days), while business travellers had the shortest (6 days). Visitors whose main reason for stay was holiday had a shorter median duration of stay (9 days) than those visiting friends and relatives (16 days).

⁷ 3401.0 Overseas Arrivals and Departures, Australian Bureau of Statistics, January 2019 <http://www.abs.gov.au/ausstats/abs@.nsf/glossary/3401.0>

⁸ Another example of which the Board is aware is Malaysia, being 90 days.

Further considerations

- 4.23 The Board notes that, by adopting an income-year basis, an individual who migrates to Australia in the last 44 days of an income year will not be a resident for that period of their first income year in Australia.
- 4.24 The Board considers that the 45-day standard provides simplicity and certainty – individuals will be aware of this possible outcome and can plan their affairs accordingly. The Board is aware that this outcome will be preferred by some but not others. Ultimately, the Board considers that setting a clear threshold is appropriate and the trade-off between flexibility and certainty is in line with the Board’s guiding principles.
- 4.25 While the Board prefers not to depart from the 45-day standard, this issue is highlighted should it warrant further consideration during implementation.

EXAMPLE 8

Karen migrates to Australia on 1 June 2019, having not been to Australia before.

Karen did not spend 183 days in Australia and has to apply the commencing residency test. Under the Board’s preferred approach, as Karen did not spend 45 days in Australia in the 2019 income year, she will be a non-resident in that year regardless of the factors that she may satisfy during that 45 day period.

Karen will need to apply the 183 Day Test or commencing residency test in the following income year.

Interaction with the 183 Day Test

- 4.26 As outlined in the Board’s 2017 Report and 2018 Consultation Guide, the Board recommends a bright-line test for individuals commencing residency.
- 4.27 This standard will be provided by the 183 Day Test. The commencing residency test interacts with the 183 Day Test as follows:
- (a) If an individual is present in Australia for 183 days or more, they satisfy the 183 Day Test and will be an Australian tax resident for that income year. No further inquiries are necessary.
 - (b) If an individual does not satisfy the 183 Day Test and was a non-resident in the preceding income year, they must apply the commence residency test (as they must determine if they commence residency in the income year).
 - (c) If an individual does not satisfy the 183 Day Test and was a resident in the preceding income year, they do not apply the commencing residency test

(because, as the name seeks to clarify, they have already commenced residency at an earlier time). Rather, the individual will need to determine if they have ceased residency in the income year (discussed further in the following chapter).

- 4.28 These tests are designed to be logical for individuals arriving in Australia to follow. For instance, an individual who arrives in Australia will be able to determine if they have commenced residency using a set of simple rules including the 183 Day Test and the commencing residency tests.
- 4.29 More information on the 183 Day Test is set out in the preceding chapter.

Interaction with the Factor Test

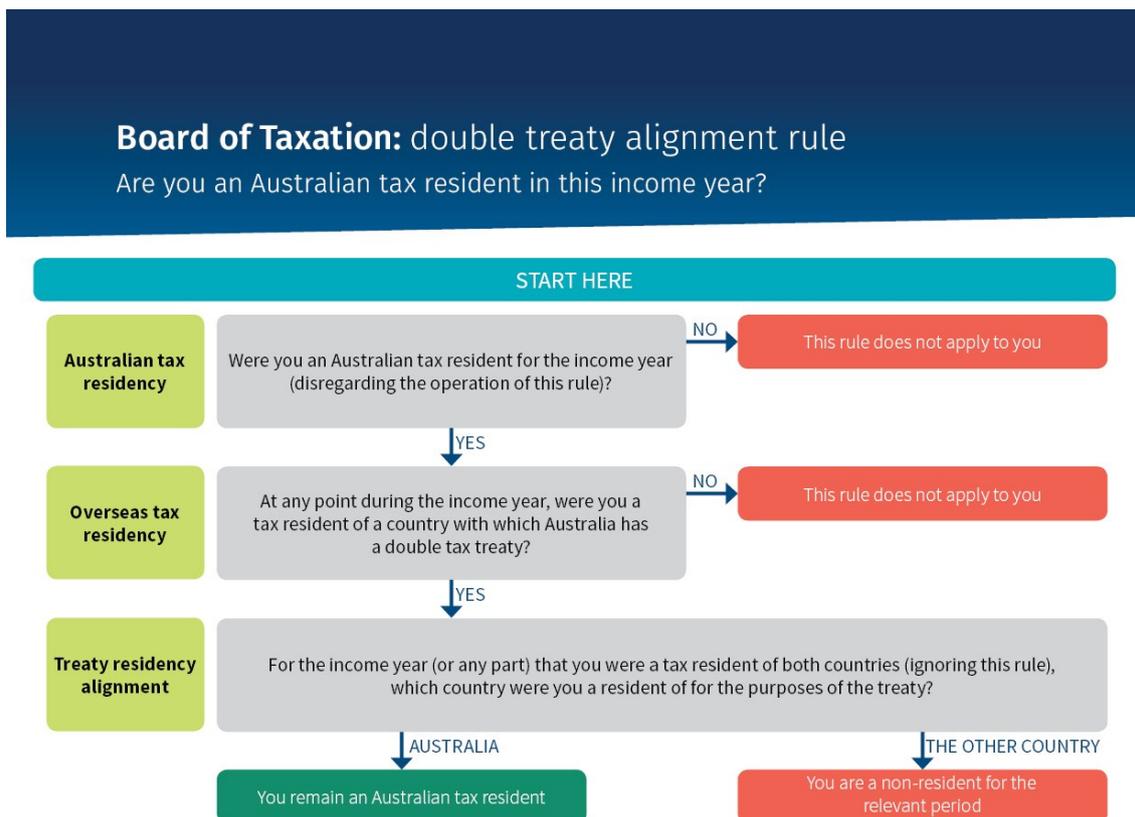
- 4.30 The Board consulted on the basis that an individual's residency will not be assessed purely on their physical presence in Australia, as this may give rise to inappropriate outcomes and manipulation.
- 4.31 For the purposes of determining whether an individual has commenced residency, consultees were largely supportive of the factors outlined by the Board, as well as their focus on Australian connections. More information on each of these factors is set out in a later chapter.
- 4.32 The Board considered the relevant number of factors necessary to commence residency. In analysing this issue, the Board considered the extent to which individuals must establish ties to Australia under the existing rules. The adhesiveness of the existing rules shows that a relatively minor connection is required (for example, evidence of accommodation and an intention to stay in Australia for a period of time).⁹
- 4.33 Ultimately, the Board seeks to reflect this existing standard within the Factor Test for commencing residency, while eliminating the uncertainty of determining intention. In light of this, the Board recommends that if an individual satisfies two factors, this establishes a sufficient connection to Australia that, together with 45 days or more in Australia, means the individual is a resident.
- 4.34 This two out of four standard for the Factor Test is also designed to be consistent with the Board's preferred standard for the Factor Test when ceasing residency.

⁹ For example, see *R v Barnet London Borough Council; Ex parte Shah* [1983] 1 All ER 226, Groves and Commissioner of Taxation [2011] AATA 609.

Tax treaty interactions

- 4.35 Within Australia's tax treaty network, an individual can only be treaty resident of one country.
- 4.36 The Board consulted on the basis that reform of residency is an opportunity to align domestic tax residency with residency under Australia's comprehensive tax treaty arrangements (commonly referred to as 'double tax treaties').
- 4.37 Broadly an Australian resident individual is taxed on their worldwide income (that is income sourced in Australia and foreign sourced income). In contrast Australia's taxing rights will be limited where a double tax treaty operates to treat the Australian resident as being a resident of the treaty partner country. Where this occurs Australia's ability to tax is limited to Australian sourced income only and the treaty partner is able to continue to exercise its right to tax the worldwide income of the individual. As a further consequence, the Australian resident is unable to access benefits under other Australian tax treaties by virtue of the rule which excludes a person from being a treaty resident where they are 'liable to tax' in Australia in respect only of income from Australian sources.
- 4.38 It is important to note that the result of the treaty tie-breaker rule does not immerse itself into Australia's domestic tax law. Thus the individual is still regarded as a 'resident for domestic tax purposes'. This means that the individual still has access to the tax free threshold and the Capital Gains Tax (CGT) discount even though the treaty has limited Australia's tax rights to Australian source of income (i.e. the same as a non-resident).
- 4.39 The above mentioned treatment of such individuals is inconsistent with the fundamental tax policy position of taxing residents on a worldwide basis. It follows that they should be treated as a 'non-resident' for domestic tax purposes. This would align the domestic law with tax treaty outcomes.
- 4.40 During consultation, the Board received broad support for this view. As Australia's tax treaties apply to individuals regardless of whether there is alignment between domestic law and treaty, some consultees supported alignment as the reduction in complexity of domestic law would reduce the compliance burden, such that only the tax treaty analysis of facts and circumstances would require a more holistic review of facts and circumstances (which persists regardless of whether or not these reforms are adopted). Some consultees did not support alignment as the outcomes may be disadvantageous; the Board was not persuaded by this assertion.
- 4.41 The Board supports the alignment of domestic law with tax treaty outcomes.
- 4.42 The Board therefore recommends that where an Australian is treated as a resident of another country under one of Australia's comprehensive tax treaty arrangements the individual should also be treated as a 'non-resident' for domestic tax law purposes.

4.43 The operation of this rule is set out in the flowchart below



Clarifications and other considerations

4.44 The Board has identified a number of important issues that are relevant to individual tax residency in the course of preparing its recommendations. The Board has analysed these issues and set out relevant observations below.

Government officials

4.45 The Board has addressed government officials in a separate chapter regarding the modernisation of the superannuation rule. Where an Australian Government official deployed overseas satisfies the test set out in that chapter, they are excluded from the commencing residency test (as they will already be a resident).

Visitors and temporary residents

4.46 During consultation the Board heard concerns from stakeholders as to the manner in which the 183 day standard and the inclusion of a commencing residency test would take into account the circumstances of tourists, working holiday makers, students and

other visitors that come to Australia for work or academic purposes, and may stay in Australia for 183 days or more in an income year. That is, consultees sought clarity on whether it is envisaged the residency status of visitors to Australia is proposed to change.

- 4.47 In 2017-18, there were 6,300,288 arrivals in Australia of Visitors on Tourist and Business Group Visas (a 6.8 per cent increase on the prior year).¹⁰
- 4.48 The vast majority of these visitors would not generally reside in Australia under the current rules. Importantly, from the Board's analysis and design it is not expected that many would have spent sufficient time or developed sufficient ties to Australia under the proposed model to commence residency. As such, the vast majority of arrivals should not be subject to any change in residency status. They will not be provided access to the tax-free threshold were they to derive Australian sourced income, nor will they be subject to tax on their worldwide income. However, individual circumstances will vary.¹¹
- 4.49 Nonetheless, a small proportion of individuals on these visas can (and do) exhibit the characteristics of individuals who reside in Australia. Accordingly, all individuals should be treated the same under the proposed residency rules. The Board has ultimately concluded that a specific exemption for all visitors to Australia, for example based on visa classes, is not warranted (see also the alternate models in **Annexure B**). The Board considers that the proposed rules provide greater certainty of residency outcomes for all individuals, and that this will be particularly beneficial to these individuals where there may currently be heightened uncertainty.
- 4.50 The Board considers that the 183 Day Test and commencing residency tests will appropriately determine the residency status of these individuals. However, this design risk should be monitored during implementation.

Temporary Resident Rules

- 4.51 Nonetheless, the Board has considered concessions and specific policy settings in the current income tax laws that can apply to individuals on temporary visas to ensure that the interaction between these concessions and the proposed rules would be appropriate. For example, genuine visitors, international students, visiting professors, authors, entertainers and corporate executives may be temporary residents for income tax purposes under the temporary resident rules.

¹⁰ BP0019 Temporary Visa Holders in Australia, Department of Home Affairs, <https://data.gov.au/dataset/ds-dga-ab245863-4dea-4661-a334-71ee15937130/details?q=>

¹¹ For example, while the median international student stay in Australia was 123 days in 2018, many students would have stayed for longer than that time period and as such may have become residents under the existing rules (see *R v Barnet London Borough Council; Ex parte Shah* [1983] 1 All ER 226).

- 4.52 These rules generally provide an exemption from Australian taxation on foreign income except income earned from employment or services performed overseas. As noted in the Board's 2017 Report, these incentives encourage highly skilled mobile expatriates and reduce the administrative and compliance costs for Australian businesses. They apply to all individuals on temporary visas subject to certain requirements; most importantly, that an individual cannot be a temporary resident if they are the spouse of an Australian citizens or permanent resident.¹²
- 4.53 The Board considers that a broader application of the temporary resident rules (to a wider range temporary visa holder) may better complement the Board's revised residency settings, as following its analysis the Board considers some outcomes to be anomalous.¹³
- 4.54 The Board recommends that these rules be analysed further during implementation, to identify whether there are opportunities to change the rules and ensure access is available for all appropriate classes of temporary visa holder.¹⁴
- 4.55 The Board also affirms its recommendation from the Board's 2017 Report to time-limit temporary resident relief – that the concessions are not available where an individual has been in Australia for more than four years. This should be considered as part of implementation.¹⁵
- 4.56 The Board remains of the view that further simplification may be possible with further alignment of the individual tax residency rules and Australia's immigration visa regime.¹⁶

¹² Under the temporary resident definition, an individual will not be a temporary resident if either they, or their spouse, are residents under Social Security law (broadly to exclude from temporary residency individuals who have a spouse that is a citizen or permanent resident).

¹³ For example, the temporary resident rules could be relaxed by removing the exclusion for those with spouses that are Social Security residents (such as Australians). This connection to Australia, in the context of the Board's revised residency rules, is captured by the Factor Test, and as such marriage to a citizen or permanent resident may no longer be an appropriate proxy for the permanence of a stay in Australia.

¹⁴ The Board notes that the interaction between the long-term resident test will require further consideration to ensure alignment is maintained.

¹⁵ The Board also recommended that, should the Board's recommended reforms be adopted, non-resident tax rates be applied to temporary residents. Following consultation and further policy development, the Board has not progressed this recommendation, but notes it may be considered further during implementation.

¹⁶ See recommendation 11 of the Board's 2017 Report.

EXAMPLE 9

Huw is a famous actor based in the United States of America. In 2020, Huw is contracted to film a blockbuster movie in Australia for nine months from August 2020 until May 2020.

Huw enters Australia on 1 August on a temporary work visa that satisfies the temporary resident rules. As Huw spends over 183 days in Australia in the 2020 income year, Huw commences residency on 1 August. However, as the temporary resident rules apply to Huw, he will generally not be taxed on his worldwide income in accordance with those rules.

Other temporary visitor rules

- 4.57 The Board also considers that the seasonal labour mobility program and working holiday maker rules will remain unaffected by the Board's revised residency rules. Under these specific regimes, the Government provides targeted relief for individuals who work in Australia on particular visas or in certain circumstances.
- 4.58 Notwithstanding, the Board has had special regard for the interaction with the working holiday maker rules.
- 4.59 In 2017-18, there were 210,456 working holiday maker visas granted – the Board appreciates that while this is a small proportion of overall visitors, it is a significant proportion of potential Australian-income earning visitors (in particular given the conditions of these visas and extensions).¹⁷
- 4.60 The Board understands that it is relatively common for working holiday makers to be in Australia for more than 183 days and, under the Board's proposed rules, 183 days or more spent in Australia in a single income year would satisfy the 183 Day Test.
- 4.61 Although residency is not relevant for determining the rates of tax applying to working holiday makers, there is some uncertainty as to how the existing residency rules apply to working holiday makers. This uncertainty is unresolved with differences of view within industry and the ATO.¹⁸ The Board understands that, as of March 2019, there is ongoing litigation around the residency of a working holiday maker. The court is considering the

¹⁷ BP0017 Working Holiday Maker visa program, Department of Home Affairs <https://data.gov.au/dataset/ds-dga-602f74a0-a588-4dea-ae28-0fe123cbb182/details?q=>

¹⁸ A number of cases have been heard by the Administrative Appeals Tribunal on these matters, where individuals have been found to be resident in two cases and non-resident in three cases (heard together by a Presidential member): *Groves and Commissioner of Taxation* [2011] AATA 609, *Guissouma and Commissioner of Taxation* [2013] AATA, *Re Koustrup and Commissioner of Taxation* [2015] AATA 126, *Re Clemens and Commissioner of Taxation* [2015] AATA 124, *Re Jaczenko and Commissioner of Taxation* [2015] AATA 125.

According to ATO guidance, a working holiday maker who establishes a semi-permanent and settled lifestyle in a single location in Australia is more likely to be a tax resident. Nonetheless, the ATO considers most working holiday makers will be non-resident, see 2 November 2016 media release, *Commissioner clarifies tax arrangements for working holiday makers* <https://www.ato.gov.au/Media-centre/Media-releases/Commissioner-clarifies-tax-arrangements-for-working-holiday-makers/>.

interaction between the working holiday maker tax rate legislation and the non-discrimination article in one of Australia's double tax treaties and the decision may warrant consideration during implementation.

- 4.62 While the Board considers that any further commentary on the taxation of working holiday makers is beyond the scope of this review, the Board emphasises that its proposed rules are carefully targeted and designed in their operation for individuals arriving in Australia and provide far greater certainty than the existing rules.

Recommendations

RECOMMENDATION 4

The Board recommends that the 183 Day Test be supplemented by a Commencing Residency Test as the secondary rule for individuals who were not residents in the preceding income year. This test is summarised by the following principle:

A commencing residency individual is a resident of Australia where the individual is present in Australia for 45 days or more in an income year and satisfies two or more factors.

This test will also apply on an income-year basis where any part of a day spent in Australia counts towards this test. The first day of physical presence in Australia will be the day on which residency commences.

RECOMMENDATION 5

The Board recommends that where an Australian is treated as a resident of another country under one of Australia's comprehensive tax treaty arrangements the individual should also be treated as a 'non-resident' for domestic tax law purposes.

CHAPTER 5: CEASING TAX RESIDENCY

KEY POINTS

- From the Board's consultation and investigations, when an individual ceases residency is the most contentious and uncertain area within the existing rules.
- The ceasing residency test is designed to simplify and streamline the existing rules, while maintaining certain critical elements that have developed over time. However, the proposed tests have been designed more explicitly and consciously balancing certainty, simplicity, integrity and adhesiveness.
- As such, three key tests have been developed for individuals who were residents in the previous income year to determine if they cease residency. These tests adopt different levels of adhesiveness for individuals the longer they maintain residency.
- A long-term resident test (for individuals who have been residents for three or more income years) – these individuals only cease residency if they spend less than 45 days in Australia in the current income year, and less than 45 days in Australia in each of the two preceding income years.
- A short-term resident test (for individuals who have been residents for less than three income years) – these individuals apply a less adhesive test to reflect that they have only commenced residency more recently.
- Overseas employment rule – this additional rule for long-term residents to cease residency largely codifies a simplified, streamlined version of the existing common law test for overseas employment assignments.
- The ceasing residency tests also remove inconsistent outcomes that currently arise due to the interaction between domestic tax rules and double tax treaties.

Ceasing to be a resident of Australia

- 5.1 Under the Board's recommended model, an individual who spends 183 days or more in Australia in an income year will be an Australian tax resident. However, under the Board's recommended model if an individual spends less than 183 days in Australia, secondary tests must be considered to determine an individual's residency status.
- 5.2 As outlined earlier, an individual who was not a resident of Australia in the previous income year will also be a resident if they satisfy the commencing residency test (or remains a non-resident if the test is not satisfied).

- 5.3 The Board's recommended model maintains the distinction between inbound and outbound individuals in the existing rules, as this distinction provides an appropriate framework and identifies current areas of heightened risk and complexity. In order to simplify the existing standard and provide certainty of outcomes, the Board has adopted a ceasing residency test for individuals to determine when residency ends.
- 5.4 This completes the residency cycle. The proposed test focuses on individuals ceasing residency by setting out how individuals, who have commenced and maintained residency, are treated as ceasing residency.

The overarching principle – physical presence

- 5.5 The Board consulted on creating a test for ceasing residency, previously referred to as outbound individuals. The Board considers that the terminology of cessation better reflects the principles underpinning the Board's model – that an individual only ceases residency if they lack physical presence or other factors as relevant.
- 5.6 The ceasing residency test is primarily a physical presence test, and is based on the following principle:

An individual ceases residency in Australia for the current income year if they spend:

- (a) *less than 45 days in Australia in the current income year; and*
- (b) *less than 45 days in Australia in each of the two preceding income years.*

- 5.7 The ceasing residency test reflects the Board's preference for physical presence to be the primary mechanism to determine residency. The Board notes that the time spent in Australia to cease residency in each income year is much lower than the threshold for commencing residency (i.e., 183 days). This reflects the Board's adoption of the adhesive residency principle. Further, the multi-year nature of the test is consistent with the way in which the existing rules have developed and is adopted in other countries.
- 5.8 As such, further mechanisms are required to balance these competing priorities and maintain other (simplified) elements of the existing rules that the Board considers should continue. The key departures from the physical presence standard are:
- (a) **Short-term resident rule:** a lower threshold (less adhesive) for ceasing residency if an individual has only recently commenced residency; and
 - (b) **Overseas employment rule:** an additional rule for ceasing residency to codify the existing common law for overseas employment assignments.
- 5.9 More information is provided below.

Changes from the existing rules

5.10 From the Board's consultation, it became clear to the Board that ceasing residency (and outbound individuals) poses the most difficulty in the existing rules. In particular, the Board heard from consultees:

- (a) **Overseas work assignments:** A significant number of Australian expatriates are seconded overseas in any given year, where the outcome of the residency tests can be uncertain and the consequences significant. The Board heard from stakeholders that providing certainty for these Australian expatriates assigned overseas for over two years during the course of their employment with Australian and multinational employers should be a key focus of these rules. As these assignments, where common conditions such as minimal return trips to Australia and available accommodation overseas are met, generally lead to an individual ceasing residency upon departure from Australia, it was recommended this standard be maintained in a streamlined and simplified way to reduce compliance costs.
- (b) **Adhesive residency:** Some consultees considered that there should be stricter standards for citizens in terms of ceasing residency. This led to Board consideration of the existing conceptual framework where those who have been in Australia for a significant period of time have a higher standard to meet in order to cease residency than those that have only commenced residency recently. The existing residency rules (such as resides and domicile) that enforce this framework lead to uncertainty, and as such an alternative measure has been adopted in the Board's recommended model (distinguishing between short-term and long-term residents). This framework is informed by similar overseas practices. The Board does not rely on immigration status for this purpose but considers physical presence and prior year residency to be of greater relevance.
- (c) **Facts and circumstances – simplification into factors:** The Board consulted on using Australia-focused factors to determine Australian residency (rather than globally comparative factors). Overwhelmingly, consultees supported the Board's approach in this regard to use Australia-focused evidentiary based factors including for the purposes of determining whether an individual ceases Australian residency. This is a significant policy departure from the existing rules (e.g., the permanent place of abode and usual place of abode tests). The Board and most consultees consider that testing only an individual's connection to Australia is the most appropriate setting.

Interaction with 183 Day Test and Commencing Residency Test

- 5.11 The Board has designed the 183 Day Test as the primary test. As such, outcomes will be mutually exclusive.
- 5.12 The ceasing residency test will only apply where an individual, having been a resident in the previous income year, is not in Australia for 183 days in the current income year.
- (a) The Board considers that the design of this test will ensure that outcomes are consistent with the 183 Day Test (i.e., that there is no overlap between tests).
 - (b) It is also designed as a series of logical tests for individuals leaving Australia. That is, where an individual has spent less than 183 days in Australia in an income year, they will need to determine if they have ceased residency using a set of clear rules.
- 5.13 The Board has also designed the ceasing residency test to ensure that there is no overlap between this test and the commencing residency test. By adopting the same 45-day standard, the Board's comments regarding setting the 45-day threshold in the commencing residency test chapter apply equally here (as the Board recommends that the two thresholds be identical for consistency, simplicity and integrity).

Ceasing residency: short and long term residents

- 5.14 The ceasing residency test determines the circumstances in which an individual ceases residency. It will therefore be framed that an individual, who was a resident in the preceding income year, will remain a resident unless they satisfy certain requirements.
- 5.15 Designing the revised standards by reference to the current rules (e.g., the 'domicile' and 'resides' test), the Board recognised that individuals who maintain residency for multiple years commonly build up stronger ties and, as such, the connections that must be severed (both physical presence and other facts and circumstances) are more significant. This is, in practice, a greater level of adhesiveness. However, the existing rules do not provide clear, consistent outcomes in this regard as they are uncertain and subjective.
- 5.16 The Board considers it appropriate to replicate some level of increasing adhesion as individuals build ties in Australia. To do so, the Board recommends differentiating between individuals who have been Australian residents for a significant period of time, and those that have only recently commenced residency. While this is broadly consistent with the existing rules, the mechanism is different in order to improve

simplicity and certainty, by measuring the strength of connection solely through physical presence in income years. Other countries also adopt similar mechanisms.

5.17 The Board's recommended model differentiates between the following individuals:

- (a) Individuals who have been resident for three consecutive income years or more (long-term residents); and
- (b) Individuals who have been resident for less than three consecutive income years (short-term residents).

5.18 The Board has adopted a three-year period as a reasonable proxy for a more enduring connection to Australia. A three-year test period is also a relatively common international standard.¹⁹ However, the Board supports further analysis of this standard through the development and implementation of these rules to confirm its appropriateness.

Long-term residents

5.19 Under the Board's preferred model, individuals who have resided in Australia for the last three income years consecutively are considered to be 'long-term' residents.

5.20 The Board considers that, following three consecutive income years of residence, it is reasonable to increase the level of adhesion for individuals. That is, it will be harder to break residency.

5.21 Under the current rules (e.g., the 'domicile' test), similar outcomes arise. However, as the existing rules determine residency on the basis of facts and circumstances, it is difficult to discern a clear pattern or distinguish between classes of individuals other than:

- (a) those who have established stronger ties to Australia will need to sever those ties; and
- (b) those born in Australia (or otherwise domiciled) will need to sever ties to an even greater extent.

5.22 The Board seeks to provide a more effective and objective mechanism than the existing rules which rely amongst other things on a person's intention, for increasing the level of

¹⁹ For international comparability on multi-year residency testing, a three-year standard is adopted in the Republic of Ireland's ordinarily resides test, which provides similar outcomes. Although not for similar outcomes, the United Kingdom's statutory residency test and Norway's residency rules also include multi-year tests using a three-year period, while India adopts a four-year test period.

adhesiveness for certain individuals that have developed an enduring connection to Australia.

5.23 By replacing the current rules with a clearer standard, the long-term resident test clearly identifies individuals with more enduring ties to Australia and increases the level of adhesiveness while allowing those individuals to conclusively determine when they break residency.

5.24 The Board's recommended model for long-term residents is the principle stated earlier:

An individual, resident in Australia for the three income years preceding the current year, ceases residency in Australia for the current income year if they spend:

- (a) *less than 45 days in Australia in the current income year; and*
- (b) *less than 45 days in Australia in each of the two preceding income years.*

5.25 The individual will cease to be a resident from the beginning of the test year (i.e., the current year if the individual spends less than 45 days in Australia in each of the two preceding years).

EXAMPLE 10

Steve and Betty are retired. They have lived in their Australia their whole lives. In early 2018, they decided to spend 18 months travelling around the world. As a result, they are only in Australia for 20 days in the 2019 income year. As they were not in Australia for 183 days or more, Steve and Betty failed the 183 day test. Hence, they need to consider the ceasing residency test, specifically the ceasing long-term residency test.

Under the ceasing long-term residency test, Steve and Betty are residents of Australia in the 2019 notwithstanding that they were in Australia for less than 45 days in the 2019 income year. To break residency under this test, Steven and Betty would have had to spend less than 45 days in Australia in each of the 2017, 2018 and 2019 years.

5.26 The long-term resident test is a key simplification of the existing rules – it does not consider the factors that connect an individual to Australia. Residency is maintained for at least two income years regardless of factors or time spent in Australia.

5.27 The Board considers that long-term residents should retain residency regardless of their physical presence in Australia for a set number of income years, and has designed this rule to reflect this view.

5.28 The Board recommends that the period be set at two income years – this strikes the balance of certainty, simplicity and integrity that the Board considers necessary. This will significantly reduce opportunities to structure out of being a resident, as any structure

would require at least two years of minimal presence in Australia, after which point the Board believes that the connection is sufficiently remote to change the incidence of tax.

- (a) For example, the Board considers a single year of automatic residency would be too short (and easily manipulable), whereas a third year of automatic residency would be too adhesive (and increase pressure on other areas of the tax system).

5.29 During implementation, this may be confirmed with due regard for migration and citizenship movement statistics to estimate the impact of these recalibrated rules. However, given the uncertainty of the existing rules, the Board notes it may be difficult to determine the existing benchmark (and thus the extent of any departure therefrom).

EXAMPLE 11

Grace is a successful entrepreneur who is a long term resident of Australia. During 2019, she decided to move to New Zealand. As she has extensive personal and business connections in Australia, she frequently returns to Australia for short visits.

The table below sets out the number of days Grace was in Australia in each income year, and whether she would be an Australian resident under the Board's proposed model.

Income year	Number of days in Australia	Is Grace an Australian resident or a non-resident for this income year?
2019	215	Australian resident (183 day test)
2020	54	Australian resident (ceasing long-term residency test)
2021	39	Australian resident (ceasing long-term residency test)
2022	27	Australian resident (ceasing long-term residency test)
2023	15	Non-resident (ceasing long-term residency test)

5.30 The Board also considered whether the Factor Test should apply in addition to a multi-year physical presence requirement, in order to address potential circumstances in which individuals that, under the existing rules, may cease residency through inappropriately structuring their affairs. In the Board's view, the proposed rules will not give rise to analogous risks and as such it is not necessary to impose this more onerous requirement – this is elaborated on later in this chapter.

- 5.31 The Board considers this level of adhesiveness is appropriate for long-term residents.
- 5.32 The Board acknowledges that a standard of this kind will likely ensure individuals who are not physically present in Australia for a significant period of time remain residents of Australia. While there may be administrative challenges for the ATO, the Board expects that these challenges would be no more difficult than current administrative matters and unlikely to increase the burden on the ATO. This should be confirmed during implementation.
- 5.33 Where an individual maintains residency under the long-term resident test and earns income on which tax is payable in another country, in accordance with existing law the foreign income tax offset rules shall provide appropriate relief, although the Board considers that this should be monitored throughout implementation. This will apply regardless of whether an individual is a resident of Australia and another country, unless the country is within Australia's tax treaty network.
- 5.34 If an individual is otherwise a resident based on the long-term residency test and is also a tax resident of another country with which Australia has a double tax treaty, the Board proposes that a provision be included to align 'treaty residency' and domestic residency. This is explored further below.

Short-term residents

- 5.35 The Board considers that individuals who have been resident for less than three income years are less likely to have developed an enduring connection to Australia. These individuals are referred to as short-term residents and under the ceasing residency test will be provided an avenue to cease residency that does not rely solely on physical presence.
- 5.36 The Board considers that test should be adopted in line with the following principles:
- (a) *An individual, who has been a resident for less than three consecutive income years immediately preceding the current income year, ceases to be a resident if they spend less than 45 days in the current income year and satisfy less than two factors.*
 - (b) *The individual ceases to be a resident on the day that they depart Australia.²⁰*
- 5.37 This reduced adhesiveness, predominantly the reduced physical presence requirement, allows for individuals to commence and cease residency within a shorter period of time if they do not have factors that would maintain their residency status. In effect, this test

²⁰ The consequences of changing residency status during an income year are set out in Chapter 8 Part-year residency and other matters.

only provides an opportunity for short-term residents who do not maintain an enduring connection with Australia (e.g., buy a home, move family etc.) to cease residency.

- 5.38 However, the Board does not consider that a reduced physical presence requirement would appropriately balance simplicity and integrity as it would likely lead to more opportunities for manipulation – thus, the test includes a consideration of factors.

Moving between short-term and long-term resident classes

- 5.39 The Board has developed short-term and long-term resident classes to operate in a co-ordinated way. These categories follow a logical progression from commencing residency to long-term residency. The follow explanation is provided for clarity.

- 5.40 An individual will be a short-term resident for the first three income years of residency (being the year residency is established and the following two income years). From the fourth income year, an individual will be a long-term resident.

- 5.41 In testing, the Board identified that the physical presence of an individual during short-term residency should be counted for the purposes of the long-term resident test. That is, if an individual spends less than 45 days in Australia in an income year in which they were a short-term resident, this will be relevant for ceasing residency under the long-term resident test.

- 5.42 To illustrate:

- Year 1: individual becomes a resident. They spend 100 days in Australia, buy a home and move their family to Australia.
Short-term resident under the commencing residency test
- Year 2: the individual then spends 90 days in Australia and maintains the home and family.
Short-term resident who did not cease residency
- Year 3: the individual then spends 30 days in Australia but maintains the home and family.
Short-term resident who did not cease residency
- Year 4: the individual spend 20 days in Australia but maintains the home and family.
Long-term resident who did not cease residency
- Year 5: the individual spend 40 days in Australia but maintains the home and family.
Non-resident – ceased residency under the long-term residency test (Y3: 30 days, Y4: 20 days, Y5: 40 days)

Interaction with the Factor Test

- 5.43 The Board consulted on when the Factor Test should apply in the context of ceasing residency. The Board received mixed feedback: while consultees were generally supportive they highlighted the interaction between the Factor Test and physical presence as significant.
- 5.44 In the other models considered by the Board, including the model in the 2018 Consultation Guide, the Factor Test received greater prominence to ceasing residency. As outlined above, in the Board's recommended model the Factor Test only applies to short-term residents ceasing residency.
- 5.45 In the Board's view, this change in application has changed the focus of the Factor Test. While a reduction in factors will lead to the cessation of residency as at the final day of physical presence, residency is adhesive and as such the Board considers that a very low level of connection is needed.
- 5.46 Under the commencing residency test, two or more factors is sufficient to commence residency.
- 5.47 The Board considers that it is appropriate to align the ceasing residency test to that standard. As such, an individual may only satisfy one or less factors under the short-term residency test to cease residency.
- 5.48 This standard maintains an appropriate level of adhesion, while providing some flexibility for individuals who have recently commenced residency and subsequently reduced their connection.

Tax treaty interactions

- 5.49 Within Australia's tax treaty network, an individual can only be tax resident of one country.
- 5.50 The Board consulted on the basis that reform of residency is an opportunity to align domestic tax residency with residency under Australia's double tax treaties. During consultation, the Board received broad support for this view.
- 5.51 The Board therefore recommends that, if an individual is otherwise a resident based on the ceasing residency test and is also a tax resident of another country with which Australia has a double tax treaty, a provision should be added to the revised residency rules such that, if an analysis under the tiebreaker test of the relevant treaty would find that the individual is a resident only of the other country for treaty purposes, then for Australian tax law purposes that individual will be a non-resident.

EXAMPLE 12

Following on from Example 11, under New Zealand domestic tax laws, Grace is a tax resident of New Zealand from the date she arrived in New Zealand in 2019.

In accordance with the tie-breaker rule in the Australia / New Zealand tax treaty (Article 4, paragraph 2), she is deemed to be a resident of New Zealand as this is where her permanent home is located.

Under the current law, Grace would benefit from the protection of the tax treaty to ensure that she is only subject to tax in Australia on her Australian sourced income in the 2019, 2020 and 2021 income years. However, because she is a resident of Australia under Australia's domestic law, she still has access to residence-based concessions such as the tax free threshold and the CGT discount.

Under the Board's preferred model, as Grace is deemed to be a resident of New Zealand under the treaty tie-breaker provision for part of the 2019 income year as well as the full 2020 and 2021 income years, she will be treated as a non-resident of Australia for Australia's domestic law purposes. This rule overrides the outcome of the ceasing long-term residency test, ensures consistency between domestic law and the tax treaty, and removes opportunities for tax arbitrage.

Clarifications and other considerations

5.52 The Board has identified a number of important policy issues that are relevant to individual tax residency in the course of preparing its recommendations. The Board has analysed these issues and set out observations below.

Government officials

5.53 The Board has considered Government officials posted overseas in the context of modernising the superannuation test. The Board recommends that any Government official that satisfies the Government officials test is excluded from the ceasing residency test.

Improving engagement of individuals and ATO oversight when ceasing residency

5.54 The Board understands that there are significant administrative difficulties identifying individuals who claim to have ceased residency (and may not file Australian income tax returns), and that these difficulties are particularly prevalent for high net-wealth individuals.

- 5.55 Much of this difficulty is due to a lack of information. While global developments and technological advancements are, over time, providing tax administrators with greater intelligence, the Board considers that there is an opportunity to promote strategic engagement between individuals and the ATO within this problematic area when redesigning the residency rules.
- 5.56 In the United States of America, certain individuals do not cease residency until they submit specific forms relating to expatriation.²¹ These forms require the individual to provide details to the Internal Revenue Service, which are important in finalising the individuals tax affairs in that country, such as whether an expatriation tax applies.
- 5.57 While Australia's income tax system does not include an expatriation tax, the Board considers the imposition of an additional requirement whereby cessation of residency must be reported via the submission of an income tax return warrants further consideration.
- 5.58 The Board understands that the vast majority of individuals would currently furnish returns to the ATO in such circumstances as needed and imposes no further compliance costs on most individuals. However, the requirement provides an incentive for all individuals to engage with the ATO when ceasing residency. Preparing this return encourages individuals to confirm their residency status, while also providing the ATO with greater intelligence regarding when individuals cease residency – from which the ATO could provide more timely and tailored services. This should also reduce the potential for disputes over time.
- 5.59 The Board supports further work on whether ceasing residency should be subject to individuals submitting an income tax return disclosing their change in residency status, to improve engagement and sharing of information between individuals and the ATO upon ceasing residency. The design of this measure requires further consideration (for example, how the return impacts the day on which residency ceases).

Overseas employment rule

- 5.60 As noted earlier in this chapter, a significant number of Australian expatriates are seconded overseas in any given year. For these individuals, the outcome of the existing residency rules can be uncertain and the consequences significant. During consultations, stakeholders highlighted particularly acute difficulties in the existing rules for the expatriate community due to their circumstances, while also noting concerns if the existing outcomes significantly change.
- 5.61 As such additional analysis of this particular class of individual has been undertaken.

²¹ See Guide materials: *International Taxpayers Expatriation Tax*, United States of America Internal Revenue Service <<https://www.irs.gov/individuals/international-taxpayers/expatriation-tax>>

- 5.62 In reflecting on this matter, the Board considered the existing rules. Currently, residency tests an individual's connection to Australia and overseas countries comparatively, with weight given to duration and the individual's intentions among other factors.²² Throughout the Board's consultations, consultees emphasised the importance of an individual's place of employment in determining residency status as part of this comparative analysis. For expatriates, the existing 'rule of thumb' for overseas stays in ATO Taxation Ruling IT 2650 is commonly used to conclude whether they have become non-residents for an intended physical absence from Australia of two years or more. This rule of thumb currently forms part of a broader analysis, which has given rise to significant uncertainty and an increase in litigation in recent years.²³
- 5.63 The Board considers that a rule clarifying the treatment of individuals leaving Australia to work overseas is appropriate, given the size of the population and significance of the impact of residency status on these expatriates in particular. However, the Board has not found evidence, nor support during consultation, for significantly departing from the existing rule of thumb (for example, by providing a new standalone concession). Indeed, there would be significant benefits in simply codifying a version of the existing standard. Codifying this standard would vastly improve the ability for individuals to comply with the law and reduce compliance costs for individuals and their employers as well as administrative costs for the ATO.
- 5.64 The Board therefore recommends that the ceasing residency test adopts an additional rule for certain Australian residents taking up employment overseas.
- 5.65 From its analysis, the Board considers that the simplified codification should be designed as follows:

An individual will cease residency on the day after departure from Australia if they:

- (a) *are an Australian tax resident for the three consecutive income years prior;*
- (b) *undertake employment overseas that is mandated to be for a period of more than two years at the time employment commences;*
- (c) *have accommodation available continuously in the place of employment for the duration of their employment; and*
- (d) *return to Australia for less than 45 days in each income year that they continue their overseas employment after the year in which they depart.*

²² See ATO Taxation Ruling IT 2650 *Income tax: residency - permanent place of abode outside Australia*, 8 August 1991 and *Applegate v Federal Commissioner of Taxation* [1978] 1 NSWLR 126.

²³ For example, see *Re Dempsey and Commissioner of Taxation* [2014] AATA 335, *Harding v Commissioner of Taxation* [2018] FCA 837.

5.66 The design is elaborated on below.

Long-term resident requirement

5.67 The Board prefers to limit the overseas employment rule to long-term residents. As short-term residents are provided a separate avenue of reduced adhesiveness to cease residency (via the short-term residency test) the Board does not consider it necessary to increase the complexity of their circumstances through the addition of this rule.

5.68 Further, the overseas employment rule strikes an appropriate balance for long-term residents against the increased level of adhesion of the long-term resident test. That balance is not necessary in the short-term residency test.

Overseas requirements

5.69 The Board identified the key facts required under the existing rules for an individual leaving for overseas employment to be characterised as a non-resident. In balancing the holistic analysis and wide range of facts and circumstances that can be taken into account, the Board has taken a balanced view and concluded that the follow key facts should be present for the overseas employment rule to apply:

- (a) An overseas employment engagement of more than two years; and
- (b) Accommodation available in the place of employment for the duration of the engagement.

5.70 To align employment arrangements with current practice and rule of thumb, the Board recommends that an individual must undertake employment based in a location outside Australia on an ongoing basis. This rule will be satisfied for the period of the individual's employment; that is, the rule will apply from the day following the date of departure from Australia or when employment commences (whichever is later) and will cease to apply on the day following the final day of employment (subject to further consideration). These issues are also explored in the part-year residency section later in this Report.

5.71 The Board considers that ongoing employment will be satisfied by an employment agreement of more than two years (or, subject to further analysis during implementation, three years or more to align with the model's adoption of a three year standard as a proxy for an enduring connection). Importantly, these requirements remove the current need for evidence of 'intention' that creates significant compliance difficulty and uncertainty.

5.72 The Board has received feedback that this standard may be manipulated if employment relationships are put in place within business structures of closely related parties where the actual activities of the individual would not materially change. This is a particular risk for high-wealth individuals. These arrangements should not be covered by this rule and may require a limitation to be developed during implementation to exclude associates

and related parties. However, the scope of any limitation must be targeted to ensure that it does not undermine the certainty this rule provides more generally.

- 5.73 During consultation, the Board was made aware that accommodation standards vary significantly between foreign jurisdictions. This was a particular source of uncertainty for the ‘domicile’ test. In order to avoid replicating this issue, accommodation will satisfy this requirement on the basis of longevity rather than form. This means that an individual must have ongoing access to accommodation in the place of employment for its entire duration.

Time spent in Australia

- 5.74 Under the existing rules, it is common for individuals to return to Australia for small periods of time on work and personal matters. The Board considers that it is appropriate for individuals to be able to return to Australia, and also to provide certainty on this issue.
- 5.75 More broadly, the Board’s model adopts a ‘less than 45 days in an income year’ standard for minimal physical presence in Australia. The Board considers this should also be adopted for this rule. A 45-day period sufficiently allows for visits to Australia and that any more time spent in Australia would disqualify an individual from this rule.
- 5.76 The Board’s preferred view on the consequences of breaching the 45-day standard is that it would only apply per income year. That is, where employment is ongoing the next year, an individual can satisfy the rule without having to cease and recommence employment.
- 5.77 However, the Board appreciates that there may be integrity and manipulation risks that require close consideration – for example, were individuals to have the ability to retrospectively determine their residency status the overseas employment rule be taken never to have been satisfied if the 45-day standard is breach at any time throughout its duration.

Examples

- 5.78 The Board has prepared the following examples to illustrate the operation of the overseas employment rule in accordance with the Board’s views set out above.

EXAMPLE 13

Elijah is 29 years old and has lived in Australia all his life. His employer in Australia has arranged a three year secondment for him with a related company in New Zealand. He departed Australia for New Zealand on 15 October 2019. Up to and including his day of departure, he was in Australia for 106 days during the 2019-20 year. When he arrived in New Zealand, he spent two weeks living in a hotel while he found alternative accommodation. At the beginning of November, he signed a one year lease on a furnished apartment in Auckland,

with the expectation that he will live in this apartment for the period of his secondment.

He returns to Australia for five days in June 2020. In the 2020-21 income year, he spends 22 days in Australia. In the 2021-22 year, he spends 12 days in Australia. Elijah's secondment ends on 18 October 2022, and he returns to Australia permanently to live on 3 November 2022.

Elijah satisfies the overseas employment rule Accordingly, Elijah is:

- a non-resident from 16 October 2019 to 30 June 2020;
- a non-resident for the entire 2020-21 and 2021-22 income years;
- a non-resident from 1 July 2022 to 19 October 2022.

For the purpose of applying the overseas employment rule in the year of departure, the period following departure from Australia is treated as a separate non-resident period, while the period up to and including the day of departure is treated as a resident period. This is relevant for determining if Elijah spent less than 45 days in Australia, which is only tested for the non-resident period. Similarly, in the year Elijah returns to Australia, the period prior to the cessation of his overseas employment is treatment as a separate non-resident period. Therefore, for the purpose of determining if Elijah is a resident of Australia upon his return, he needs to apply the 183 day test or the commencing residency test to the period 20 October 2021 to 30 June 2022.

EXAMPLE 14

Mila has similar facts to Elijah in Example 13, but she ends her secondment early and returns home after 12 months due to illness. Mila left Australia on 15 October 2019, with an employment agreement of three years, intending to remain overseas for the term of her secondment. However, she returned to Australia on 22 April 2021.

Option 1: As Mila satisfied the overseas employment rule when she departed Australia:

- Mila is a non-resident from 16 October 2019 to 30 June 2020;
- Mila is a non-resident from 1 July 2020 to 21 April 2021.

The early termination of her secondment and return to Australia does not affect her ability to apply the overseas employment rule. Similar to Elijah in Example 13, the 2020-21 income year is split into two periods for the purposes of determining her residency for the period 22 April 2021 to 30 June 2021 using either the 183 day test or the commencing residency test.

However, the Board considers that this outcome may warrant further consideration during

implementation, where the alternative outcome may be considered:

Option 2: When Mila left Australia, she satisfied the overseas employment rule, which would have treated her as a non-resident for part of the 2019-20 income year (from 16 October 2019 to 30 June 2020). However, her early return to Australia means she failed to meet the requirements of the rule, and therefore is unable to apply the overseas employment rule. She needs to re-assess her residency for both income years using the other tests in the Board's preferred model.

Further implementation considerations

5.79 The Board notes that, by providing clear thresholds for taxpayers to comply with, there is a risk of manipulation. The Board considers that the boundaries identified for this rule reduce the likelihood of broader manipulation; in particular, in seeking to replicate existing standards, compliance risks should be broadly analogous to those currently being monitored within the expatriate and high-wealth segments. An example of manipulation that the Board considers should be considered during implementation follows.

EXAMPLE 15

Cath is planning to spend a few years living and working in Switzerland. Before she leaves Australia, she arranges employment with a company owned and operated by her uncle who lives in Switzerland. She intends to work there for at least three years, and arranges to rent an apartment in Geneva also owned by her uncle. Her employment with a related party does not satisfy the requirements of the overseas employment rule, and accordingly, Cath needs to assess her residency status against the other tests in the Board's preferred model.

5.80 The Board considered fly-in fly-out and offshore workers who, while often working overseas, generally reside in Australia between offshore work periods. These individuals are not intended to come within scope of this rule, and it is expected that the ongoing physical presence and accommodation requirements would operate to exclude them.

EXAMPLE 16

Willow is a long term resident of Australia. She signs up to a two year contract, beginning 1 July 2018, to work on an offshore rig in the Gulf of Thailand. Under the terms of the contract, she works 'five weeks on, three weeks off' – that is, she spends five weeks working on the rig, and then has three weeks off during which she returns to Australia.

Accordingly, Willow spends approximately 130 days in Australia in each of the 2019 and 2020 income years and cannot satisfy the overseas employment rules. Under the ceasing long-term

residency test, Willow is an Australian resident for 2019 and 2020.

- 5.81 Given the test is forward looking (i.e., it determines residency based on likely future circumstances that must then be satisfied), the Board appreciates that there may be administrative difficulties determining when conditions are met, which will need to be resolved during implementation. This may involve a mechanism that aligns the availability of this exception with the extent to which the employment contract is fulfilled by the individual, as there may also be a need for some flexibility regarding employment (i.e., where unexpected resignation or retrenchment occurs and the individual arranges for a return to Australia) and accommodation (i.e., when accommodation is arranged a few weeks after employment commences). Alternatively, an extension of time to lodge an assessment and the period of review may be considered.
- 5.82 The Board supports further consideration of these matters during implementation.

Alternative options

- 5.83 The Board considered a number of alternative options when considering the Ceasing Residency Tests. While further analysis in **Annexure B** provides a high-level overview, certain key considerations in this context are outlined below.

Broader application of the Factor Test

- 5.84 Under the proposed model, the long-term resident test does not require any application of the Factor Test. This is a key feature of the revised ceasing residency rules, which reflect the Board's view that, as a general principle, adhesiveness should increase as the period of residency increases.
- 5.85 The Board's preferred mechanism for increasing adhesion is to impose a stricter test on individuals that have been resident for a greater number of years. As outlined above, the Board has taken a preliminary view that three consecutive income years is a suitable proxy for long-term, enduring attachment to Australia.
- 5.86 The Board considered whether, alternatively, the Factor Test should apply in the model – either in addition to the physical presence rules or within a differently constituted test (see **Annexure B**).
- 5.87 In the Board's view, the use of a different standard, including the Factor Test, is more appropriate for short-term residents, as while adhesive, it provides flexibility to recognise that an individual who has recently commenced residency may subsequently depart and have either reduced factors or never had those factors. Under the long-term

residency test, the Board considers that increased adhesiveness better reflects the enduring connection a long-term resident has to Australia, while providing certainty of outcomes for those individuals who have resolved to leave and no longer reside in Australia. It is also consistent with international practices (noted earlier in this chapter).

- 5.88 Under the proposed model, the Factor Test assists to identify clear connections when commencing residency and ceasing short-term residency. In the Board's view it is unnecessary to apply the Factor Test in the long-term resident test.
- 5.89 However, the Board is aware that integrity and manipulation risks may be identified through the implementation process and as such, considers that it would be appropriate to monitor whether such risks are sufficient to adopt a Factor Test requirement in the long-term resident test.

Residents of nowhere

- 5.90 The Board has consulted on addressing the resident of nowhere phenomenon and set out a series of measures in the Board's 2018 Consultation Guide.
- 5.91 It is the Board's view that no specific integrity rule to target the resident of nowhere phenomenon is currently justified. The Board has formed this view on the basis of the scope of the Board's proposed rules as well as extensive consultation on the existing rules and schemes that purport to achieve resident of nowhere outcomes.
- 5.92 In its deliberations, the Board reflected on the ability of individuals to manipulate the existing rules to become residents of nowhere and avoid tax in Australia. In many of the circumstances of which the Board has been made aware, the ability to avoid tax is predicated on a transitional arrangement where the individual ceases Australian tax residency but has not commenced tax residency in another country that imposes personal income tax at the time a large gain is crystallised, distribution made, or other form of income derived. Generally, the offending arrangements relate to a single amount or series of related amounts.
- 5.93 Consultees stated that while the population of individuals theoretically capable of entering into resident of nowhere arrangements is small, the tax outcomes would commonly be substantial. Consultees largely preferred one of two approaches: a standalone integrity rule to specifically address the issue, or an automatic rule that can apply broadly but based on clear, objective criteria.
- 5.94 Regarding the former, these consultees considered that the issue requires further analysis and should be addressed separately – that is, if a solution is justified it should be a standalone provision. Such a rule could then target the inappropriate behaviour and minimise the disturbance to other taxpayers. Importantly, the scope of any such rule would necessarily differ depending on whether, and to what extent, the Board's revised residency rules were adopted.

- 5.95 Regarding the latter, consultees expressed support for adopting rules based on the United Kingdom's temporary absence provisions. Effectively, these provisions bring to income tax certain amounts derived during a period of non-residency that occurs between two periods of residency. If an individual ceases and resumes residency within five income years, the rules automatically apply – the effect of which is to eliminate uncertainty and compliance costs that would arise under a purpose based test.
- 5.96 The Board was also informed that a number of these schemes do not actually achieve resident of nowhere status – that is, when identified the ATO is able to address the cases based on the existing law. However, in some cases the problem stems from other areas of the tax laws, such as CGT event I1.
- 5.97 In Australia's tax system, CGT event I1 determines the tax treatment of assets held by Australian residents when residency ceases. In accordance with existing policy settings, this taxes similar gains and distributions as those targeted by the United Kingdom's temporary absence provision. However, consultees noted these rules suffer from broad non-compliance.
- 5.98 CGT event I1 was identified as a key source of this problem, exacerbating the resident of nowhere risk. Many consultees (during both the Board's first and second reviews) strongly supported more compliance action on this issue, which would provide a greater understanding of the risk the resident of nowhere phenomenon poses to the Australian tax base. Were the rule found to be ineffective or otherwise deficient, then the United's Kingdom's temporary absence provisions provide an alternate model.
- 5.99 This mix of tax policy and administration issues has made identifying concerns more challenging.
- 5.100 In light of this, the Board has reflected on the extent to which it is appropriate for Australia to impose tax on individuals that do not satisfy the physical presence and/or factor tests. In particular, what relationship must income, profit or gains have to Australia for an individual to be taxed in Australia on these amounts as a resident. The amounts in question will generally not have an Australian source (or not be attributable to taxable Australian property), as otherwise they will be captured within Australia's source and capital gains rules (including CGT event I1) to the extent that policy settings have deemed appropriate.
- 5.101 Under the short and long term resident tests, the Board's recommended level of adhesion will eliminate the potential for residents of nowhere within parameters the Board considers reasonable. For example, under the long-term resident rules, an individual will maintain residency for two income years of minimal time spent in Australia. The Board considers that this adhesiveness provides more appropriate tax outcomes, eliminates significant uncertainty while providing robust integrity.
- 5.102 However, if an individual enters into a resident of nowhere style arrangement under which the amount is derived following a two year period of absence and non-resident

status is obtained under the proposed rules, the Board considers that adopting additional residency rules that would tax such an amount impose too strict (and too adhesive) a standard on those individuals – as outlined earlier, this is also why the Board does not recommend applying the Factor Test in addition to the long-term resident test at this stage. The calibration of this test should be monitored through implementation.

5.103 In the Board’s view, the ceasing residency test provides a reasonable balance between simplicity, certainty and integrity at a level of adhesion that the Board considers appropriate.

Further work on CGT event I1

5.104 As noted earlier, the Board continues to hear from consultees of significant non-compliance with CGT event I1. The Board considers that renewed efforts should be made to rectify this perception through further work by the ATO.

5.105 The Board recommends that further work be undertaken in accordance with the following observation by the Board in its 2017 Report:

The Board observes that while some individuals may seek to manipulate CGT event I1, the Board considers that the ATO should increase its compliance efforts to identify ‘deemed-TAP’ assets that should be taxable in Australia.

The Board suggests any assets which taxpayers have elected to be deferred as a ‘deemed disposal’ upon ceasing residency should be catalogued and reported to the ATO to use as a reference point for the tracking of any future disposal of such assets. This could be incorporated as part of the annual tax return process.

5.106 The requirements for reporting capital gains made by non-residents (including those under CGT event I1) to the ATO should also be considered.

5.107 Should this work lead to the identification of persistent resident of nowhere arrangements under the existing rules or the proposed residency rules once adopted, the Board suggests that further work be undertaken on whether to move to a system akin to the United Kingdom’s temporary absence provisions.

Recommendations

RECOMMENDATION 6

The Board recommends that the 183 Day Test be supplemented by a Ceasing Residency Test as the secondary rule for individuals who were residents in the preceding income year. This test is made up of three standards that seek to maintain simplified, streamlined versions of the existing rules:

1. a long-term resident test;
2. a short-term resident test; and
3. an overseas employment rule.

The Board supports further work on whether ceasing residency should be subject to individuals submitting a first non-resident income tax return, to improve engagement and sharing of information between individuals and the ATO upon ceasing residency.

RECOMMENDATION 7

The Board recommends that a long-term resident test be adopted for individuals who have been residents for the three income years immediately preceding the current income year. This test is summarised by the following principle:

An long-term resident individual ceases residency in Australia for the current income year if they spend:

- (a) less than 45 days in Australia in the current income year; and
- (b) less than 45 days in Australia in each of the two preceding income years.

This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. Residency status will be determined on a full income-year basis.

RECOMMENDATION 8

The Board recommends that a short-term resident test be adopted for individuals who have been residents for less than three income years immediately preceding the current income year. This test is summarised by the following principle:

- (a) A short-term resident individual ceases to be a resident if they spend less than 45 days in the current income year and satisfy less than two factors.

- (b) The individual ceases to be a resident on the day that they depart Australia.

This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. The last day of physical presence in Australia will be the last day of residency.

RECOMMENDATION 9

The Board recommends that an overseas employment rule, based on the existing rule of thumb, be adopted for individuals who have been residents for the three income years immediately preceding the current income year, where that individual undertake overseas employment. This test is summarised by the following principle:

An individual will cease residency on the day after departure from Australia if they:

- (a) reside in Australia for the three consecutive income years prior;
- (b) undertake employment overseas that is mandated to be for a period of more than two years at the time employment commences;
- (c) have accommodation available continuously in the place of employment for the duration of their employment; and
- (d) return to Australia for less than 45 days in each income year that they continue their overseas employment after the year in which they depart.

This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. The last day of physical presence in Australia will be the last day of residency.

RECOMMENDATION 10

The Board recommends that, in accordance with the commencing residency test and 183 Day Test, a provision should be added to remove inconsistent outcomes for domestic and treaty residency.

RECOMMENDATION 11

The Board recommends against a separate rule to address the existing 'resident of nowhere' phenomenon as it is not necessary within the Board's proposed rules.

In the Board's view, the proposed rules eliminate the potential for residents of nowhere within appropriate parameters (for example, via the long-term resident test). This adhesiveness provides more appropriate tax outcomes, eliminates uncertainty and provides

robust integrity. Any additional rules would cause uncertain outcomes and increase complexity.

RECOMMENDATION 12

The Board recommends that further work be undertaken in accordance with the following observation by the Board in its 2017 Report:

The Board observes that while some individuals may seek to manipulate CGT event I1, the Board considers that the ATO should increase its compliance efforts to identify 'deemed-TAP' assets that should be taxable in Australia.

The Board suggests any assets which taxpayers have elected to be deferred as a 'deemed disposal' upon ceasing residency should be catalogued and reported to the ATO to use as a reference point for the tracking of any future disposal of such assets. This could be incorporated as part of the annual tax return process.

Should this work lead to the identification of persistent resident of nowhere arrangements or other integrity issues under the existing or proposed residency rules once adopted, the Board recommends that moving to a system akin to the United Kingdom's temporary absence provisions be considered.

CHAPTER 6: GOVERNMENT OFFICIALS – REFORMING THE SUPERANNUATION TEST

KEY POINTS

- As per the terms of reference, the Board has reviewed the superannuation test and concluded that it is no longer appropriate.
- The more appropriate, globally accepted policy setting is to treat Australian government officials deployed overseas as Australian tax residents for the duration of their deployment.
- An ‘Overseas Government Officials Test’ should be included in the proposed rules where government officials (including federal, state and territory) deployed overseas in the service of an Australian government are tax residents throughout their deployment.

Background

- 6.1 In the Board’s 2017 Report, the superannuation test was identified as outdated – applying only to Commonwealth Government officials (as well as their spouses and children under 16) that are members of certain government superannuation funds. As the last fund closed to new members in 2005 this class of individuals is finite and will reduce over time. It is no longer clear what function this test serves from a policy perspective.
- 6.2 During consultation, the Board sought the community’s views on whether to update the Superannuation test, and if so, how.

Consultation

- 6.3 The Board consulted with stakeholders on the need for a revised superannuation test.
- 6.4 Almost universally, stakeholders supported the Board’s proposal to revise the Superannuation test – in particular, by replacing it with a test that applies to all government officials that are deployed overseas.
- One stakeholder identified the historical policy objective of the superannuation test was to target particular overseas officials in the United Kingdom in the 1930s who were neither taxed in either Australia or the United Kingdom.

- The stakeholder noted this has not previously been publicly revisited to consider whether it should apply more broadly to all government officials, or whether superannuation fund membership is an appropriate proxy for such status. The stakeholder considered such reconsideration worthwhile.
- 6.5 The Board also sought to confirm income tax practices in other countries with respect to government officials. The Board found the following treatment in most comparable jurisdictions:
- (a) where government officials are deployed overseas, most countries' tax laws deem the official to be a tax resident in the country of the government that employs them for the duration of the deployment; and
 - (b) countries also maintain exclusive taxing rights over their government officials deployed overseas under double tax treaties – indeed, there is a specific article to this effect in the Organisation for Economic Co-operation Development model tax convention.
- 6.6 Based on these investigations and the consultation process, the Board has concluded that it is appropriate to design a new test with a revised policy target. In the Board's view, the appropriate, globally accepted policy setting is to treat Australian Government officials deployed overseas as Australian tax residents for the duration of their deployment.

Proposal options

Option A: update the list of superannuation funds

- 6.7 During its deliberations, the Board considered whether to maintain superannuation fund membership as the relevant proxy for government officials working overseas. The Board concluded the following:
- (a) As at June 2018, there were 1,987,000 public sector employees, including 240,700 Commonwealth employees.²⁴
 - (b) The Board was unable to conclusively determine how many employees are currently posted overseas, as this data is not readily available from the Australian Bureau of Statistics.
 - (c) As of 30 June 2018:

²⁴ 6248.0 Annual Survey of Employment and Earnings, Public Sector, Australian Bureau of Statistics <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/6248.0.55.002/>>

- (1) the Commonwealth superannuation scheme was made up of 4,814 contributors and 4,298 members in deferred/preserved phase;
- (2) the public sector superannuation scheme was made up of 74,131 contributors and 99,731 members in deferred/preserved phase.²⁵

- 6.8 Historically, many government officials overseas would have been contributors to these funds. However, that is no longer the case. Through consultation, the Board found that Commonwealth Government Departments with significant overseas deployment programs generally do not have regard for superannuation fund membership when determining tax residency of employees for payroll purposes. Any correlation between membership in the Commonwealth superannuation scheme or the public sector superannuation scheme and being deployed overseas in the service of the Commonwealth Government is now more likely to be coincidental, in particular given the ‘choice of fund’ rules which decouple the link between government employment and Commonwealth superannuation fund membership. As such, adopting a superannuation fund model would more likely lead to arbitrary or manipulable outcomes.
- 6.9 On this basis, the Board has ruled out using the list of superannuation funds within the superannuation test to achieve the policy setting.

Option B: replace the Superannuation test with a new Overseas Government Officials Test

- 6.10 Legislation will be necessary to characterise government officials deployed overseas as tax residents under an ‘Overseas Government Officials Test’. The Board’s stakeholders strongly supported replacing the Superannuation test with a new overseas government officials test.
- 6.11 The Board consulted on the design features of any new test, to identify the key issues and the most appropriate mechanism by which to give effect to the policy setting outlined above.
- 6.12 Three key design principles have been identified:
- (a) Government officials;
 - (b) Government functions;
 - (c) Deployment overseas.

²⁵ Source Commonwealth Superannuation Corporation 2017-18 Annual Report at appendix 2 page 319.

Government officials

- 6.13 It is necessary to identify the population of individuals that will be subject to the Overseas Government Officials Test. In the Board’s view, the test should cover all government employees and office holders at all levels of government (including local government, state government and federal government). This covers employees of government agencies and departments.²⁶
- 6.14 This definition would then apply for the purposes of the Overseas Government Officials Test.
- 6.15 The Board considers that the relevant threshold should be whether an individual is engaged by a public body, and whether the body is effectively controlled by the government. As such, if the body operates as an agent or instrument of the Australian Government, then the individual would be captured.²⁷
- 6.16 However, some individuals should not be captured. This includes employees of Government-owned enterprises and independent contractors.
- 6.17 This feature could be addressed by enumerating the government entities that would be captured (or alternatively, the relevant legislation governing the employment of the individuals such as the *Public Service Act 1999*). While such an approach would provide certainty, it would require a black-letter law approach without any flexibility. Further, it would suffer from the same risks as the existing superannuation test (requiring constant monitoring to ensure it is up-to-date). As such, the Board would not recommend this approach.
- 6.18 A better approach, in the Board’s preferred principles-based drafting style, would be to draw an explicit link between the individual and the governmental function that is provided, without requiring a specific form of employment relationship. The Board’s preference is for this relationship to be elaborated upon in extrinsic materials, which will inform the interpretation.
- 6.19 This is explored further below.

Government functions

- 6.20 The Board considers that where a government agency, or any other enterprise that is effectively controlled by the government, carries out any function in another

²⁶ The test should not distinguish between employees at this level, as the way in which some workers are carved out should be at the ‘deployment’ stage. This should include locally engaged staff.

²⁷ For example, see the New Zealand approach: <<https://www.ird.govt.nz/resources/9/2/9227e1f5-aaac-4bab-8bf1-5ef527fd4441/IS+1603.pdf>>

jurisdiction, the individual carrying out this function should be covered by the Overseas Government Officials Test.

- 6.21 For example, Australian trade representatives, employees from the Department of Foreign Affairs and Trade and defence personnel should all be covered due to the nature of the services they render (rather than pursuant to the specific legal form of their employment).
- 6.22 It is not necessary to set a specific threshold for this test. The Board considers that, broadly, where a government department or other agency performs any functions overseas, these functions will be caught by adopting appropriately broad wording. This may be informed by international approaches such as ‘service’ of an Australian government, without specifying the capacity in which the individual acts.
- 6.23 This should also capture the categories of income Australia has maintained taxing rights over, as outlined in the ATO view in Taxation Ruling TR 2005/8, which states that income from services rendered by an employee or office holder in completing or performing any functions undertaken by a government satisfies the relevant articles most of Australia’s double tax treaties.²⁸

Deployment overseas

- 6.24 The Board’s stakeholders noted that this test could apply either to all government officials, regardless of location, or limited to those that are deployed overseas.
- 6.25 Were the test to apply to all government officials, there would be potential duplication between the Overseas Government Officials Test and the other residency tests (where government employees based in Australia are likely to be resident).
- 6.26 Alternatively, this test could be targeted to apply to individuals that are deployed overseas to perform the relevant government functions. In effect, their absence from Australia (i.e., their departure and expected return) should be a determinative factor in qualifying for the Overseas Government Officials Test.
- 6.27 This would have the effect of identifying individuals within the government official population who would, but for their deployment, be tax residents of Australia, as well as aligning with the global practice of maintaining (and exercising) taxing rights over income from personal services of representatives of government when overseas.

²⁸ While this Ruling also sets out treatment where Australia’s double tax treaties are of limited scope, this should not be imported into the Overseas Government Officials Test. This would unnecessarily increase complexity of the rules. Further, as the treaty taxing rights relate only to income not the residency status of the government officials, these are different concepts and require different considerations.

6.28 The Board considers that this test should be limited to the period of overseas deployment.

International comparison: New Zealand

6.29 In the New Zealand *Income Tax Act 2007*, government officials are treated as tax residents through the following legislative drafting:

“a natural person who is personally absent from New Zealand in the service, in any capacity, of the New Zealand Government is treated as a New Zealand resident during the absence.”

6.30 The Board considers that this principles-based approach is instructive. In particular, the approach identifies nexus between individuals, physical absence, and government service for the purposes of determining residency.

6.31 A number of the Board’s stakeholders expressed explicit support for adopting a test akin to the New Zealand test.

Further observations and sensitivities

6.32 A number of other matters will need to be considered further in the policy and law design development process. The Board has outlined matters it considers to be of particular importance, and its indicative views on the path forward.

Contractors

6.33 Unless contractors are Australian government employees, agents or otherwise considered instruments of Australian governments, they will not be covered by this test.

6.34 This accords with the international expectation that such treatment, at treaty level, does not apply to ‘persons rendering independent services to a state or deriving pensions related to such services’.²⁹

6.35 However, the Board understands that some contractors work in roles akin to employees and may also be captured. For example, under the *Australian Federal Police Act 1979*, contractors can be either appointed or non-appointed. The terms of an appointed contractor’s services are governed by the *Australian Federal Police Act 1979* in a similar

²⁹ Paragraph 34 of Taxation Ruling TR2005/8.

way to employees, and it is arguable that these contractors should be treated in a similar way.

- 6.36 The Board considers that this issue may be resolved through adopting a principles-based approach to ‘service’ of the Australian government. Where contractors (and government-owned enterprises) are considered to be in service of Australian governments (for example, because they are covered by agency enabling legislation), the individuals that they employ will be captured by this rule. However, this will be a factual matter and may provide some flexibility for contractors that are actually acting in service of Australian governments and carrying out government functions, or where contractors do not actually have a material degree of independence or discretion such that they are effectively under the direct control and direction of the relevant government. It is expected that this matter can be clarified during implementation.

Locally engaged staff

- 6.37 Engaging local staff in overseas jurisdictions is common practice in Australia’s foreign service and certain other agencies. Local staff is commonly made up of individuals who already reside in the country in which the staffing engagement is required – that is, the positions are not traditional deployments of an Australian based individual from an Australian government agency or department. Further, the government generally provides no (or limited) relocation assistance.
- 6.38 These individuals are not generally Australian tax residents. However, stakeholders commented that where an employee is on deployment and accompanied by a spouse (who is also a government official), that spouse is often hired in a position that may have otherwise been a locally engaged staff position. These spouses can sometimes be considered Australian tax residents for the duration of the deployment.³⁰ The extent to which this occurs is unclear, but was described during consultation to be commonplace.
- 6.39 To avoid this complexity, the Board considers that the design principle of ‘deployment overseas’ should distinguish between those that qualify under the Overseas Government Officials Test and those that should use the other residency tests. This should also provide clearer guidance for government departments and agencies, should they seek to employ both spouses where one is deployed. This would improve certainty and simplicity.
- 6.40 This test should allow Australia to exercise its taxing rights over the income of government employees posted overseas in Australia’s double tax treaties, while not treating locally engaged staff as residents where Australia does not have the exclusive right to tax their income.

³⁰ The scope of services rendered is also understood to vary considerably, depending on the individual’s skillset.

Spouse and dependants

- 6.41 The OGOT should only apply to the individual actually rendering services and deployed overseas. This is consistent with global practices, and reflects the broader individual-basis for income tax in Australia.
- 6.42 The other residency tests should continue to apply to other members of the individual's family, as they do to all other individuals. The Board understands that many spouses of deployed officials also work for the Government in some capacity – in those circumstances the Overseas Government Officials Test may apply to them in their own right. However, if they are not deployed overseas (and rather just take up employment once they have settled in the overseas country), then the Overseas Government Officials Test should not apply. This is largely consistent with the taxing rights Australia has reserved under its double tax treaties.
- 6.43 There was minimal support from stakeholders for including spouses and dependants in the Overseas Government Officials Test. There was also some concern raised that treating spouses as tax resident due to their partner's employment may be discriminatory (breaching the *Sex Discrimination Act 1984*).³¹ While the Board is unaware of the likelihood of any such issue arising, it reflects the Board's considered view that the residency tests apply on an individual basis.
- 6.44 Nonetheless, the Board appreciates that spouses and dependants outside of government employment also commonly travel with a deployed official for understandable family reasons, the cause of their relocation being the official's foreign service. During consultation it was raised that, depending on their circumstances, spouses may prefer to maintain tax resident outcomes during this period. However, the Board considers that these preferences will vary depending on the individual and prefers its view that residency apply on an individual basis.³² Further, given the common deployment scenarios of which the Board was made aware, in practice many spouses applying the short-term or long-term resident tests would likely remain resident.

Officials on leave without pay

- 6.45 Stakeholders confirmed to the Board that many government officials take leave without pay to travel overseas on holiday as well as to undertake secondments for government and non-government organisations that may be similar to the services that they would provide while working for the relevant government.

³¹ A stakeholder commented that the *Income Tax Assessment Act 1936* is listed as a statutory authority that persons acting in accordance with are not affected by the relevant provisions in the *Sex Discrimination Act 1984*.

³² For example, practical difficulties in determining tax outcomes when disposing of jointly held taxable Australian real property if one spouse is a resident and the other is non-resident.

- 6.46 The Board considers that these arrangements should not be covered by the Overseas Government Officials Test. This should be effectively eliminated by the deployment requirement.

State, territory and local government employees and officials

- 6.47 It was suggested by stakeholders that this test should also apply to any individual performing analogous services for political subdivisions of Australia (e.g., state, territory and local government).
- 6.48 The Board understands that state governments commonly contract individuals for overseas roles as locally engaged individuals subject to local conditions. In those circumstances, were the Overseas Government Officials Test to be extended then the ‘deployed overseas’ threshold would not be met and as such there would be no change in existing treatment. This would also be consistent with treatment at federal level.
- 6.49 However, there are some instances in which individuals are employed in Australia and deployed overseas. The Board considers that it would be appropriate to extend the Overseas Government Officials Test to cover these individuals.
- 6.50 The current residency status of such individuals is unclear. Similar to federal government employees, there is likely a *prima facie* assumption these individuals would remain residents through the duration of their deployment, although this may be rebutted in individual circumstances given the way in which the current tests operate.
- 6.51 The Board considers that providing certainty for all employees, and consistent treatment that is aligned more closely with federal government employees, international norms and treaty policy should be adopted.
- 6.52 Further consideration of the existing tax treatment of these individuals is warranted to ensure that changes to current practices for exceptional cases are worked through.

Tax treaty interactions

- 6.53 As noted above, all of Australia’s double tax treaties include a Government Services Article that retain exclusive taxing rights over the remuneration (and to some extent pensions) paid by Australian governments to staff where those payments are made regarding services provided overseas.
- 6.54 The taxing rights negotiated by Australia and its treaty partners vary.³³ However, as these articles apply at the income level (rather than the individual) these different

³³ See Taxation Ruling TR 2005/8.

standards do not impact the residency of individuals. As such, the allocation of taxing rights will be an overlay upon residency, by clarifying the jurisdiction in which the income is taxable.

- 6.55 The Board’s preferred approach is to provide a low consistent threshold of overseas government official residency, which applies to all officials equally for simplicity. This will then allow the relevant treaty article to determine the taxing rights over any relevant remuneration and pensions as appropriate, being the same treatment as is currently the case (and consistent with treaty interaction more generally).

Examples

- 6.56 The Board has prepared the following illustrative examples.

EXAMPLE 17

Floyd is employed by an Australian Government department and is based in Canberra. The department has requested that Floyd relocate to China for a three year deployment. The department will pay Floyd’s relocation costs, and he remains employed by the department during his time working overseas. Floyd satisfies the Overseas Government Officials Test and is Australian tax resident throughout the three years as he is deployed overseas in the service of the Australian Government.

EXAMPLE 18

Continuing on from Example 17, Floyd’s partner Grace accompanies him to China.

Variation A: Once in China, Grace gains employment teaching English at a local school. Grace does not satisfy the Overseas Government Officials Test and will have to determine her residency based on the general residency rules for individuals.

Variation B: Prior to leaving Australia, Grace arranges employment with the department as an assistant in China. As a result, Grace is deployed overseas in the service of the Australia Government in her own right, and therefore satisfies the Overseas Government Officials Test.

EXAMPLE 19

An Australian Government department has an office in London with two vacant positions. Following a recruitment drive, Justine and Ethan are employed to fill those vacant positions as locally engaged staff members.

Justine was an Australian resident present in Australia and was employed in Australia by the relevant department when she applied for the London job. The interview process was conducted via video conference, and she left Australia only after she had secured the position. Accordingly, Justine satisfies the Overseas Government Officials Test as she is deployed overseas in the service of the Australian Government.

Ethan was a UK resident present in the UK when he applied for the job. He was interviewed in person in the London office. Ethan does not satisfy the Overseas Government Officials Test as he is not deployed from Australia to work in the service of the Australian Government.

EXAMPLE 20

Jaxon is an Australian expatriate that has been living and working in San Francisco for the past five years for a United States tech company. He is a non-resident of Australia for tax purposes. Jaxon hears that an Australian Government department is hiring people to work in their New York office. He applies for a position, is successful and relocates to New York.

Jaxon will not become an Australian resident under the Overseas Government Officials test as a result of his employment by the Australian Government department. He is not deployed in the service in the Australian Government as he was living outside of Australia prior to his appointment to the position, and the performance of his duties is not the reason for his absence from Australia.

N.B. The Board considers that there may be variations on this fact pattern may lead Jaxon to qualify for the Overseas Government Officials Test, which should be monitored during implementation.

Recommendation

RECOMMENDATION 13

The Board recommends that the Superannuation Test be replaced with an Overseas Government Officials Test.

The Overseas Government Officials Test will characterise any individual deployed overseas in the service of an Australian government (federal, state or territory government) to be a tax resident for the duration of their deployment.

CHAPTER 7: FACTOR TEST

KEY POINTS

- Individuals who do not satisfy the proposed rules based solely on physical presence may need to apply the Factor Test.
- The Factor Test is a new modular test in the revised residency rules, replacing various tests in the existing rules that rely on facts and circumstances. The factors apply in the manner regardless of when the test applies.
- The Factor Test applies in the commencing residency test and ceasing short-term residency test. An individual with two or more factors is a resident (when supported by the relevant physical presence requirement).
- The factors are based on key residency considerations from the existing rules and international comparisons, but reduced to simpler, modernised factors that can be objectively determined.
- Factors only test Australian connections. Two individuals with the same connection to Australia under the Factor Test should be treated analogously.
- There are four factors:
 - The right to reside in Australia (e.g., citizenship or permanent residency);
 - Australian accommodation;
 - Australian family;
 - Australian economic connections.

Understanding the Factor Test

- 7.1 The existing residency rules require a holistic examination of an individual's facts and circumstances to determine residency status. As outlined in the Board's 2017 Report, this analysis can be complex, cause uncertainty and increase the likelihood of disputes. This was a key consideration in the Board recommending that the residency rules be modernised.
- 7.2 The Board's proposed rules focus on the principle that residency is primarily determined by physical presence. However, the Board does not consider residency rules based purely on physical presence to be appropriate. Such rules would give rise to behavioural responses (such as manipulation based on tax outcomes) and inflexible rules may lead to

other inappropriate outcomes. As such, the Board's recommended model requires a second level of testing that is based on both physical presence and facts and circumstances. This testing of facts and circumstances is called the Factor Test.

When does the Factor Test apply?

- 7.3 Under the Board's proposed residency rules, where an individual's residency status is not resolved by the 183 Day Test, they must apply a secondary test.
- 7.4 As outlined earlier in this Report, these secondary tests are the commencing or ceasing residency tests. An individual will be required to apply the Factor Test in the following circumstances:
- (a) **Commencing residency test:** any individual who was not a resident in the previous income year and spends between 45 and 182 days (inclusive) in Australia;
 - (b) **Ceasing residency test:** any individual who was a short-term resident (i.e., a resident for up to two consecutive income years) and spends less than 45 days in Australia.

Framework for the Factor Test

- 7.5 The Factor Test applies to test whether an individual has specific, identifiable connections to Australia. In establishing the parameters for each factor, a variety of scenarios have been identified, based on both historical cases and common 21st century global work and travel practices.
- 7.6 The Factor Test applies for arriving individuals who have spent significant time in Australia (45 to 182 days), and short-term residents who have only spent minimal time in Australia in a single income year. In both of these circumstances, two factors are required to achieve residency status.
- 7.7 While the Board has set out its views on the parameters below, the framing principle for the Factor Test is the adhesiveness principle. That is, residency should be harder to cease than it is to commence. Given this framework the Board considers that, as the factors have been identified due to their relevance to residence, they should be relatively simple to satisfy.
- 7.8 The Board has analysed each factor with regard to when the Factor Test will apply. Were the test to apply in other circumstances, it would be necessary to reconsider the calibration of the factors.

Changes from the existing rules

- 7.9 The Factor Test draws some parallels to the existing residency rules, in particular the resides test, the domicile test (including the permanent place of abode test) and the usual place of abode test which are defined at common law, adding significant complexity to the determination as to whether someone is a tax resident of Australia. In accordance with the key policy decisions outlined earlier in this Report, the following distinctions can be drawn between the existing rules and the new rules:
- (a) These rules do not test an individual's intention – given the uncertainty of such a standard (whether objective or subjective), this has been eliminated to provide greater simplicity and certainty.
 - (b) These rules are only focused on an individual's connection to Australia – this is distinct from the existing comparative thresholds, and will provide greater certainty, reduce the compliance burden for determining overseas connections as well as remove anomalous outcomes that may arise when considering overseas arrangements from an Australian perspective (that is, where outcomes solely based on overseas arrangements notwithstanding identical connections to Australia).
 - (c) This test has reduced the number of relevant factors from existing case law down to four based on an analysis of previous cases, where these factors were considered to provide significant evidence of a person's connections or lack thereof. These factors are therefore an effective distillation of the historical concepts drawn from case law, but which have been modified into modernised, objective versions of these key concepts that can adapt to developments in the future.
- 7.10 The Factor Test is intended to simplify the operation of the law significantly. In doing so, there will be some changes to the outcomes of individuals from the existing law. The Board is strongly of the view that doing so will greatly enhance the ability of individuals and employers to comply with the law and reduce compliance costs.

What are the factors?

Consultation

- 7.11 The Board consulted on introducing a second step into the revised residency rules. If an individual, either coming to or leaving Australia, does not satisfy the bright-line tests, the individual would apply a second step to determine their residency status. This second step was called the Factor Test.
- 7.12 In the 2018 Consultation Guide, the Board outlined its preference to test an individual's connection to Australia through specific, objective factors. These factors were:

- (a) Time spent in Australia;
- (b) A right to reside in Australia;
- (c) Australian accommodation;
- (d) Australian family; and
- (e) Australian economic connections.

7.13 Consultees were largely supportive of an approach that adopted a streamlined, objective inquiry of specific factors that could be easily ascertainable. In particular, consultees generally agreed with a focus on ties to Australia given the simplification and compliance benefits such an approach provides.

7.14 Concerns were raised about using time spent in Australia as a factor as, given its use elsewhere in the proposed rules. There was some concern that this may cause confusion. The Board agrees with this feedback and removed time spent from the list of factors in the proposed rules.

Recommended factors

7.15 Under the Factor Test, individuals are required to conclude whether they satisfy any of four factors:

- (a) The right to reside permanently in Australia (including citizenship and permanent residency);
- (b) Australian accommodation;
- (c) Australian family;
- (d) Australian economic connections.

7.16 When an individual is required to apply the Factor Test (see residency flowchart), where an individual satisfies any two of these factors, the individual will be a resident under the Factor Test. If not, they will not be a resident under the Test.

7.17 Generally, the Factor Test applies on a full year basis. Where the part-year rules apply, the Factor Test will apply in each part of the income year separately (that is, on a split-year basis).

7.18 As noted above, during consultation each of the recommended factors received overwhelming support. However, the Board acknowledges that each of these factors will involve some level of complexity given the nature of a fact-based test. To the extent possible, the Board has sought to provide simple yet clear boundaries for each factor

including the use of illustrative examples below, which can be developed during implementation.

- 7.19 It should also be noted that the Board’s proposed factor tests is broadly comparable with the international tax treaty standard factors contained in the individual tie-breaker rule.

The right to reside permanently in Australia

- 7.20 The first factor is satisfied by an individual if they have the right to reside permanently in Australia for immigration purposes. This includes citizens and permanent residents of Australia.

- 7.21 There was near unanimous support from consultees that this factor should be included in the Factor Test.

- 7.22 The Board has considered the boundaries of this factor will be relatively clear, and provides the following comments:

- (a) In accordance with Australia’s tax treaty obligations, this factor does not discriminate on the basis of nationality.³⁴ Rather this factor considers the lawful right to reside permanently in Australia.
- (b) An individual on a transitional or temporary visa that is a pre-requisite for a permanent visa will not satisfy this factor. The only way in which this factor will be satisfied is with a legal right to reside in Australia permanently.
- (c) An individual that is in Australia without a visa (such as an unlawful non-citizen for the purposes of the *Migration Act 1958*) will not satisfy this factor. The Board considers that this is an appropriate threshold, as the factor is based on the lawful right to reside in Australia – the fact that an individual is in Australia without any lawful basis (such as following the revocation of a visa) does not affect the physical presence test, where it is most appropriately incorporated.

- 7.23 The Board has prepared the following examples.

³⁴ In a number of Australia’s double tax treaties, nationals of Australia’s treaty partners that are in the same circumstances (including having the same residency status) as Australian nationals cannot be discriminated against (i.e., have imposed on them more burdensome taxation or other requirements) based on their nationality. The Board understands that adopting a factor of this nature within the residency rules will not breach Australia’s obligation in this regard and is entirely consistent with international practices – this can be confirmed during implementation.

EXAMPLE 21

Arlo arrived in Australia in March 2019 under a provisional Significant Investor Visa (subclass 188C). He was nominated by the NSW Government and invited to apply for this visa, and invested more than \$5 million in complying significant investments.

The visa entitles Arlo to remain in Australia for up to four years and three months. Arlo hopes to make Australia his permanent home, and intends apply for an extension to his current visa for an additional two years, and then for a permanent Significant Investor Visa (subclass 888C).

Even though his Significant Investor Visa is a pathway to permanent residency, it does not meet the requirements of being a right to reside permanently in Australia for the purposes of the factor test. This factor would only be satisfied if and when he held a subclass 888C permanent Significant Investor Visa.

EXAMPLE 22

Matias is a Chilean national who came to Australia on a Work and Holiday Visa (subclass 462). This visa allows him to stay in Australia for up to 12 months whilst working and travelling. This does not meet the requirements of being a right to reside permanently in Australia for the purposes of the factor test.

EXAMPLE 23

Frankie is a United Kingdom citizen who is married to Hunter, an Australian citizen. Frankie relocated to Australia after she married Hunter. She permanently resides in Australia under a Partner (Migrant) Visa (subclass 100). This meets the requirements of being a right to reside permanently in Australia for the purposes of the factor test.

Australian accommodation

- 7.24 At a principled level, an individual is taken to have satisfied this factor of having Australian accommodation if the individual has an arrangement to access accommodation at any time during an income year.
- 7.25 Consultees raised a number of issues regarding this factor. These issues can generally be categorised as regarding the rights attached to accommodation as well as the use of accommodation.

The ability to access accommodation

- 7.26 Consultees noted varying proprietary and other rights relating to property. Examples included the rights of ownership, leasehold interests, life interests, licences as well as circumstances in which an individual may not have any enforceable rights against the property owners. Consultees suggested that a substantive test be adopted, rather than one that relies on legal or equitable rights.
- 7.27 The Board prefers this substance over form approach. The ability to access accommodation should not rely upon an identifiable legal right, but rather whether, from a factual inquiry, an individual has an arrangement to access accommodation in Australia.
- 7.28 While ownership of accommodation, both direct and indirect, will be relevant to this inquiry and likely determinative for the owners, they may not be the only individuals that satisfy this factor with regards to the single unit of accommodation. For example, all members of a family that live in a unit of Australian accommodation should satisfy this factor due to that relationship.

Use of accommodation

- 7.29 Consultees suggested a *de minimis* period of time an individual should stay in accommodation before satisfying this factor. The Board prefers no *de minimis* period. The individual must have an arrangement that provides the individual with the ability to access identified premises at any point in the year. The Board considers this test will provide a clear standard.

Other matters

- 7.30 The Board has also identified further issues that warrant consideration during implementation. The following comments represent the Board's indicative view:
- (a) The accommodation must have the nature of residential accommodation – this excludes hotels and other purely short-term lodging arrangements.
 - (b) Accommodation includes arrangements where a licence provides the right to occupy residential accommodation.
 - (c) This does not include a mere expectation that an individual would reside at a parent or other relative's residence when in Australia. This excludes the family home (i.e., parents' home) of individuals that live overseas but do not own, rent or arrange to use any Australian accommodation on their own. For example, while most individuals could reasonably expect the homes of their family members to

be available after time living outside Australia, this is not sufficient to be considered an arrangement.³⁵

- (d) This factor should be satisfied where individuals have moved overseas and maintain ownership of and access to accommodation, regardless of intention to sell or rent. However, where a property is owned but rented out for the entire income year, then that property would not satisfy the accommodation factor.

(1) However, the Board notes that, practically, a property that is owned but rented out as accommodation would nonetheless satisfy the Australian economic connections factor. This means that a property, rented out for a part of a year, would be accommodation for part of a year but an economic connection for another part, or where a property may be an individual's accommodation one year, and an economic connection the next.

- (2) This may create unnecessary complexity. While the Board's preference is to align the use to which the property is put with the relevant factor, the Board appreciates that there may be a trade-off between this alignment accuracy and complexity, and ownership of a residential property may be sufficient to be considered Australian accommodation in some circumstances – for example, while it is treated as an individual (or their spouse's) main residence.

7.31 The Board has prepared the following examples.

EXAMPLE 24

Audrey is a United Kingdom citizen who came to Australia in January 2017 on a short term secondment. When she first arrived, she purchased an apartment in Melbourne that she lived in as her permanent home for the duration of her secondment. In March 2019, she returned home to the United Kingdom to care for her elderly parents. She decided to leave the apartment vacant as she intends to frequently visit Melbourne and stay in her apartment. The apartment is counted as Australian accommodation for the purposes of the factor test.

³⁵ This should include elderly relatives living in a granny flat without legal agreements in place, which was raised with the Board during consultation. The arrangement in the Administrative Appeals Tribunal case of *Tan* would also be a sufficient arrangement to satisfy this standard (for example, where the individual and his spouse's belongings stayed at the accommodation, they continued to use the accommodation under an arrangement that the room was only available to the individual and spouse), although this should be confirmed during implementation.

EXAMPLE 25

Cooper has the same basic facts as Audrey in Example 24, but decided to keep the apartment as an investment and rent it out with a property manager. In this case, the apartment is not counted as Australian accommodation, as it is not available to Cooper to access at any time during an income year. The apartment would, however, be counted as an Australian economic connection under the factor test (see also Example 44).

Note that when applying the factor test as part of the ceasing short-term residency test, the factors must be tested for the part of the income year in which the individual is not in Australia. Accordingly, the test is applied based on the availability of the accommodation after Cooper has left Australia. It is not relevant that he may have resided in the apartment for part of the income year up to the time in which he left Australia.

EXAMPLE 26

Alice and James are retired. They mostly live in Ireland, having left Australia five years ago, but still spend a substantial amount of time in Australia each year visiting their children and grandchildren. They have an informal agreement with their daughter to live in a granny flat at the back of her property in Tasmania while they are in Australia. They have exclusive access to the granny flat at any time during the year, and leave their possessions in the granny flat year round.

Using the substance over form approach preferred by the Board, this would be treated as an arrangement to access accommodation in Australia for the purposes of the factor test, even though there is no legal agreement between Alice, James and their daughter.

EXAMPLE 27

Piper is an Australian citizen and is 30 years old. When Piper was 18, she moved out of her parent's house in Sydney to attend university in Canberra. She rented an apartment in Canberra for 4 years while she completed her university studies, and then decided to move to London. Prior to her move to London, she gave up the lease to her apartment in Canberra and moved some of her belongings to her parent's house for storage purposes.

Piper has now been in London for 8 years, and has decided to move back to Australia. She knows that her parents will allow her to stay with them while she finds a permanent place to live. When Piper returns to Australia, for the purposes of the factor test this short term expectation to stay with her parents is not considered to be a right to access Australian accommodation as it is a short term temporary arrangement.

EXAMPLE 28

Ruby is a wealthy entrepreneur who likes to holiday in far North Queensland. She is not an Australian citizen and spends the majority of her time outside of Australia. She has access (with notice) to a house in Port Douglas under a licence agreement. Other individuals may stay in the house at other times in the year. For the purpose of the factor test, this is considered to be a right to access Australian accommodation.

EXAMPLE 29

Logan works for a large multinational and frequently travels to Australia on business, often spending several months in Australia providing on the ground support to local employees. Whenever he comes to Australia, he books a serviced apartment to stay in. This is not considered to be access to Australian accommodation for the purposes of the factor test as it is a short-term temporary lodging arrangement.

Australian family

- 7.32 An individual will have an Australian family (and thus satisfy the third factor) if their spouse or any of their children under the age of 18 are generally located in Australia.
- 7.33 In consultation there was broad agreement for a family based factor, given its significance in residency jurisprudence. However, consultees raised concerns regarding the extent to which this standard might apply if broadly drafted.
- 7.34 The Board accepts that this standard is less likely to be met by single individuals with no dependants. This is by design. A single individual does not have a connection of this nature to family located in Australia, and as such it would be inappropriate to develop a mechanism to approximate social interactions that may mirror this factor. This will achieve certainty and is a key simplification measure.
- 7.35 A spouse or child will be located in Australia if they live in Australia on an ongoing basis at any point during an income year. This should be a relatively simple factual inquiry, as it has been in residency cases.
- 7.36 On further issues that warrant consideration during implementation, the Board's indicative view is as follows:

- (a) The terms spouse and child should take their meanings from the income tax laws.³⁶ While aligning to social security definitions was preferred initially, it is not practically feasible as those definitions are quite complex and often rely on the opinion of the Secretary of the Department.
- (b) Spouse will include partners in all de facto relationships (regardless of sex), but it will not include prohibited relationships. It will be appropriate to confirm during implementation that all relevant couple relationships are covered.
- (c) This is not expected to include estranged relationships. However, given the nature of this test it is reasonable to expect that family relationships will be included even where an individual is living overseas for an extended period of time without their family and maintain family connections.
- (d) This will not include children over the age of 18, notwithstanding that 25 is commonly used for other public policy purposes. These extensions would not always be relevant and would create additional complexity.
- (e) The test will not have regard to the parents of an individual who is over 18 years of age. This test seeks to identify the immediate family of an individual who is in a de facto relationship and/or where an individual's dependants reside only.

7.37 The Board acknowledges that inquiries into the status of a spousal relationship are factual and will turn on particular circumstances. The Board expects that most inquiries of this nature will be simple; however, exceptional cases may make this inquiry more difficult. The Board has provided illustrative examples below to assist in implementation.

7.38 The Board has prepared the following examples.

EXAMPLE 30

Ryan and Lucas are legally married and have an adopted son who is eight years old. Ryan spends most of each year outside of Australia on business. Lucas and the child remain in Australia for the majority of the year, except for occasional short holidays outside of Australia. Ryan has an Australian family for the purposes of the factor test.

³⁶ Child and spouse are defined for income tax purposes in the *Income Tax Assessment Act 1997*, and the Board considers these would be appropriate definitions to adopt (while also adopting an under 18 limit for children).

EXAMPLE 31

Charlie is 27 years old, is an Australian citizen but has lived most of his life in the United Kingdom. When he was 10 years old, his parents divorced and he moved with his mother to the United Kingdom. His father remained in Australia, and still lives there now. Following the completion of his university studies, Charlie decided to spend some time in Australia. Charlie does not have Australian family for the purposes of the factor test even though his father lives in Australia as the test only has regard for the spouse and children of an individual.

EXAMPLE 32

Maya is an Australian citizen who has been living and working abroad for many years. She left Australia in 2010 following her divorce. Her ex-husband and daughter aged 12 live in Australia. Maya provides financial support for her daughter. Maya's daughter living in Australia means that Maya has Australian family for the purposes of the factor test.

EXAMPLE 33

Harrison has similar facts to Maya in Example 32, except his son is aged 23. Harrison does not have Australian family for the purposes of the factor test.

EXAMPLE 34

George and Olivia are legally married but have been living independently of each other for many years. They have no financial ties and are rarely in contact. George is an Australian citizen and lives permanently in Australia. Olivia lives overseas but is considering moving to Australia. Olivia does not have Australian family for the purposes of the factor test.

EXAMPLE 35

Ella and Chloe have been living together in a genuine domestic relationship since 2014. Ella and Chloe maintain a joint bank account into which both of their wages are paid, and all living expenses are deducted. Chloe is flight attendant who spends a lot of time outside Australia. When she is travelling, she keeps in contact with Ella via daily video calls.

Chloe and Ella are in a de facto relationship. Accordingly, Chloe has Australia family (i.e. her spouse is in Australia) for the purposes of the factor test.

EXAMPLE 36

Violet and Finn are Canadian citizens and are legally married. They have no family living in Australia.

Violet and Finn travel to Australia on holidays, and spend a total of 55 days in Australia. For the purposes of the factor test, Violet does not have Australian family, notwithstanding that her legal spouse is in Australia at the same time she is. The same analysis applies to Finn. This is because neither Violet nor Finn live in Australia on an ongoing basis.

EXAMPLE 37

Lincoln has come to Australia for three months to help set up an Australian branch of the company he works for. During his stay in Australia, his wife comes to visit him for two weeks. For the purposes of the factor test, Lincoln does not have Australian family, notwithstanding that his legal spouse is in Australia at the same time he is. This is because his wife does not live in Australia on an ongoing basis.

Australian economic connections

- 7.39 An individual will have Australian economic connections where they are employed in Australia, actively participate in carrying on a business in Australia or, directly or indirectly, have interests in certain Australian assets.
- 7.40 Consultees have noted that this factor may be more difficult to define than the other factors, and would lead to significant uncertainty if left undefined.
- 7.41 The Board's preferred approach is to provide a greater level of clarity for this factor, by setting out the three key Australian economic connections, any of which should satisfy this factor. Those connections are:
- (a) Employment located in Australia;
 - (b) Active participation in the carrying on of a business in Australia;
 - (c) Interests in Australian assets.

Employment

- 7.42 In accordance with a preponderance of case law, the location of employment is a key issue to consider for residency. The Board considers that this should remain the case, and as such if an individual usually carries out their employment duties in Australia then this factor is satisfied.

7.43 An individual is employed in Australia by a business (Australian or foreign) and commonly carries out their employment duties in Australia. The Board prefers a test of “commonly”, which acknowledges that individuals may undertake travel for work as well as work on overseas holidays due to the nature of work and cyber presence.³⁷ Further, individuals may work in Australia on holidays, but not commonly in accordance with their work arrangements. The Board does not prefer a test based on a majority or predominant of an individual’s work being carried out in Australia, but that it must be a common, or not infrequent occurrence.

7.44 The Board has prepared the following illustrative examples.

EXAMPLE 38

Archie arrived in Australia in January 2019. He has come to undertake a two year secondment with an Australian firm. The secondment was arranged by his previous employer in the Netherlands. His employment in Australia gives rise to an Australian economic connection for the purposes of the factor test.

EXAMPLE 39

Eli is employed as a crew member on a cruise ship that sails year round out of Sydney. The cruise ship primarily visits various Pacific Islands and New Zealand, with an occasional trip along the east coast of Australia. Eli is employed by a company resident in Bermuda. Eli’s employment with the cruise line is not considered to be employment in Australia giving rise to an Australian economic connection, as his employment duties are not commonly carried out in Australia.

EXAMPLE 40

Irene migrated to Australia from Malaysia in 2017. She has full-time employment in Australia with an Australian company. In early 2019, her elderly mother fell ill, so she arranged for an 18 month leave of absence from her job to return to Malaysia and care for her ailing mother. For the purposes of the factor test, during her leave of absence Irene does not have an Australian economic connection by virtue of employment located in Australia. Even though she is still legally employed by the Australian company, she is not carrying out her employment duties in Australia during this period.

³⁷ The Board considers that further consideration should be undertaken on whether there is an existing concept within the income tax laws that may be adopted rather than introduce a new definition.

Active participation in the carrying on of a business in Australia

- 7.45 An individual satisfies this test if they control (directly or indirectly) or play a significant role in the operations or management of a business in Australia.
- 7.46 This will apply to individuals regardless of whether a formal arrangement is in place between the business and the individual. It is a factual inquiry as to the role an individual plays in the carrying on of a particular business, including a business carried on by that individual, another individual, or a company, partnership, trust or any other entity.
- 7.47 The Board also provides the following indicative views:
- (a) The Board considers that directorship of an Australian company will not automatically satisfy this connection, but is significant within the factual inquiry. The activities of the director in respect of the underlying business will determine the connection. The Board considers that involvement with a business should be a relatively low threshold, as it reflects a significant economic connection to Australia.
 - (b) An individual will satisfy this test if they are the trustee of a trust that carries on a business in Australia. However, this will depend on the arrangement. For example, if a trust does not carry on business but is part of a broader business being carried on by multiple entities that the individual manages, operates or otherwise controls, the individual will satisfy this test. Further, if the individual is involved with a corporate trustee (i.e., plays a significant role in the operations and management of the corporate trustee, which itself carries on a business) then the test will be satisfied. This test will not rely on whether a business is carried on by a particular entity.
 - (c) An employee of a business will be excluded from this factor – an individual carrying out employment duties in Australia will satisfy this factor through the employment threshold. It is not intended that an employee working overseas for a large organisation that has operations in Australia (but not employed as part of those operations) would be caught. However, to the extent that an individual may participate in the carrying on of business operations in Australia but avoid satisfying this factor by virtue of their employment, this test will rely on substance over form to capture such individuals.

7.48 The Board has prepared the following illustrative examples.

EXAMPLE 41

Belinda is a partner in a small accounting firm in Perth. She plays an active role in the carrying on of the business activities of the partnership. This constitutes an Australian economic connection for Belinda.

EXAMPLE 42

Maisie is a director of an Australian company and actively involved in the management of the business in Australia. For the purposes of the factor test, given Maisie's activities as a director and active involvement in carrying on of a business, Maisie has an Australian economic connection.

Directly or indirectly holding interests in Australian assets and similar interests

- 7.49 An individual satisfies the Australian economic connections factor if they directly or indirectly have an interest in Australia assets.
- 7.50 The Board appreciates that there may be some complexity identifying the relationship between an individual and Australian assets or other interests. As such, the Board considers that this assets and interest test should be limited to a specific list of interests. The Board has identified the following interests (held directly or indirectly) that will satisfy the factor, being an interest in:
- (a) taxable Australian property;
 - (b) a bank account with an Australian bank with significant cash deposits (e.g. an Australian bank account – the scope should be considered further in implementation as to whether it should only target deposits that benefit from the Australian banking system and Australian Government deposit guarantee);
 - (c) an interest in a family trust (determined by reference to the family trust election family group);
 - (d) receipt of Australian social security payments in the preceding income year (including a social security payment which is portable³⁸ (that is, the individual maintains an 'entitlement to an Australian social security payment while outside Australia'), but only where Australia continues to be responsible for some part of the social security payment under a Social Security Agreement³⁹).

³⁸ For more information, see <http://guides.dss.gov.au/guide-social-security-law/1/1/p/310>

³⁹ Australia's Social Security Agreements are treaties based on the principle of shared responsibility - each country pays a benefit that reflects that person's association with that country's social security system <http://guides.dss.gov.au/guide-social-security-law/10/1>

EXAMPLE 43

Riley is a majority shareholder in a company that operates a business in Australia. For the purposes of determining if Riley has Australian economic connections, this is not considered to be active participation in the carrying on of a business in Australia. It would, however, be counted as a connection if the shares constituted taxable Australian property, which would satisfy the Australian economic connections factor.

7.51 The Board has also identified a number of matters on which it seeks to provide clarity for implementation purposes:

- (a) An interest of an individual in a foreign pension fund that holds taxable Australian property will not satisfy this test;
- (b) An interest in a foreign managed investment vehicle that entitles the holder to returns on taxable Australian property held by the vehicle should satisfy this test;
- (c) The level of tracing to identify indirect interests should not be limited to a set number of steps through a chain of entities⁴⁰;
- (d) Australian accommodation that satisfies the Australian accommodation factor is excluded from consideration under this test;
- (e) An interest in an Australian superannuation fund should only satisfy this test if the individual is a contributing member or drawing a pension – the Board considers that due to regulatory requirements that restrict individuals from exiting the superannuation system mean that dormant accounts may lead to inappropriate outcomes.

EXAMPLE 44

Sofia is an Italian citizen who came to Australia January 2017 on a short term secondment. When she first arrived, she purchased an apartment in Melbourne that she lived in as her permanent home for the duration of her secondment. In March 2019, she returned home to Italy. She decided to keep her apartment as an investment property, renting it out through a property manager. This apartment is an Australian economic connection for the purpose of the factor test.

⁴⁰ For example, the round tripping rules in the management investment trust withholding provisions in the *Income Tax Assessment Act 1997* and the tracing rules in the *International Tax Agreements Act 1953* may be instructive.

EXAMPLE 45

Continuing on from example 25 above, except that in that example Audrey decided to leave the apartment vacant as she intends to frequently visit Australia and stay in her apartment.

In this case, the apartment is counted as Australian accommodation for the purposes of the factor test. Where an individual owns property in Australia which is available to them as accommodation, it is only counted once in the factor test as Australian accommodation. That is, the asset is not counted as an Australian economic connection to avoid duplication.

Alternative option: points-based test

7.52 As outlined in the Board's 2017 Report and 2018 Consultation Guide, the Board also considered whether to recommend a points-based test rather than a factor-based test. While the Board prefers the Factor Test over a points-based test, some consultees devoted significant resources to evaluating a points-based system and the Board wishes to provide its observations.

7.53 The points-based systems that the Board considered would involve identifying a wide range of connections to Australia and giving each connection a weighting (e.g., an Australian passport may be 20 points). This system would then be calibrated by setting a number of points to be considered a resident (e.g., 100 points = resident).

7.54 Connections identified included:

- (a) Citizenship or permanent residency visa;
- (b) Ownership of a dwelling within a family group;
- (c) Holding a lease within a family group;
- (d) Tax resident spouse or dependants;
- (e) Directorships of Australian companies and trusteeships of self-managed super funds;
- (f) Each 30 days physically present adding a set number of points;
- (g) Being registered on an Australian electoral roll.

7.55 While many of these connections are captured by the Factor Test, a points-based system can recognise less significant connections, similar to the existing residency rules, to provide a proxy for a holistic analysis. By adopting more connections, the test may provide more avenues to residency, but it also increases the complexity and compliance costs as individuals must analyse and evaluate more issues. Were the number of

connections under the points-based system reduced to four factors, there would be no practical difference between the factor and point tests.

- 7.56 During consultation the Board discussed the benefits of both tests. Most consultees preferred a factor-based test, noting the increased complexity of a points-based test. Further, consultees considered that points-based testing may also increase the risk of unintended or inappropriate outcomes (for example, if a number of smaller connections could add up to satisfy residency) that would not arise under the Factor Test.
- 7.57 The Board agrees with the feedback. While there are benefits of each approach, the Board considers that reducing the number of factors that individuals must consider is a major improvement and simplification of the existing rules that the recommended rules provide. As such, the Board prefers a factor-based test.

Recommendations

RECOMMENDATION 14

The Board recommends that a Factor Test be adopted. This Test will apply as set out in the commencing residency test and the ceasing residency test.

Under the Factor Test, individuals test their personal circumstances against four objective, Australia-focused criteria to conclude whether they satisfy any of the four factors:

- (a) The right to reside permanently in Australia (including citizenship and permanent residency);
- (b) Australian accommodation;
- (c) Australian family; and
- (d) Australian economic connections.

RECOMMENDATION 15

The Board recommends that a factor based on the right to reside permanently in Australia be adopted. This factor is satisfied if an individual has the right to reside permanently in Australia for immigration purposes. This includes citizens and individuals with permanent visas.

RECOMMENDATION 16

The Board recommends that a factor based on Australia accommodation be adopted.

An individual is taken to have satisfied this factor if the individual has an arrangement to access accommodation at any time during an income year.

The ability to access accommodation should not rely upon an identifiable legal right, but rather whether, from a factual inquiry, an individual has an arrangement to access accommodation in Australia.

The individual must have an arrangement that provides the individual with the ability to access identified premises at any point in the year. This will provide a clear standard.

RECOMMENDATION 17

The Board recommends that a factor based on an individual's family being located in Australia be adopted.

This factor is satisfied if an individual's spouse or any of their children under the age of 18 are generally located in Australia. A spouse or child will be located in Australia if they live in Australia on an ongoing basis at any point during an income year. This should be a relatively simple factual inquiry.

RECOMMENDATION 18

The Board recommends that a factor based on an individual's economic connections to Australia be adopted.

An individual will have Australian economic connections where they are employed in Australia, actively participate in carrying on a business in Australia or, directly or indirectly, have interests in certain Australian assets.

The Board's preferred approach is to provide a greater level of clarity for this factor, by setting out these three key Australian economic connections, where satisfying any standard will satisfy the entire factor. The connections are:

- (a) Employment located in Australia;
- (b) Active participation in the carrying on of a business in Australia;
- (c) Interests in certain Australian assets.

CHAPTER 8: PART-YEAR RESIDENCY AND OTHER MATTERS

KEY POINTS

- The proposed rules will include part-year provisions to ensure that residency periods have clearly identifiable start and end dates.
- The part-year rules adopt a split-year model – if residency changes during an income year, the year will be split into a resident period and a non-resident period.
- Generally, if part-year treatment is available:
 - residency will commence on the first day of physical presence in Australia in that income year;
 - residency will cease on the day following departure from Australia in that income year.
- Further monitoring during implementation will be necessary to ensure that the part-year rules provide appropriate outcomes. For example, minimising opportunities to manipulate the start and end dates of residency.
- In terms of transitional arrangements, sufficient time is needed for individuals, employers, practitioners and the ATO to prepare for the new rules to come into effect – consultees proposed a lead time of at least 12 to 24 months.

Background

- 8.1 There are currently only limited rules in the income tax law that take into account a change in residency during an income year (e.g. the tax free threshold part-year rules and the CGT discount apportionment rules).
- 8.2 In the Board's 2018 Consultation Guide, the Board sought feedback from consultees on how a change in residency status within an income year should be treated.
- 8.3 In this chapter, the Board also provides observations regarding transitional matters based on feedback during consultation.

Part-year residency

Consultation

- 8.4 During consultation, the Board received strong feedback for clear rules to apply when residency status changes during an income year.
- 8.5 The Board discussed two broad models with consultees:
- (a) A split-year model (where an income year is split into two periods, one during which the individual is treated as a resident, the other non-resident); and
 - (b) An apportionment model (where taxable income is calculated on a full year basis then some method of apportionment is based on resident and non-resident periods).
- 8.6 Consultees largely preferred a simple, split-year approach, as this provides appropriate outcomes based on the residency status of the individual at the date the relevant income, profit or gain is derived.
- 8.7 The Board agrees with this feedback, and has developed a split-year approach to address changes in residency within the Board's proposed residency rules.

When does part-year residency arise?

- 8.8 The Board has identified the circumstances in which it is intended that residency status will change during an income year and set out the relevant treatment below.
- 8.9 The Board's preferred approach to splitting the income year into two (or more) periods is to align the period with physical presence, rather than identifying when an individual ceases to satisfy a factor under the factor test. More information on this issue is also provided below.

Commencing residency

- 8.10 Under the 183 Day Test and the Commencing Residency Test, if an individual was not a resident in the prior income year and becomes a resident in the current income year, the Board considers that it is appropriate for the individual to be a resident from the first day of physical presence in Australia.
- 8.11 For the purposes of the Factor Test, the relevant test period is from the first day of physical presence until the end of the income year. This aligns the testing of factors with the actual time during which residency may commence.
- 8.12 During consultation, some consultees suggested that in certain circumstances that for individuals (such as professionals coming to work in Australia), it may be appropriate to disregard days prior to the individual actually coming to Australia for work (for example,

coming to look at accommodation). A suggestion was to distinguish these stays based on visa. The Board does not consider that such complexity is warranted. Further, the interaction between the proposed residency rules and the temporary resident rules should result in an appropriate outcome for such individuals, although this may be confirmed in implementation.

EXAMPLE 46

Janice migrates to Australia on 1 November 2019 and spent the remainder of the income year in Australia.

As Janice spends 183 days or more in Australia, Janice commences Australian tax residency on 1 November.

Ceasing residency: short-term

- 8.13 Under the Ceasing Residency Test, an individual may cease residency under the long-term residency test, short-term residency test and the overseas employment rule.
- 8.14 Under the long-term residency test, residency is tested on a full income year basis (see below). The short-term residency test is intended to apply differently. When an individual becomes a non-resident under the short-term residency test, that individual becomes a non-resident from the day following their last day of physical presence in Australia.
- 8.15 In addition, the individual must, from that day, have reduced their factors to 1 or nil for the remainder for the income year.
- 8.16 Where these conditions are satisfied the part-year rules will apply to split the income year accordingly.

EXAMPLE 47

Trish moved to Australia early in the 2019 income year on a temporary work visa, seconded to a professional services firm for three years. Trish spent more than 183 days in Australia and thus commenced residency.

On 1 August 2020, Trish's employment was unexpectedly terminated. Trish immediately ended her lease and left Australia on 10 August. Trish spent less than 45 days in Australia in the 2020 income year and had no factors connecting her to Australia.

Trish ceased Australian residency on 11 August 2020.

Ceasing residency: long-term and overseas employment

- 8.17 As noted above, the long-term residency test is designed to test residency on an income year basis. This means that there will be no need for part-year residency rules for individuals becoming non-residents under the long-term residency test.
- 8.18 The Board recommends this full-year basis for long-term residents (being individuals who have been resident for three consecutive income years) to reflect the level of adhesiveness appropriate for individuals that have established a connection to Australia over a number of years.
- 8.19 Given the way in which the rules are designed to operate only with regard to physical presence (testing 45-day presence in each of three consecutive income years) the Board does not consider that any part-year test is feasible. However, were the Board's alternative option adopted (to also apply the Factor Test to long-term residents), the Board considers that a part-year rule would then be appropriate, similar to the short-term resident test.
- 8.20 The overseas employment rule provides an exception to the above. For example, if a long-term resident ceases residency under the overseas employment rule, the individual will be a non-resident from the day following their departure from Australia.
- 8.21 The part-year rules will apply to split the income year into resident and non-resident periods. Throughout the non-resident period, the individual must also be compliant with the conditions of the overseas employment rule (i.e. spending less than 45 days in Australia, undertaking overseas employment and having available accommodation).

EXAMPLE 48

Layla, a long term resident of Australia, departed Australia for Brazil for a four year secondment on 4 March 2019.

Notwithstanding that she spent more than 183 days in Australia during the 2018-19 year, if she satisfies all the requirements of the overseas employment rule, she is a non-resident from 5 March 2019.

This is because the overseas employment rule applies to individuals who have been long term residents to split the year of departure approach.

- 8.22 In both the year that employment commences and ceases, the Board considered whether to align residency with employment or physical presence (for example, a split-year based on either the day on which employment ceases overseas or the individual arrives back in Australia). The Board notes that there may be manipulation risks, such as

‘runway payments’. However, the Board considers that either rule may be easy to manipulate. This may warrant further consideration during implementation.

- 8.23 Providing for residency status to change from the day following departure from Australia is broadly consistent with the existing rules (in particular, the ‘rule of thumb’ the Board recommends be codified). However, this rule provides employees, employers and the ATO with far greater certainty than the existing rules.
- 8.24 In line with the observations in Chapter 5, the Board considers that the impact of ceasing employment should be considered during implementation. The Board prefers an approach where, from the day after ceasing employment, a split-year approach is adopted. The individual then applies the residency test in two periods – the part of the year when they were employed, and the remainder of the year. However, this should not be available when individual’s fail any other conditions.

Tax treaty alignment provision

- 8.25 Under the proposed rules, where an individual is a resident of Australia as well as a resident of another country with which Australia has a tax treaty, the individual may be deemed a non-resident for Australian tax purposes if they ‘tiebreak’ to the other country.
- 8.26 In these circumstances, the Board considers that special consideration will be needed during implementation to ensure that there is alignment of tax periods being tested. Since the income tax periods in countries differ (for example, in the United Kingdom the tax year begins in April), if an individual is only a resident of both countries for part of an Australian income year, the Board considers that the income year will need to be split to maintain consistency with the other part-year residency rules.
- 8.27 For the purposes of each of these tests, it is clearly identifiable when an individual commences or ceases residency as relevant. As such, the Board considers that an income year should be split based on the day on which residency commences or ceases and the tax law apply to the individual accordingly.
- 8.28 The Board considers that the tax-free threshold part-year rules to be instructive for the purposes of drafting and implementation.

Interaction between part-year rules and the Factor Test

- 8.29 During consultation, the Board heard some support for a part-year test based on identifying the last day on which a factor applied to an individual. Supporters of this approach noted that it could provide some flexibility for both arriving and departing individuals and increased accuracy in determining the date on which connections of a ‘resident’ nature commence and cease. However, many consultees preferred a physical presence approach and considered testing factors to be unnecessary and complex.

- 8.30 The Board recommends against adopting this approach using the Factor Test due to the significant complexity required. Further, focusing on physical presence aligned with the primacy given to presence throughout the Board's proposed rules.
- 8.31 The Board identified very simple examples, such as the day on which an individual sells a property, to very difficult examples, such as the day on which an individual's family relationship breaks down. Regarding the latter, while the Australian family (and the existing residency rules) will require some level of inquiry, they do not require this specificity. Such specificity increases the compliance costs on individuals in analysing their own circumstances, and will increase the administrative burden on the ATO given the difficulty obtaining precise certainty on such personal information that may not be otherwise verifiable. This does not align with the Board's guiding principles of certainty and simplicity.
- 8.32 The Board has also learned from the experience in the United Kingdom in this regard. The split-year approach in the United Kingdom is particularly complex as it allows for changes in residency status depending on when ties (similar to factors) start and end. The Board heard from consultees that these rules can be difficult to apply.
- 8.33 The Board considers that adopting a factor-based analysis for part-year residency would make the proposed rules far more difficult to apply. The potential for increased accuracy or flexibility does not justify the increased complexity.

Other considerations

- 8.34 The Board notes that it would be theoretically possible to commence and cease residency during the same income year (for example, beginning overseas employment and then returning within that income year due to a change in circumstances). These scenarios are considered unlikely due to the design of the Board's recommended rules. While the Board has not considered these scenarios in great detail, it is expected that the part-year rules should be capable of splitting an income year into multiple periods should these outcomes be considered sufficiently likely.
- 8.35 The Board acknowledges that under the part-year rules there may be short periods whereby residency ceases in Australia and has not yet commenced in another country. This risk, similar to the existing resident of nowhere phenomenon, has been a focus of the Board's part-year residency considerations.
- 8.36 As noted earlier in this Report, the Board considers that the long-term resident test sufficiently addresses this concern for most individuals that the Board considers have established a sufficient connection to Australia. Further, the commencing residency part-year test will apply from the very first day of physical presence, reducing the potential for manipulation and aligning with the Board's preferred measurement of residency.

- 8.37 The remaining individuals that are afforded part-year residency treatment are short-term residents and overseas employees. The Board considers that the settings outlined above are appropriate to reflect the circumstances in which residency ceases for these individuals.
- 8.38 The Board supports further consideration during implementation of these matters.
- 8.39 For completeness, the Board has also considered international comparisons – in particular, the United Kingdom split-year rules in the statutory residency test – and seeks to provide some observations.⁴¹ As outlined in the Board’s 2017 Report, the statutory residency test is overly complex and the Board’s recommended model has been developed to avoid some of the complicated provisions required due to the way in which those rules have been designed. During consultation, consultees noted that the United Kingdom’s approach is known to produce anomalous outcomes due to its complexity. While the Board appreciates the intended precision of such an approach, it ultimately prefers a simpler and more certain approach that focuses on physical presence, which is the primary matter in determining residency.

Transitional issues

- 8.40 The Board consulted on the need for transitional arrangements to accompany the proposed rules upon enactment.
- 8.41 The Board received support for the following transitional arrangements:
- (a) To allow for a long period of time between when the rules are legislated and come into effect, to allow for systems to be updated and educational programmes to be rolled out. Periods from 12 to 24 months were suggested.
 - (b) For the existing rules to continue to apply until an individual’s residency status would change under the existing rules – akin to grandfathering or, if time-limited, an amnesty period.
 - (c) An ‘opt-in’ approach where individuals could choose to apply either the existing or proposed rules.
 - (d) For an optional rule to assist individuals determine whether they need to apply the commencing or ceasing residency test, to provide greater certainty should the outcomes under existing rules be unclear.

⁴¹ Guidance Note RDR3: Statutory Residence Test, Her Majesty’s Revenue and Customs <<https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt>>

- 8.42 The Board considers that the appropriate transitional arrangements can be determined during implementation. However, the Board supports providing sufficient time for individuals, employers, practitioners and the ATO to prepare for the new rules to come into effect.
- 8.43 The Board also supports ensuring that the rules governing periods of review are monitored during implementation. The Board expects that, depending on the transitional arrangements ultimately adopted, the first years of the transition between the existing rules and the new rules will need to be carefully monitored. Taxpayers should be provided flexibility to self-correct their returns as appropriate, while also providing the ATO on an on-going basis with sufficient time for review. This will be particularly important in the case of long term residents ceasing residency as it includes consideration of residency status and the assessment of the number of days spent in Australia for a period of at least six years.
- 8.44 Regarding the other options proposed during consultation, the Board is concerned that any option that provides multiple elections would increase compliance costs as individuals would apply both the existing and proposed rules in order to determine their optimal outcome – an entirely appropriate, rational approach.
- 8.45 The Board's preference is that any other transitional arrangements are only provided where they are needed to ensure that the proposed rules operate effectively. Option (d) above may meet this criteria and warrants further consideration.

Recommendations

RECOMMENDATION 19

The Board recommends that part-year rules be adopted as part of the proposed residency rules. Part-year treatment should be based on an individual's physical presence in Australia.

RECOMMENDATION 20

When an individual commences residency under the 183 Day Test or Commencing Residency Test, the Board recommends that the first day of residency is the first day of physical presence in Australia.

RECOMMENDATION 21

When an individual ceases residency under the short-term residency test or the overseas employment rule for long-term residents, the Board recommends that the last day of residency is the day following departure from Australia.

RECOMMENDATION 22

The Board recommends that special care be taken to ensure that the tax treaty alignment provisions only affects an individual's residency status for the period during which the individual would be a resident of both countries (taking into account the other country's income year).

CHAPTER 9: FURTHER INFORMATION ON THE BOARD'S PROPOSED RESIDENCY FRAMEWORK

9.1 In this chapter, the Board elaborates on the framework set out in the introduction.

Guiding policy principles of the Board's proposal

9.2 In the Board's 2018 Consultation Guide, four key guiding policy principles were set out for designing new individual tax residency rules.

- (a) **Adhesive residency:** it should be harder to cease residency than it is to establish it. Generally, once sufficient time is spent in Australia, and their connections are sufficiently embedded, then it is appropriate that this level of engagement with and benefit from Australian society must be scaled back to a large extent before residency ceases. This is a feature that will be maintained from the existing rules, and reflects international practice.
- (b) **Certainty:** the new rules should be designed to be straightforward and provide clear outcomes for the majority - there should be virtually no impact from this change in the majority of cases. However, unlike the current rules there will be clear thresholds for confirming residency.
- (c) **Simplicity:** to remove uncertainty and complexity through clear, reasonable rules for determining residency for individuals with more complicated circumstances. This should balance the time spent in, and other connections with, Australia but in a way that removes the perceived subjectivity of the current rules.
- (d) **Integrity:** the rules should not make it easier for individuals that have close ties to Australia to be able to manipulate the system and not pay their fair share of tax in Australia.

: For example, a test based purely on time spent in Australia could be easily manipulated through simply achieving the relevant number of days over/under a threshold depending on the tax profile of any given year. This will need to be balanced against the aim of providing simple, clear rules.

9.3 These principles aim to achieve equity by applying equally to all individuals, while also improving economic efficiency by removing uncertainty and removing distortions. The

development of the Board's recommended model in this paper balances these principles and outlines key trade-offs as appropriate.

Maintaining existing policy settings versus modernised policy settings

- 9.4 The different existing residency tests have evolved into a complex area of law. While the majority of individuals would likely assume that they are residents, they may well be unclear of the analysis that would be required to confirm such an assumption; the law does not clearly state how to determine this outcome.
- 9.5 Inbound and outbound individuals are navigating an increasingly complex series of tests that are subject to significant judicial uncertainty. This judicial uncertainty continues to grow – there are currently over 25 cases before the Federal Court and Administrative Appeals Tribunal.
- 9.6 The Board considers that this outcome is unsatisfactory. As the residency rules are a fundamental part of the income tax system, determining both an individual's tax base and rate, it is not appropriate that these tests, applicable to every individual, should be so complex. Simplification and modernisation will improve certainty, reduce compliance costs and increase the integrity and sustainability of the income tax system.
- 9.7 While developing this policy proposal, the Board has considered the extent to which existing residency rules should be codified, or whether to take this opportunity to reconsider key policy settings in light of global work, life and travel arrangements and deficiencies in the existing rules that lead to integrity concerns.
- 9.8 Ultimately, the Board concluded that residency policy settings should be modernised, while maintaining aspects of the existing rules where needed to provide consistency of outcomes that align with the current definition where such policy settings are appropriate.
- 9.9 The Board considers that the following policy settings require updating:
- (a) A clear, concise test based on physical presence should be adopted to determine the residency status of the vast majority of individuals in place of the existing uncertainty.
 - (b) The number of factual considerations should be reduced to four clear objective criteria, to be adopted in the Factor Test.
 - (c) The integrity risk of high wealth individuals manipulating the residency rules to become 'residents of nowhere', resulting in the avoidance of tax in Australia, should be eliminated in the design of the new rules.

- (d) The 'superannuation test' should be updated to reflect that Government officials posted overseas maintain tax residency in Australia.

9.10 The following sections of this report outline areas in which the Board prefers codification and others in which modernisation is needed, as relevant.

Whether to adopt a unified test or separate tests?

9.11 The Board consulted on whether there should be a single definition of resident that applies equally to all individuals, or separate tests that apply to the areas of complexity identified in the Board's 2017 Report, inbound and outbound individuals.

9.12 As set out previously, the Board sees merit in both approaches. A single definition provides simplicity and clarity, although being incapable of quarantining the more complex features of residency from the majority of individuals or coping with the needs of inbound and outbound individuals separately.

9.13 On the other hand, inbound and outbound tests would be able to address specific complexities in a more targeted way. While this may make the residency rules somewhat more complicated, it is unlikely to make them more inherently complex in their application. The Board's consultation also drew out significant support for separate inbound and outbound standards to streamline compliance; in particular, for employees being seconded overseas.

9.14 On balance, the Board prefers an approach adopting separate tests. Separate tests for inbound individuals and outbound individuals will determine when an individual commences and ceases residency respectively. Both of these tests will adopt a two-step approach, including a bright-line physical presence assessment, followed by a factor and physical presence based assessment, but only for those that cannot conclusively determine their residency status under the physical presence test. These approaches are outlined in further detail earlier in this paper.

Whether to test only Australian connections or global connections?

9.15 A key setting that the Board considered is whether individual residency policy should be comparative (i.e., based on an individual's connection to Australia vis-à-vis their connection to other countries) or domestic (i.e., only testing an individual's connection to Australia). In particular, the Board has considered:

- (a) Whether to adopt a 'day count' standard that counts days in Australia or days in each country visited; and

- (b) How to define 'factors', for example considering whether an individual's family, accommodation and economic/financial interests are in Australia or also requiring a test of overseas connections and then determining the stronger connection (similar to the existing standards).

9.16 During consultation, the vast majority of consultees preferred an Australia-centric approach to residency.

- (a) Most consultees consider this will provide significant simplification benefits. The simpler standard, approaching a 'tick-the-box' compliance standard, would greatly improve the useability of the rules for individuals, employers, and tax practitioners, thereby reducing compliance costs.
- (b) Some consultees noted that a domestic focus would eliminate arbitrary and inequitable outcomes that arise where the residency status of an individual changes depending solely on the country to which they have moved (where the individual does not control foreign standards of work, accommodation, culture etc. It was emphasised that two individuals with the same connection to Australia should, to the extent possible, have consistent residency outcomes.

9.17 The Board agrees with this feedback. As such, the Board's preferred model primarily tests an individual's connection to Australia. Where an individual has competing claims of residency in other countries, this will be resolved under the proposed double tax treaty alignment provisions or the existing foreign income tax offset rules.

9.18 This better reflects the policy underpinnings the Board has outlined, including that Australian residency should test an individual's connection to Australia and their access to the privileges of Australia's economy and society.

ANNEXURE A: TABLES

Table 1: Comparison of existing rules and key recommended changes

The Board has prepared this table to set out the existing rules and key changes proposed under the Board's proposed rules.

Test	Description	Key changes
Resides test	<p>A holistic review of a taxpayer's circumstances to determine whether the common law test of 'residency' is satisfied. Commonly perceived as a subjective test, balancing various factors including:</p> <ul style="list-style-type: none"> - the intention or purpose of their presence in Australia; - the family and business/employment ties; - the maintenance and location of assets; - the social and living arrangements; - any relevant overseas factors. 	<p>Repeal this test as the primary residency test.</p> <p>Replace with primary bright-line test of 183 days or more in Australia.</p> <p>Supplement with commencing residency test for those that are in Australia for 45 days or more who satisfy specific objective, Australia-based factors.</p>
Domicile test	<p>This applies to those that do not 'reside' in Australia under the first test.</p> <p>Individual is a resident (even without any intention) if nonetheless 'domiciled' in Australia in accordance with the common law and statutory meaning of that term (based predominantly on parental lineage), unless the individual's 'permanent place of abode' is outside Australia, which requires an analysis similar to 'resides' as a comparison of relevant objective and subjective factors including intention and other ties.</p>	<p>Repeal this test as the test for individuals that are not in Australia for the majority of the income year.</p> <p>Replace with the ceasing residency test which determines if individuals break residency based on a clear day count and objective Australia-focused factors only (including an overseas employment rule).</p>
183 day test	<p>This applies to those that do not 'reside' in Australia but stay in Australia during the year.</p> <p>A taxpayer is assumed to be a resident if they are in Australia for 183 days or more, unless the Commissioner is satisfied that the individual's 'usual place of abode is outside Australia' and, if so, the individual 'does not intend to take up residence in Australia'.</p>	<p>This test is retained as the primary bright-line test – the requirement to satisfy the Commissioner of abode and intention are removed.</p>
Superannuation test	<p>A taxpayer is a resident if they are a member of certain Government superannuation funds, established under the <i>Superannuation Act 1990</i> or the <i>Superannuation Act 1976</i>. It also treats spouses, or children under 16, of such a member as a resident.</p>	<p>This test is replaced by the Overseas Government Officials Test that treats all government officials deployed overseas in foreign service as residents.</p>

Table 2: Comparison of resident and non-resident tax outcomes

The following table sets out a number of tax provisions that apply differently to residents and non-residents (broadly based on how the tax laws applied in 2018). This table is not exhaustive and merely seeks to illustrate that outcomes for individuals vary significantly and any conclusion as to whether residency leads to better or worse tax outcomes depends on an analysis of an individual's broader tax affairs.

Tax matter	Australian Resident	Non-resident
Australian sourced income	Resident marginal tax rates (including access tax-free threshold (currently \$18,200) and 19% rate up to \$37,000)) ⁴²	Non-resident marginal tax rates (no tax free threshold, 32.5% rate from first dollar) unless other rules apply (e.g. see withholding taxes)
Foreign sourced income	Resident marginal tax rates (as above) subject to certain exclusions and modifications within the tax system	Generally, not taxable in Australia
Medicare levy	Medicare levy and Medicare levy surcharge apply	Exempted from Medicare levy and Medicare levy surcharge
Temporary Resident rules	Resident marginal tax rates (as above) on Australian sourced income and certain other amounts of income related to their Australian employment.	Generally the same as non-resident taxation with modifications for interest withholding and foreign income related to Australian employment activities
Withholding taxes	Withholding taxes apply (e.g. on salary or when TFN not supplied) but generally reconciled in an individual's income tax return	Withholding taxes apply as final taxes generally (subject to certain exemptions).
Dividends	Unfranked dividends paid are assessable income taxed at marginal rates. Franked dividends paid are assessable income (grossed-up) taxed at marginal rates, with entitlement to franking credit offsets dependent on certain rules	Unfranked dividends are generally subject to withholding tax (ranging from 0% to 30% depending on the individual's country of residence (e.g., whether a double tax treaty applies). Dividends that are conduit foreign income are not taxed (non-assessable non-exempt). No tax is payable on franked dividends (non-assessable non-exempt income)
Interest	Interest is assessable income taxed at marginal rates	Interest is generally subject to 10% withholding on the gross (subject to certain treaty and domestic law exemptions)

⁴² These rates are for the 2018 income year, the Board notes that this does not include the changes outlined in the Personal Income Tax Plan.

Royalties	Royalties are assessable income taxed at marginal rates	Royalties are generally subject to withholding tax rates (30% non-treaty country and 5-10% for treaty country)
Capital gains	Worldwide assets are taxable, concessions available to residents	Taxable on 'taxable Australian property', concessions generally unavailable to non-residents
Tax offsets	Tax offsets typically available (e.g. foreign income tax, low income, private health, senior Australians, remote zone or overseas forces etc.)	Offsets typically not available to non-residents
Trust distributions	Resident beneficiary (presently entitled no legal disability) generally taxed at marginal rates on Australian and foreign sourced income (as applying to residents above)	Generally trustee is taxed for non-resident beneficiary (presently entitled) at marginal rates on Australian sourced income (as applying to non-residents above)
Partnership income	Assessable on share of net income from all sources	Assessable on share of net income from Australian sources

Table 3: Observations on the impacts of the proposed rules

In the Board's 2018 Consultation Guide, the Board set out its expectations on the impacts of changing the residency rules. The Board has revised those expectations below.

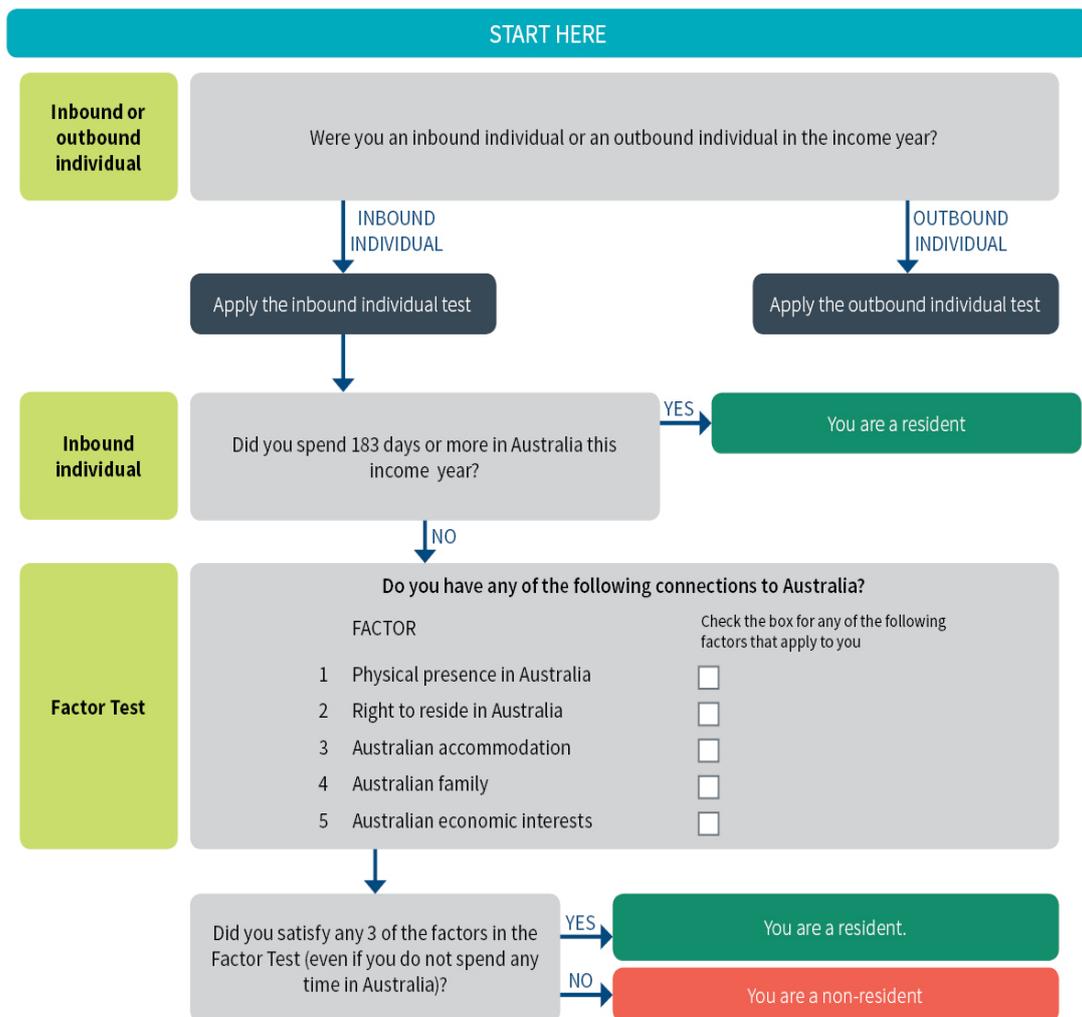
Issue	Observation
Revenue impact	<p>The Board has not undertaken costings of the proposed rules but has identified areas in which further data analysis may inform the policy design and costing process.</p> <p>It is the Board's expectation that this reform will be revenue neutral. However, this expectation is based on holistic consideration of the proposed rules.</p> <p>The departures from the existing rules cannot be reasonably separated and costed – this would not provide an accurate reflection of such a wholesale reform.</p>
Compliance burden impact (red tape)	<p>While the Board expects that there will be some upfront cost to advisers and employers modifying their systems and educating staff on the Board's proposal, over time the compliance burden should reduce, including the need for external advice.</p> <p>The Board considers that this proposal reduces red tape.</p>
Economic impact	<p>The Board's proposal is intended to provide certainty for individuals and employers regarding every individual.</p> <p>The Board expects that this increased certainty improves the accessibility of Australia's tax laws for Australian businesses, Australian expatriates and Australian employers of inbound migrants, all of which may lead to broader economic benefits.</p>
Administrative impact	<p>The implementation of, and transition to, the Board's proposal will require some investment in the ATO's systems and efforts regarding education and public</p>

	<p>guidance.</p> <p>It is expected that the increased certainty should, however, reduce the costs of ongoing monitoring and drastically reduce need for private rulings or likelihood of costly litigation over time. As outlined in the Board’s Report, increased certainty in the United Kingdom (albeit on the basis of different residency rules) has led to similar outcomes.</p>
Impact on affected individuals	<p>The Board’s proposal seeks to provide certainty and reduce the compliance burden for individuals and their employers that currently exists.</p> <p>It is expected that the majority of individuals will be unaffected by the transition to the Board’s proposal – there will be no noticeable impact and no cost.</p> <p>However, there will be some individuals affected by a change in residency status. As the key changes are for individuals commencing and ceasing residency, the Board’s proposal only applies prospectively and as such the impact will be clearly identifiable before any rules come into operation.</p> <p>Any unforeseen impacts may also be addressed via transitional arrangements.</p>
Other impacts	<p>The Board does not expect that its proposal will have any impact on human rights or other matters required to be considered through the Government’s regulatory impact statement procedure.</p>

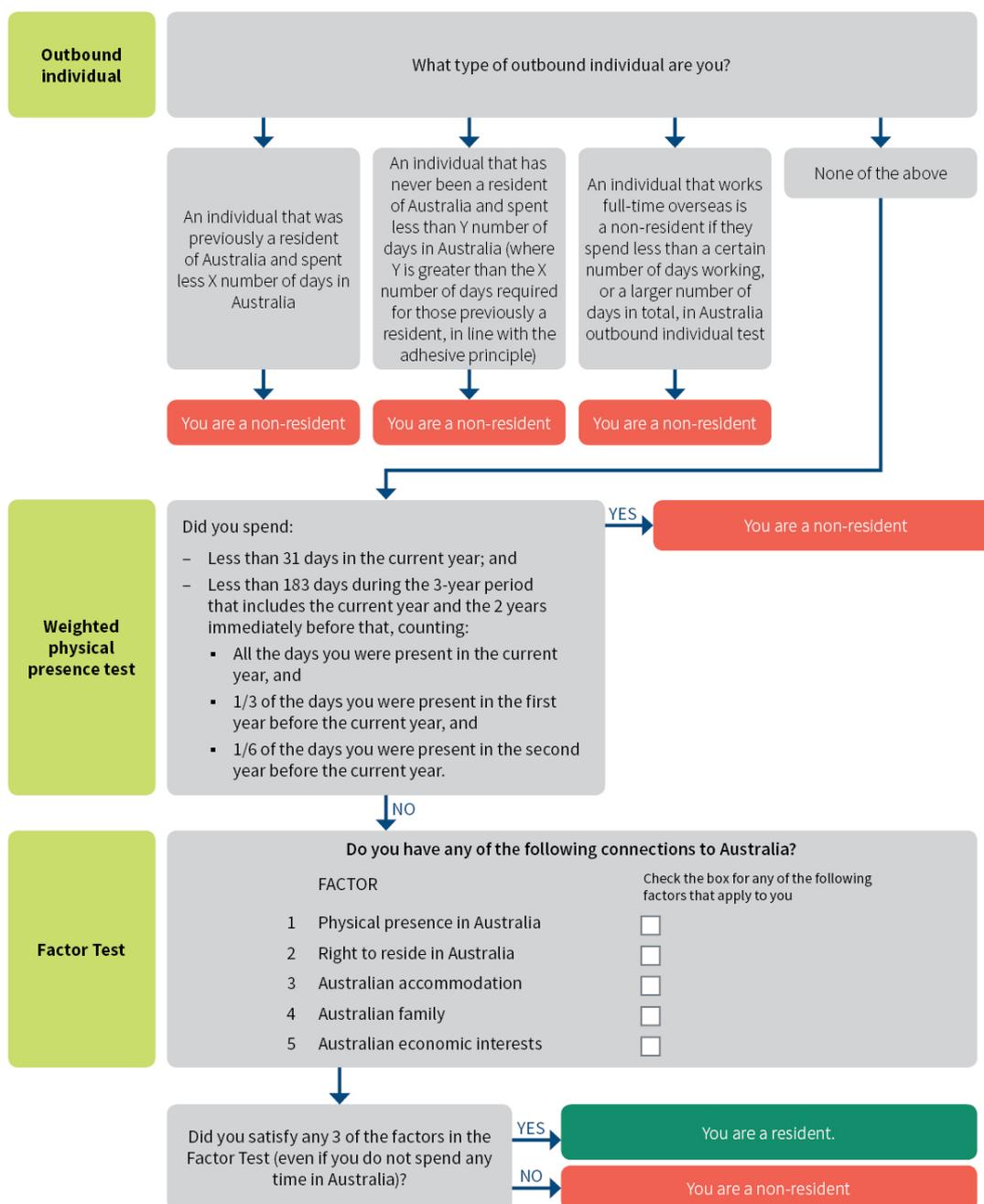
ANNEXURE B: OTHER OPTIONS CONSIDERED

Alternate 1: 2018 Consultation Guide model – inbound and outbound individual residency tests

Board of Taxation: alternate residency flowchart 2
Are you an Australian tax resident in this income year?



continued from over the page



Inbound and Outbound residency tests

1. This model applies separate tests for inbound individuals and outbound individuals to determine an individual's residency status.
2. Both of these tests will adopt a two-step approach, including a bright-line physical presence assessment, followed by a factor test only for those that cannot conclusively

determine their residency status under the physical presence test. These approaches are outlined in further detail below.

Inbound individual – physical presence ‘bright-line’ (183-day test)

3. The inbound individual test includes a bright-line test to conclusively determine residency. This would only apply to inbound individuals, characterised as individuals that have never previously been resident of Australia.
4. The Board’s 2018 Consultation Guide suggested 183 days or more of physical presence would satisfy the inbound physical presence test such that the individual is a tax resident.
5. The 183-day test would only conclude when an individual is a resident. It would not conclude that an individual is a non-resident – inbound individuals who spend less than 183 days in Australia will be required to apply the factor test.

Observations

6. The Board consulted on adopting a separate test for inbound individuals. The Board received strong support for an inbound physical presence test. However, a number of issues were raised:
 - Consultation raised concerns over visiting students, academics and other arrangements that may be for longer than 6 months but not considered appropriate to commence tax residency.
 - Many stakeholders raised concerns about the uncertainty a ‘rolling’ 12-month test may create, where days in a future income year may modify a prior year’s residency status. However, other stakeholders raised similarly strong concerns about the potential to ‘game’ a static income year test, as well as the arbitrariness of outcomes for those that arrive in the second half of an income year and would currently expect to become resident upon arrival.
7. The Board received mixed feedback about other features of the inbound individual test. Consultees raised the difficulties that individuals may face when working out whether they have previously been residents across their entire lifetimes and whether there may be overlap between the inbound and outbound categories.

8. It was suggested that a simpler standard could be adopted (e.g., four to six years⁴³), although it was generally agreed that an approach involving ‘previously not residents’ is overly complex and onerous, and that it was unclear the benefit such an approach provides. In contrast, it is easier to establish if a person is resident in particular prior period and provides better certainty (feedback the Board has adopted in its proposed model).
9. The Board also considered whether to adopt a medium-term physical presence test for inbound individuals – for example spending 300 days in Australia over any three year period.⁴⁴ The Board considered that this would provide greater certainty and simplicity by virtue of its bright-line design. However, the Board ultimately preferred a secondary test that relies on the Factor Test, rather than solely on physical presence, and that adding a third test for inbound individuals would increase complexity.
10. Ultimately, the Board agreed with this feedback, and determined that this approach was too complicated to achieve the desired simplification and modernisation.

Outbound individuals – weighted physical presence ‘bright-line’

11. The inbound individual test includes a bright-line test to conclusively determine residency. This would only apply to inbound individuals, characterised as individuals that have never previously been resident of Australia.
12. The outbound individual test would include bright-line tests to conclusively determine non-residency. This would apply to outbound individuals – including short-term visitors and residents.
13. The 2018 Consultation Guide outlined a number of various potential tests that would automatically determine an individual to be a non-resident as follows:

⁴³ The Board considered a five year period, suggested during consultation, which broadly aligns with entitlement to access Australian Government services. This was not pursued further as it does not provide any improvement to the rules when considering simplicity, certainty, integrity or adhesiveness.

⁴⁴ This is similar to the Irish residency ‘look back test’ of 280 days or more in the current and immediately preceding income years: *Taxes Consolidation Act 1997 (Ireland), Part 34 Provisions Relating to the Residence of Individuals*.

Bright-line test	Description
Previously a resident	An individual that was previously a resident of Australia is a non-resident if they spend less X number of days in Australia
Previously not a resident	An individual that has never been a resident of Australia is a non-resident if they spend less than Y number of days in Australia (where Y is greater than the X number of days required for those previously a resident, in line with the adhesive principle)
Working overseas	An individual that works full-time overseas is a non-resident if they spend less than a certain number of days working, or a larger number of days in total, in Australia

14. The 2018 Consultation Guide also sought views on whether the above tests should apply on a single year basis or a multi-year basis.
15. Where the bright-line tests did not apply, an outbound individual would apply the factor test.

Observations

16. While stakeholders supported a bright-line test to conclusive determine non-residency, there was limited support for the model as set out in the 2018 Consultation Guide.
17. In particular, a number of concerns were raised:
 - The complexity of the tests was generally considered inappropriate. For example, stakeholders considered that the reason for different day-count tests for residents, non-residents and overseas workers was unclear and significantly increased complexity.
 - Most stakeholders supported a multiple year test over a single year test, which improves the integrity and adhesiveness of the rules while also maintaining simplicity and certainty.
18. Following consultation, the Board considered the form a multi-year bright-line test might take, including an example based on the United States substantial presence test, summarised as follows:
 - An individual is considered a United States tax resident if they meet this test. The individual must be physically present in the United States on at least: 31 days in the current year, and 183 days during the three year period that includes the current year and the two years immediately before that, counting:
 - : All the days you were present in the current year, and
 - : $\frac{1}{3}$ of the days you were present in the first year before the current year, and

: $\frac{1}{6}$ of the days you were present in the second year before the current year.

19. While this test only applies to determine residency, the Board considered models that might conclude that an individual is a non-resident. The Board did not undertake consultation on this weighted presence standard; however, during deliberations, it was generally agreed that the weighting mechanism did not provide any clear benefits to outweigh the increased complexity of such an approach.
20. The Board ultimately concluded that an outbound individual test of this nature was too complicated and did not provide simplification benefits based on the majority of feedback.
21. In formulating the proposed rules recommended, the Board adopted a multi-year test (the long-term resident test) noting the strong support of consultees and, in reconsidering how an overseas employment rule should apply, concluded to align more closely with current practice to avoid unnecessary complexity.
22. The Board also considered that only having a long-term resident test without an overseas employment rule would create a significant burden for individuals as employees as well as their Australian employers, which led the Board to recommend maintaining a streamlined version of the existing settings.

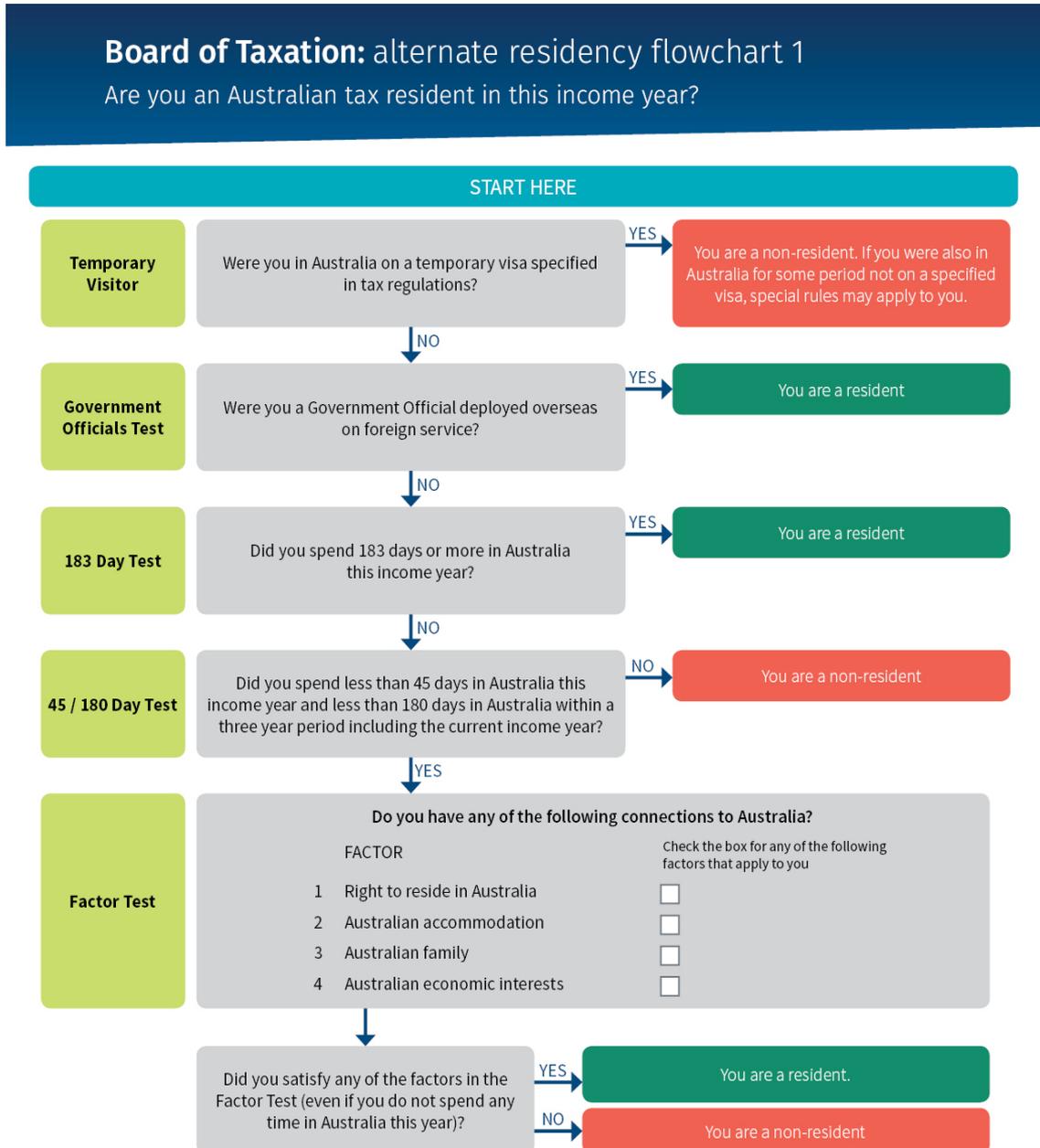
Factor test

23. The factor test will determine whether an individual is a resident or non-resident based on whether they satisfy a set number of factors.
24. Consultation was conducted regarding the following factors:
 - (a) Physical presence in Australia
 - (b) Immigration status
 - (c) Australian family
 - (d) Australian accommodation
 - (e) Australian economic interests
25. The 2018 Consultation Guide also sought views on whether to adopt a test based on factors or a points-based test.

Observations

26. Stakeholders did not generally comment on the number of factors that should be required to pass this test and be considered a resident. One stakeholder proposed that three factors out of five should be satisfied.
27. The Board considered all further feedback when considering the Factor Test as part of the proposed rules.

Alternate 2: Residency tests applying to all individuals



A single test approach

28. This model involves a series of tests that apply to all individuals to determine their residency status.
29. These tests are either positive (i.e. they must be satisfied in order to residency to be established) or negative (i.e. if satisfied an individual is a non-resident) and apply in the order set out in the above flow chart.

30. As outlined earlier in this Report, the Board prefers a model that targets those with more complicated affairs with regard to residency, rather than a single definition that applies to all individuals. However, the Board did consider a single definition model, and has made observations below.

The temporary visitor test

31. This test would exclude genuine visitors from Australian residency. Significantly, the test would clarify that working holiday makers are not residents, which is the most common outcome under existing law. To assist in the maintenance of this test, the term 'temporary visitor' would be defined as individuals holding specified visa holders set out in regulations.

Observations

32. The Board considers that while this test seeks to increase certainty and simplicity for temporary visitors, the Board prefers the mechanism ultimately proposed. In particular, this test aligns certain visa classes with tax residency outcomes which may not align with their underlying affairs, potentially resulting in somewhat arbitrary outcomes.
33. The Board also noted that while the tax rates applying specifically to working holiday maker income apply irrespective of residency, there is ongoing litigation on this issue as covered earlier in this Report, which suggests that such an approach may be subject to legal challenges.
34. The interaction of this test with the temporary resident rules was also considered to be problematic, given the temporary resident rules generally operate where temporary visa holders have become tax residents and are provided certain forms of tax relief in accordance with government policy. The way in which these rules would interact was found to be complex and uncertain, which also led the Board not to adopt this carve out.
35. The Board's proposed model provides that individuals with analogous physical presence or connections to Australia (being only those factors determined to be relevant) are treated in the same way.

The Government Official Test

36. In this test, the policy parameters would be implemented by including a statutory definition of Government official in the Tax Acts or the regulations.
37. Generally this test seeks to exercise Australia's taxing rights under double tax treaties. In most of Australia's double tax treaties, Australia retains a taxing right over employees performing government services for Australia overseas subject to exceptions for certain

local staff engagements. If such an employee is not an Australian resident then, in the absence of a deemed source rule in the double tax treaty, Australia would not retain a taxing right.

38. This test largely mirrors the Overseas Government Officials Test in the Board's proposed model and the options considered within that chapter of this Report.

183 day test

39. This test is a relatively standard test amongst OECD countries. It would capture the vast majority of Australians who live and work here and go overseas only for short durations. It would also cover inbound persons that spend six months or more in Australia other than 'temporary visitors'.
40. This test largely mirrors the 183 Day Test in the Board's proposed model, except for its subordination to the 'temporary visitor' rule.

The 45/180 day test

41. This test is designed such that an individual will be a resident if they spend 45 days or more in Australia as well as spending 180 days over any three income year period that includes the test year. A variation of this test was that the 180 day standard could apply as a standalone test.
42. The 45 days in one year component would ensure that where an individual settles their family in Australia but works overseas and returns to Australia during periods of recreation leave to spend with their family they will remain resident where they exceed the relevant tests. Similar to the Board's proposed model, this threshold is set where physical presence is considered to be sufficiently habitual and ordinary, as the individual is exposed to the economic and social benefits of Australia.
43. The 180 day test over three years is intended to capture outbound individuals who live overseas (i.e. those in long term employment overseas) but retain significant connections with Australia. A three year period is adhesive as the longer a person remains overseas, the less likely they will satisfy the 180 day test. This reduces the ability to manipulate residency using single year absences.
44. For example, an individual currently residing in Australia and taking up a work secondment overseas of over four years, who did not return at all but maintained economic connections to Australia, would likely remain a resident for the first two years of their departure. They would also likely be residents for the two years either side of their year of return. Further, an individual who returned frequently and routinely would

likely remain a resident. This test would also capture those that leave Australia for a 'holiday' of up to four years.

45. By way of comparison, some Organisation for Economic Co-operation and Development countries adopt a longer time period (e.g. five years).

Observations

46. This test is a variation of the test the Board ultimately proposed as the long-term resident. The key differences are that the long-term resident test only considers preceding years and places a limit on days in each income year rather than two concurrent limits (being 45 days in the current income year and 180 days over three).
47. The Board does not consider it appropriate to apply such a test including surrounding years. Similar to the Board's rejection of the 'rolling year' standard in the 183 Day Test, where residency in an income year depends on the number days spent in Australia up to two years after that year undermines certainty as it would make it impossible for some individuals to know their residency status for years at a time. This does not appropriately balance integrity with simplicity and certainty.
48. On the basis of applying this test only by reference to preceding income years, the Board considers that the benefits of this test are largely comparable with the long-term resident test. However, the Board prefers a lower level of adhesiveness for short-term residents and provides an alternative method to cease residency, which broadly reflects the application of the existing rules to such individuals.

Factor test

49. The factor test under this model largely mirrors the Factor Test as proposed.
50. However, this model concluded that an individual is a resident if they satisfy any of the factors.

Observations

51. As set out earlier in this Report, the Board considered how many factors should be necessary to be treated as resident.
52. Under this model, the Board identified concerns that, unless the 'temporary visitors' test or the 45/180 day tests apply, an individual with just one factor (for example, Australian citizenship) would be an Australian resident under this test even if they were not present in Australia at all during an income year. The Board considered that this sets the threshold for residency too low.

ANNEXURE C: LIST OF RECOMMENDATIONS

No	Recommendation
1	The Board recommends that the Government replace the income tax residency rules for individuals with modernised residency rules as set out in this report.
2	<p>The Board recommends the following policy statement be adopted as an objects clause in the income tax law.</p> <p><i>"Income tax laws apply differently to you depending on whether you are an Australian resident or not. For income tax purposes, whether you are an Australian resident is based on your time spent in Australia and the nature and quality of your ties to Australia.</i></p> <p><i>These rules determine whether you are an Australian resident. This is primarily based on your physical presence in Australia. You may also be an Australian resident where you satisfy certain factors which reflect a level of connection to Australia that outweighs a lack of physical presence."</i></p> <p>This statement should be accompanied by a flowchart of how the proposed rules operate (which may be based on the flowchart in the Board's report).</p>
3	<p>The Board recommends a 183 Day Test as the primary rule for individual tax residency, in line with the following principle:</p> <p><i>An individual who spends 183 days or more in Australia in the current income year will be an Australian tax resident.</i></p> <p>This test will apply on an income-year basis and any part of a day spent in Australia counts towards this test.</p>
4	<p>The Board recommends that the 183 Day Test be supplemented by a Commencing Residency Test as the secondary rule for individuals who were not residents in the preceding income year. This test is summarised by the following principle:</p> <p><i>A commencing residency individual is a resident of Australia where the individual is present in Australia for 45 days or more in an income year and satisfies two or more factors.</i></p> <p>This test will also apply on an income-year basis where any part of a day spent in Australia counts towards this test. The first day of physical presence in Australia will be the day on which residency commences.</p>
5	The Board recommends that where an Australian is treated as a resident of another country under one of Australia's comprehensive tax treaty arrangements the individual should also be treated as a 'non-resident' for domestic tax law purposes

No	Recommendation
6	<p>The Board recommends that the 183 Day Test be supplemented by a Ceasing Residency Test as the secondary rule for individuals who were residents in the preceding income year. This test is made up of three standards that seek to maintain simplified, streamlined versions of the existing rules:</p> <ol style="list-style-type: none"> 1. a long-term resident test; 2. a short-term resident test; and 3. an overseas employment rule. <p>The Board supports further work on whether ceasing residency should be subject to individuals submitting a first non-resident income tax return, to improve engagement and sharing of information between individuals and the ATO upon ceasing residency.</p>
7	<p>The Board recommends that a long-term resident test be adopted for individuals who have been residents for the three income years immediately preceding the current income year. This test is summarised by the following principle:</p> <p style="padding-left: 40px;"><i>An long-term resident individual ceases residency in Australia for the current income year if they spend:</i></p> <ol style="list-style-type: none"> (a) <i>less than 45 days in Australia in the current income year; and</i> (b) <i>less than 45 days in Australia in each of the two preceding income years.</i> <p>This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. Residency status will be determined on a full income-year basis.</p>
8	<p>The Board recommends that a short-term resident test be adopted for individuals who have been residents for less than three income years immediately preceding the current income year. This test is summarised by the following principle:</p> <ol style="list-style-type: none"> (a) <i>A short-term resident individual ceases to be a resident if they spend less than 45 days in the current income year and satisfy less than two factors.</i> (b) <i>The individual ceases to be a resident on the day that they depart Australia.</i> <p>This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. The last day of physical presence in Australia will be the last day of residency.</p>

No	Recommendation
9	<p>The Board recommends that an overseas employment rule, based on the existing rule of thumb, be adopted for individuals who have been residents for the three income years immediately preceding the current income year, where that individual undertake overseas employment. This test is summarised by the following principle:</p> <p><i>An individual will cease residency on the day after departure from Australia if they:</i></p> <ul style="list-style-type: none"> (a) <i>reside in Australia for the three consecutive income years prior;</i> (b) <i>undertake employment overseas that is mandated to be for a period of more than two years at the time employment commences;</i> (c) <i>have accommodation available continuously in the place of employment for the duration of their employment; and</i> (d) <i>return to Australia for less than 45 days in each income year that they continue their overseas employment after the year in which they depart.</i> <p>This test will apply on an income-year basis where any part of a day spent in Australia counts towards this test. The last day of physical presence in Australia will be the last day of residency.</p>
10	<p>The Board recommends that, in accordance with the commencing residency test and 183 Day Test, a provision should be added to remove inconsistent outcomes for domestic and treaty residency.</p>
11	<p>The Board recommends against a separate rule to address the existing ‘resident of nowhere’ phenomenon as it is not necessary within the Board’s proposed rules.</p> <p>In the Board’s view, the proposed rules eliminate the potential for residents of nowhere within appropriate parameters (for example, via the long-term resident test). This adhesiveness provides more appropriate tax outcomes, eliminates uncertainty and provides robust integrity. Any additional rules would cause uncertain outcomes and increase complexity.</p>

No	Recommendation
12	<p>The Board recommends that further work be undertaken in accordance with the following observation by the Board in its 2017 Report:</p> <p><i>The Board observes that while some individuals may seek to manipulate CGT event I1, the Board considers that the ATO should increase its compliance efforts to identify ‘deemed-TAP’ assets that should be taxable in Australia.</i></p> <p><i>The Board suggests any assets which taxpayers have elected to be deferred as a ‘deemed disposal’ upon ceasing residency should be catalogued and reported to the ATO to use as a reference point for the tracking of any future disposal of such assets. This could be incorporated as part of the annual tax return process.</i></p> <p>Should this work lead to the identification of persistent resident of nowhere arrangements or other integrity issues under the existing or proposed residency rules once adopted, the Board recommends that moving to a system akin to the United Kingdom’s temporary absence provisions be considered.</p>
13	<p>The Board recommends that the superannuation test be replaced with an Overseas Government Officials Test.</p> <p>The Overseas Government Officials Test will characterise any individual deployed overseas in the service of an Australian government (federal, state or territory government) to be a tax resident for the duration of their deployment.</p>
14	<p>The Board recommends that a Factor Test be adopted. This Test will apply as set out in the commencing residency test and the ceasing residency test.</p> <p>Under the Factor Test, individuals test their personal circumstances against four objective, Australia-focused criteria to conclude whether they satisfy any of the four factors:</p> <ul style="list-style-type: none"> (a) The right to reside permanently in Australia (including citizenship and permanent residency); (b) Australian accommodation; (c) Australian family; and (d) Australian economic connections.
15	<p>The Board recommends that a factor based on the right to reside permanently in Australia be adopted.</p> <p>This factor is satisfied if an individual has the right to reside permanently in Australia for immigration purposes. This includes citizens and individuals with permanent visas.</p>

No	Recommendation
16	<p>The Board recommends that a factor based on Australia accommodation be adopted.</p> <p>An individual is taken to have satisfied this factor if the individual has an arrangement to access accommodation at any time during an income year.</p> <p>The ability to access accommodation should not rely upon an identifiable legal right, but rather whether, from a factual inquiry, an individual has an arrangement to access accommodation in Australia.</p> <p>The individual must have an arrangement that provides the individual with the ability to access identified premises at any point in the year. This will provide a clear standard.</p>
17	<p>The Board recommends that a factor based on an individual's family being located in Australia be adopted.</p> <p>This factor is satisfied if an individual's spouse or any of their children under the age of 18 are generally located in Australia. A spouse or child will be located in Australia if they live in Australia on an ongoing basis at any point during an income year. This should be a relatively simple factual inquiry.</p>
18	<p>The Board recommends that a factor based on an individual's economic connections to Australia be adopted.</p> <p>An individual will have Australian economic connections where they are employed in Australia, actively participate in carrying on a business in Australia or, directly or indirectly, have interests in certain Australian assets.</p> <p>The Board's preferred approach is to provide a greater level of clarity for this factor, by setting out these three key Australian economic connections, where satisfying any standard will satisfy the entire factor. The connections are:</p> <ul style="list-style-type: none"> (a) Employment located in Australia; (b) Active participation in the carrying on of a business in Australia; (c) Interests in certain Australian assets.
19	<p>The Board recommends that part-year rules be adopted as part of the proposed residency rules. Part-year treatment should be based on an individual's physical presence in Australia.</p>
20	<p>When an individual commences residency under the 183 Day Test or Commencing Residency Test, the Board recommends that the first day of residency is the first day of physical presence in Australia.</p>
21	<p>When an individual ceases residency under the short-term residency test or the overseas employment rule for long-term residents, the Board recommends that the last day of residency is the day following departure from Australia.</p>

No	Recommendation
22	The Board recommends that special care be taken to ensure that the tax treaty alignment provisions only affects an individual's residency status for the period during which the individual would be a resident of both countries (taking into account the other country's income year).