AN EVALUATION OF THE PROPOSED CHANGES TO THE INDIVIDUAL TAX RESIDENCY RULES

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ABSTRACT

In the 2021-22 Federal Budget, the Government announced that the current individual tax residency rules will be replaced with new tests, which will be based on recommendations made by the Board of Taxation. The current residency rules are difficult to apply in practice. This is evidenced by the large number of cases and private binding rulings from 2016 to 2021 on the issue of residency, which indicate that taxpayers are seeking guidance from the Australian Taxation Office before turning to the courts to determine their residency status. The paper evaluates the extent to which the proposed residency tests are able to meet the policy objectives of equity, efficiency, and simplicity. The paper concludes that the proposed residency tests will meet the policy objectives to a large extent, and that the tests are a step in the right direction.

I INTRODUCTION

Despite being a foundational concept in the tax system, the individual tax residency rules remain relatively unchanged since their enactment 91 years ago.

In recent years, the increase in global mobility has resulted in the issue of Australian tax residency to be a controversial area for many taxpayers. This is illustrated by the growing number of cases and private binding rulings ('PBRs') on the issue of individual tax residency. In the past five income years, there have been 18 cases and 830 PBRs dealing with the issue of individual tax residency. This is in contrast with the fact that only 25 cases were litigated

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in the 79 years between 1930 and 2009, when the residency rules were first enacted.[1] The rise in the number of cases and PBRs indicates that there is a problem with how the current residency rules operate in an increasingly globally mobile world. In 2016, the Board of Taxation ('the Board') undertook a review of the current residency rules and determined that the rules are outdated and require modernisation. In 2019, the Board proposed new tests to reform the existing individual tax residency rules.

In the 2021-22 Federal Budget, the Government announced that the current individual tax residency rules will be replaced with a new framework, which will be based on recommendations made by the Board ('the Proposed Reforms').[2] As of the date of completion of this paper, the Government has not indicated the exact form that the new residency rules will take. Therefore, this paper will assume that the new individual residency rules will largely mirror the proposals outlined by the Board in 2019.

This paper argues that there is a problem with the operation of the current residency rules, and that reform is required. This paper will examine the extent to which the Proposed Reforms are able to meet the key tax policy objectives of equity, efficiency, and simplicity. This paper argues that the Proposed Reforms will meet the three key tax policy objectives to a large extent. This paper will first outline current individual tax residency rules before analysing whether residency is a problem, and if taxpayers are actually turning to the courts or to the Australian Taxation Office ('ATO') to determine their residency status. A brief overview of the Proposed Reforms will be provided, before finally evaluating the extent to which the Proposed Reforms will meet the key tax policy objectives of equity, efficiency, and simplicity.

II THE CURRENT INDIVIDUAL TAX RESIDENCY RULES

A *Brief background on the current individual tax residency rules*

The income tax system in Australia is based upon the foundational concepts of residency and source.[3] The residency status of an individual is key in determining their tax liability. An individual who is a tax resident of Australia is taxed on their worldwide income.[4] On the other hand, an individual who is not a tax resident of Australia is only taxed on income derived from sources in Australia.[5]

The tax residency status of an individual is determined on a year-by-year basis.[6] The definition of a tax resident of Australia is contained in paragraph (a) of section 6 of the

[1] Michael Dirkis, 'Moving to a More "Certain" Test for Tax Residence in Australia: Lessons for Canada?' (2020) 68(1) *Canadian Tax Journal*, 160.
[2] The Commonwealth of Australia, *Budget Measures* (Budget Paper No 2, 11 May 2021) 21 – 22.
[3] Board of Taxation, *Reforming individual tax residency rules – a model for modernisation: a report to the Treasurer* (Report, 2019), [1.1] ('The Board of Taxation 2019 Report').
[4] *Income Tax Assessment Act 1997* (Cth) s 6-5(2).
[5] Ibid s 6-5(3).
[6] *Federal Commissioner of Taxation* v *Applegate* (1979) 27 ALR 114.

Income Tax Assessment Act 1936 (Cth). That section prescribes four tests to determine whether an individual is a tax resident of Australia for the income year: the 'resides' test,[7] the domicile test,[8] the 183-day test,[9] and the superannuation test.[10] Only one of the four tests have to be satisfied in order for the individual to be a tax resident of Australia.

Under the 'resides' test, an individual is a resident if he or she resides in Australia according to the ordinary meaning of the word 'resides'.[11] The 'resides' test is the primary test of residency; if an individual is a tax resident under the 'resides' test, the other three tests do not have to be considered. The second test of residency is the domicile test. An individual is a resident if they are domiciled in Australia, unless the Commissioner of Taxation ('the Commissioner') is satisfied that they have a permanent place of abode outside of Australia.[12]

The third test of residency is the 183-day test. An individual who is physically present in Australia for more than 183 days in an income year is a resident, unless the Commissioner is satisfied that the individual has a usual place of abode outside of Australia, and that he or she does not intend to take up residence in Australia.[13] The fourth test is the superannuation test. An individual is a resident of Australia if he or she is a member of certain superannuation schemes, or if their spouse, or child that is under the age of 16, is a member of those schemes.[14]

The current individual tax residency rules were devised 91 years ago and remain relatively unchanged since their enactment.[15] The ATO has published two public rulings on the issue of residency – TR 98/17 and IT 2650. TR 98/17 was issued 23 years ago and concerns the application of the 'resides' test to individuals entering Australia.[16] IT 2650 was issued 30 years ago, and provides guidance on the application of the permanent place of abode exception to the domicile test.[17] However, these rulings do not have the force of law, and are intended to be of guidance only.[18]

[7] *Income Tax Assessment Act 1936* (Cth) s 6(a) ('ITAA36').
[8] Ibid s 6(a)(i).
[9] Ibid s 6(a)(ii).
[10] Ibid s 6(a)(iii).
[11] *Federal Commissioner of Taxation v Miller* (1946) 73 CLR 93.
[12] ITAA36 (n 7).
[13] ITAA36 (n 7) s 6(a)(ii).
[14] Ibid s 6(a)(iii).
[15] Board of Taxation, *Review of the Income Tax Residency Rules for Individuals* (Report, 2017), [1.37] ('The Board of Taxation 2017 Report').
[16] Australian Taxation Office, *Income tax: residency status of individuals entering Australia* (TR 98/17), [1], [2].
[17] Australian Taxation Office, *Income tax: residency - permanent place of abode outside Australia* (IT 2650).
[18] *Taxation Administration Act 1953* (Cth) sch 1 div 357. Following *Harding v Commissioner of Taxation* [2019] FCAFC 29, the ATO has released a decision impact statement in which the ATO advised that IT 2650 will be reviewed to reflect the decision of the Full Federal Court that the phrase 'place of abode' refers not only to a dwelling but can also refer to a country. As of the date of completion of this paper, the ATO has yet to publish an updated ruling.

B *Problems with the current individual tax residency rules*

In the 2021-22 Federal Budget, the Government acknowledged that 'Australia's current tax residency rules are difficult to apply in practice, creating uncertainty and resulting in high compliance costs for individuals and their employers'.[19] This statement echoes the sentiments expressed by the Board in their 2017 report. This paper will provide a brief summary of the issues with the existing individual residency rules as identified by the Board in their 2017 report.

According to the Board, the current individual residency rules require taxpayers to grapple with uncertain legal concepts. The following legal concepts were identified by the Board as being ambiguous:

- The meaning of 'resides' under the 'resides' test. The Board acknowledged that 'there is no singular ordinary meaning of the word "resides"'.[20]
- The phrase 'permanent place of abode' under the domicile test is not defined.[21]
- Under the 183-day test, the phrase 'usual place of abode outside of Australia' is not defined.[22] The Board also noted that 'the usual place of abode has not been the subject of many cases nor substantive ATO guidance'.[23]

Given the lack of clarity over the meaning of key concepts in the residency rules, taxpayers are required to analyse their circumstances against common law principles, tribunal decisions, private binding rulings, and public rulings.[24] The Board noted that this is a significant undertaking even with professional assistance,[25] and that it imposes an inappropriate compliance burden on taxpayers with relatively simple tax affairs.[26] Thus, the Board concluded that the process of determining a taxpayer's residency status results in considerable uncertainty to taxpayers, the judiciary, and administrators.[27]

Furthermore, an increase in global mobility has impacted how taxpayers interact with the residency rules. Due to the nature of living and moving abroad, taxpayers are required to frequently reassess their residency status to account for changes in their circumstances overseas as well as in Australia.[28] The Board also noted that the increase in global mobility has also altered the relative importance of certain factors that are considered in the current residency rules.[29] Hence, the rise in global mobility have impacted both the frequency and

[19] The Commonwealth of Australia (n 2).
[20] The Board of Taxation 2017 Report (n 15) [1.50].
[21] The Board of Taxation 2017 Report (n 15) [1.79].
[22] Ibid [1.64].
[23] Ibid [1.62].
[24] Ibid [1.55].
[25] Anton Joseph, 'Australian Residence: Time to Change the Rules?' (2019) 73(5) *Bulletin for International Taxation*, 5.
[26] The Board of Taxation 2017 Report (n 15) [1.100], [1.163(b)].
[27] Ibid [1.100].
[28] Ibid [1.163(a)].
[29] Ibid [1.163(a)].

nature of how taxpayers interact with the residency rules. This led the Board to conclude that the current residency rules are no longer appropriate and require modernisation.

Accordingly, the inherent uncertainty in the residency rules, coupled with the fact that the rules are no longer appropriate in light of an increasingly globally mobile workforce, led the Board to conclude that the current residency rules are deficient.

III TAXPAYERS ARE FACING DIFFICULTIES WITH DETERMINING THEIR RESIDENCY STATUS

This section will first examine the case law and PBRs from the 2016 to 2021 income year to discern whether taxpayers are turning to the courts or to the ATO to determine their residency status. This paper will then evaluate recent developments in the case law to determine whether these developments are able to adequately address the problems faced by taxpayers when determining their residency status.

A *Trend in the case law and private binding rulings*

1 *Trend in the case law*

From the 2016 to 2021 income year, there have been 18 cases on residency in the Full Federal Court of Australia, the Federal Court of Australia, and the Administrative Appeal Tribunal ('AAT').[30] The following table provides a summary of the cases by issue.

Table 1: Summary of the cases by issue from the 2016 to 2021 income year

Issue	**Number of cases**	**Percentage**
Residency – Expatriate	6	33.3%
Residency – Working holiday maker	7	38.9%
Section 23AG	3	16.7%
Double tax agreement tiebreaker provision	1	5.6%

[30] *Commissioner of Taxation v Addy* [2019] FCA 1768, revd [2020] FCAFC 135; *Joubert and Commissioner of Taxation* [2020] AATA 2645; *Dapper Coelho and Commissioner of Taxation* [2020] AATA 2474; *MacKinnon and Commissioner of Taxation* [2020] AATA 1647; *Schiele and Commissioner of Taxation* [2020] AATA 286; *Pike v Commissioner of Taxation* [2019] FCA 2185; *Stockton v Commissioner of Taxation* [2019] FCA 1679; *Lochtenberg v Commissioner of Taxation* [2019] FCA 1167; *Handsley and Commissioner of Taxation* [2019] AATA 917; *Harding v Commissioner of Taxation* [2018] FCA 837, rev'd [2019] FCAFC 29; *Lochtenberg and Commissioner of Taxation* [2018] AATA 4667; *Shord v Commissioner of Taxation* [2015] AATA 355, revd [2017] FCAFC 167; *Tan and Commissioner of Taxation* [2016] AATA 1062; *Landy and Commissioner of Taxation* [2016] AATA 754; *Hughes and Commissioner of Taxation* [2015] AATA 1007; *Koustrup and Commissioner of Taxation* [2015] AATA 126; *Jaczenko and Commissioner of Taxation* [2015] AATA 125; *Clemens and Commissioner of Taxation* [2015] AATA 124.

Validity of the backpacker tax	1	5.6%
Total	**18**	**100%**

2 *Trend in the private binding rulings*

From the 2016 to 2021 income year, there have been 830 PBRs dealing with the issue of individual tax residency.[31]

Table 2: Summary of the PBRs from the 2016 to 2021 income year

Income year	**Expatriates**	**Incoming**	**Others**[32]	**Total number of private rulings**
2021	85 (75%)	28 (25%)[33]	0	113
2020	93 (84%)	16 (15%)	1 (1%)	110
2019	91 (84%)	17 (16%)	0	108
2018	132 (82%)	28 (17%)	1 (1%)	161
2017	140 (83%)	20 (13%)	0	160
2016	148 (83%)	29 (16%)	1 (1%)	178
Total	**689**	**138**	**3**	**830**
%	**84%**	**15%**	**1%**	**100%**

An examination of the case law and PBRs from the 2016 to 2021 income year reveals that there are two groups of individuals who are facing difficulties with determining their residency status – working holiday makers and Australian expatriates. It is therefore necessary to determine whether the problems faced by working holiday makers and Australian expatriates are adequately addressed by recent developments in the case law.

B *Working holiday makers*

[31] Edited Private Advice obtained through the Australian Taxation Office Legal Database. Please contact the author for more information.
[32] This category includes PBRs on the issue of part-year residency and the application of the superannuation test.
[33] The number of cases concerning incoming individuals was arguably higher in the 2021 income year due to COVID-19 and the closure of international borders. Individuals were unable to return overseas and had to consider their Australian tax residency status as they were physically present in Australia for more than 183 days in the 2021 income year.

Based on table 1, 38.9% of the cases concern the application of the individual residency rules to working holiday makers. Although the cases involving working holiday makers appear to constitute the largest proportion of cases, a closer examination reveals that these cases are no longer controversial after the introduction of a new tax rate that is applicable to working holiday makers. This will be referred to as 'the backpacker tax'.

Individuals who hold a Subclass 417 (Working Holiday) visa, a Subclass 462 (Work and Holiday), or a bridging visa in relation to one of those visas, are taxed at 15% on amounts up to $37,000 for the 2020 income year and up to $45,000 for the 2021 and future income years.[34] Ordinary tax rates apply to taxable income exceeding those amounts.

Working holiday makers are taxed at 15% regardless of their residency status; both resident and non-resident working holiday makers are taxed at 15%. Therefore, whether the backpacker tax applies depends on the individual's visa status, rather than the application of the residency rules. The backpacker tax came into effect on 1 January 2017 and applies to taxable income derived after that date.[35] Before the backpacker tax was introduced, working holiday makers were taxed differently based on whether they were a tax resident or a non-tax resident of Australia. Hence, the residency status of working holiday makers was contentious since it determined the rate of tax to be applied, and whether the individual was entitled to the tax-free threshold.[36]

The following table is a summary of the cases litigated between the 2016 to 2021 income year that concern the application of the current individual residency rules to working holiday makers. The table also examines whether the cases were litigated before or after the introduction of the backpacker tax.

Table 3: Summary of the cases by issue from the 2016 to 2021 income year that concern working holiday makers

Issue	**Number of cases**
Litigated before the backpacker tax was introduced[37]	4
Litigated after the backpacker tax was introduced but only relate to the residency status of the taxpayers before the backpacker tax was imposed[38]	2
Litigated after the backpacker tax was introduced and concerned the application of the residency rules[39]	1

[34] *Income Tax Rates Amendment (Working Holiday Maker Reform) Act 2016* (Cth) ss 3A and 8.
[35] Ibid s 8.
[36] *MacKinnon and Commissioner of Taxation* [2020] AATA 1647, [65].
[37] *Koustrup and Commissioner of Taxation* [2015] AATA 126, *Jaczenko and Commissioner of Taxation* [2015] AATA 125, *Clemens and Commissioner of Taxation* [2015] AATA 124, and *Schiele and Commissioner of Taxation* [2020] AATA 286.
[38] *Dapper Coelho and Commissioner of Taxation* [2020] AATA 2474 and *MacKinnon and Commissioner of Taxation* [2020] AATA 1647.
[39] *Stockton v Commissioner of Taxation* [2019] FCA 1679.

As indicated in table 3, four cases involved determining the residency status of individuals for income years that precede 1 January 2017, and thus were litigated before the backpacker tax was introduced.[40] Hence, if those cases were litigated now, they would be addressed by the backpacker tax.

The remaining three cases were litigated after the backpacker tax was introduced, and involved determining the residency status of the respective taxpayers for the 2017 income year.[41] However, two cases involved determining the rate of tax to be applied to income derived by the respective taxpayers before 1 January 2017.[42] The rate of tax to be applied after 1 January 2017 was not in issue. Only one case involved determining the residency status of the taxpayer, and was litigated after the backpacker tax was introduced.[43] However, that is only one out of seven cases, and today, the vast majority of cases concerning working holiday makers will be addressed by the backpacker tax.

In August 2020, the Full Federal Court in *Commissioner of Taxation v Addy* held that the backpacker tax was valid, and that it did not infringe the anti-discriminatory articles in Australia's tax treaties.[44] Therefore, despite working holiday makers comprising 38.9% of the cases from the 2015 to 2019 income year, given the decision in *Addy*, the backpacker tax adequately addresses cases concerning working holiday makers.

C *Expatriates*

As illustrated in tables 1 and 2, 33.3% of the cases, and 84% of the PBRs involved the application of the residency rules to expatriates. Given that cases concerning working holiday makers are no longer controversial after *Addy*, expatriates comprise the largest proportion of individuals who seek determination from the courts as to their residency status. Therefore, the large number of cases and PBRs indicates that expatriates are facing difficulty with determining their residency status, and that there is a problem with how the current individual residency rules operate with respect to expatriates. It is therefore necessary to determine whether recent developments in the case law are able to adequately address the problems faced by expatriates.

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[40] *Koustrup and Commissioner of Taxation* [2015] AATA 126, *Jaczenko and Commissioner of Taxation* [2015] AATA 125, and *Clemens and Commissioner of Taxation* [2015] AATA 124 involved determining whether the respective taxpayers were a resident of Australia for income year ended 30 June 2013. *Schiele and Commissioner of Taxation* [2020] AATA 286 concerned determining the residency status of the individual for the income year ended 30 June 2016.

[41] *Dapper Coelho and Commissioner of Taxation* [2020] AATA 2474, *MacKinnon and Commissioner of Taxation* [2020] AATA 1647, and *Stockton v Commissioner of Taxation* [2019] FCA 1679.

[42] *Dapper Coelho and Commissioner of Taxation* [2020] AATA 2474, [12] and *MacKinnon and Commissioner of Taxation* [2020] AATA 1647, [65].

[43] *Stockton v Commissioner of Taxation* [2019] FCA 1679.

[44] [2020] FCAFC 135, [347] (Steward J), [227] (Derrington J) ('*Addy*'). The taxpayer has been granted special leave to appeal to the High Court of Australia (https://cdn.hcourt.gov.au/assets/registry/special-leave-results/2021/11-02-21_SLA_Canberra.pdf). As of the finalisation of this paper, the appeal to the High Court of Australia is still ongoing.

The recent decision of the Full Federal Court in *Harding v Commissioner of Taxation* clarified the operation of the permanent place of abode exception to the domicile test.[45]

Harding involved an Australian citizen, Mr Harding, who worked in the Middle East in the relevant income year.[46] Mr Harding moved to Saudi Arabia in 1990 and only returned to Australia in 2006 due to social and political unrest in the Middle East.[47] In 2009, Mr Harding relocated permanently to Saudi Arabia, and did not intend on returning to Australia.[48] Although Mr Harding sold his significant personal possessions,[49] he still retained joint ownership of his home in Australia.[50] Mr Harding's now-former spouse and children remained in Australia when he relocated to the Middle East.[51] In the Middle East, Mr Harding lived in fully furnished apartment units and also moved between units within the same apartment complex.[52] Mr Harding was held not to reside in Australia under the 'resides' test.[53] Since Mr Harding was domiciled in Australia, an issue was whether he had a permanent place of abode in the Middle East.

The Full Federal Court held that the focus of the permanent place of abode exception is on determining whether the taxpayer has 'definitely abandoned' their residence in Australia.[54] The taxpayer is only required to identify a foreign country that he or she is living in permanently,[55] whether in a fixed home, or in various forms of accommodation.[56] Therefore, in *Harding*, Mr Harding was held to have a permanent place of abode in the Middle East notwithstanding the fact that he lived in temporary accommodation and moved between units within the same apartment complex.[57]

The Commissioner's application for special leave was refused by the High Court of Australia.[58] Hence, the decision of the Full Federal Court is significant as it is an authoritative statement on the operation of the permanent place of abode exception.[59] The decision in *Harding* has been applied in the subsequent case of *Handsley and Commissioner of Taxation*.[60]

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[45] [2019] FCAFC 29 ('*Harding*'). The Commissioner's application for special leave was refused by the High Court of Australia.
[46] *Harding v Commissioner of Taxation* [2018] FCA 837, [8], [14].
[47] Ibid [9], [11].
[48] Ibid [15].
[49] Ibid [15].
[50] Ibid [16].
[51] Ibid [14], [26].
[52] Ibid [21], [22].
[53] Ibid [24].
[54] Ibid [36].
[55] Ibid [40].
[56] Sylvia Villios, Michael Blissenden and Paul Kenny, 'Residence Tests for Individuals: Impact of the Harding Decision' (2020) 54(6) *Taxation in Australia*, 3-4.
[57] *Harding* (n 46) [54].
[58] *Commissioner of Taxation v Harding* [2019] HCATrans 191.
[59] Following *Harding*, the ATO has released a decision impact statement in which the ATO advised that IT 2650 will be reviewed to reflect the decision of the Full Federal Court that the phrase 'place of abode' refers not only to a dwelling but can also refer to a country. As of the date of completion of this paper, the ATO has yet to publish an updated ruling.
[60] [2019] AATA 917, [53] ('*Handsley*').

However, the utility of *Harding* is limited. This is because in most of the cases from the 2016 to 2021 income year, it was held that the taxpayer was a resident under the 'resides' test.[61] Consequently, the domicile test was either not considered at all,[62] or was dealt with briefly since it resulted in the same outcome as the 'resides' test.[63] For instance, in *Landy*, AAT Senior Member F D O'Loughlin referred to his analysis under the 'resides' test in coming to the same conclusion that the individual was a resident under the domicile test.[64] This indicates that the focus of the residency analysis is still on the 'resides' test. Although the case of *Harding* is seminal in providing clarity on the meaning of the phrase 'permanent place of abode' under the domicile test, the case does not provide guidance on the application of the 'resides' test. Accordingly, *Harding* may only make a difference in cases where the taxpayer is not a resident under the 'resides' test.

Expatriates are facing difficulty with determining their residency status. While the backpacker tax adequately addresses cases concerning working holiday makers, there has been no similar development to assist expatriates. This indicates that reform is necessary.

IV AN OVERVIEW OF THE PROPOSED REFORMS

As mentioned earlier, the Proposed Reforms will be based on recommendations made by the Board. This section will briefly outline the recommendations on which the Proposed Reforms are based on. The Board proposes a two-step approach. Firstly, a simple bright-lined test is to be applied as the primary test of residency.[65] The individual only has to apply more complex secondary tests if he or she is not a resident under the primary test.[66]

A *Primary test*

The primary test of residency is a 183-day test based on the individual's physical presence in Australia in an income year. An individual will be a tax resident if they are physically present in Australia for more than 183 days in an income year.

[61] Out of six cases, only two cases, *Handsley* and *Harding*, were decided on the basis of the domicile test.
[62] *Joubert and Commissioner of Taxation* [2020] AATA 2645 ('*Joubert*').
[63] *Pike v Commissioner of Taxation* [2019] FCA 2185 (*'Pike'*), *Landy and Commissioner of Taxation* [2016] AATA 754 (*'Landy'*), *Hughes and Commissioner of Taxation* [2015] AATA 1007 (*'Hughes'*), and *Shord v Commissioner of Taxation* [2015] AATA 355, revd [2017] FCAFC 167 (*'Shord'*) were decided on the basis of the 'resides' test.
[64] *Landy* (n 63) [23].
[65] The Board of Taxation 2019 Report (n 3) 6.
[66] Ibid. The tests are outlined in chapters 4, 5 and 7 of the Board's 2019 report.

B *Secondary tests*

Individuals are only required to apply the secondary tests if they fail to meet the primary test. There are two secondary tests, a commencing residency test and a ceasing residency test. Determining which test applies depends on whether the individual was a tax resident in the preceding year. If the individual was not a resident in the preceding income year, he or she has to apply the commencing residency test. Conversely, if the individual was a resident in the preceding income year, the ceasing residency test is to be applied.

1 *The commencing residency test*

The commencing residency test is further divided into two sub-tests, an additional day-count test and a factor test. If the individual is physically present in Australia for less than 45 days in the current income year, the individual is not an Australian tax resident. If the individual is physically present in Australia for more than 45 days in the current income year, the individual is a tax resident if he or she satisfies two or more factors in the factor test. Further information on the factor test will be provided later in this paper.

2 *The ceasing residency test*

The ceasing residency test is composed of three separate sub-tests, the overseas employment rule, the ceasing short-term residency test, and the ceasing long-term residency test.

(a) The overseas employment rule

The overseas employment rule is aimed at providing clarity to the expatriate community. The overseas employment rule targets individuals who leave Australia in the given income year to work overseas. Broadly, it is a codification of the existing common law rules relating to overseas assignments. Under the overseas employment rule, an individual is not a tax resident if all of the following are satisfied:

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.

(b) The ceasing short-term residency test

The ceasing short-term residency test applies to individuals who have been a tax resident of Australia for less than three consecutive income years. There are two sub-tests, a day-count test and the factor test. An individual is not a tax resident if they are physically present in Australia for less than 45 days in the current income year, and satisfy less than two factors in the factor test.

(c) The ceasing long-term residency test

The ceasing long-term residency test applies to individuals who have been a tax resident of Australia for more than three consecutive income years. An individual is not a tax resident if they are physically present in Australia for less than 45 days in the current income year and in each of the two preceding income years. This test is pure day-count test based on an individual's physical presence in Australia. The factor test is not applicable.

3 *The factor test*

The factor test applies in both the commencing residency test and the ceasing short-term residency test. The factor test is based on objective Australia-only factors that examines an individual's connections to Australia. The following factors are taken into account:

- Right to reside permanently in Australia;
- Australian accommodation;
- Australian family; and
- Australian economic interests

4 *The Government Officials test*

The Board also proposed to replace the current superannuation test with a Government Officials test.[67] Under the Government Officials test, Australian Government officials who are deployed overseas will be considered to be a tax resident for the duration of their deployment.[68] The Government Officials Test will not be covered in this paper.

This paper will focus on the primary 183-day test, the commencing residency test, and the ceasing residency test.

[67] The Board of Taxation 2019 Report (n 3). The test is outlined in chapter 6 of the Board's 2019 report.
[68] Ibid.

V EVALUATION CRITERIA

It has been established expatriates are facing difficulties with applying the residency rules, and that reform is required. Accordingly, it is necessary to evaluate whether the Proposed Reforms are able to address the problems faced by expatriates. This section will identify criteria that will be used to evaluate the Proposed Reforms.

The tax policy objectives of equity, efficiency and simplicity have been considered to be 'the three dominant tests of merit for individual taxes and for the tax system as a whole'.[69] These principles have been widely used in tax reform reviews,[70] and they have also been regarded in the literature as generally accepted criteria for evaluating taxes and the tax system.[71] This section will outline the key policy objectives equity, efficiency and simplicity.

A *Equity*

Equity is a crucial element of a tax system; it is 'a quality of a tax or a tax system [that] everyone demands'.[72] Equity is essential as it encourages the perception of fairness among taxpayers, which promotes voluntary compliance with the law.[73]

1 *What is equity?*

There are two dimensions to equity – horizontal and vertical equity.[74] Horizontal equity requires that taxpayers in the same circumstances should be treated equally.[75] On the other hand, vertical equity is concerned with the redistribution of wealth from rich to poor under a progressive tax system;[76] taxpayers with a greater ability to pay should pay more taxes.[77]

Horizontal and vertical equity are often classified as 'individual' equity since they are both concerned with equity as it relates to taxpayers.[78] 'Individual' equity is a national tax matter.[79] This is distinct from 'inter-nation' equity, an international tax issue that is focused on the equitable sharing of tax revenue between countries in a linked cross-border

[69] Taxation Review Committee, *Full Report January 31 1975* (Report, 1975) [3.27] ('Asprey Review').
[70] Michael Dirkis, 'Is It Australia's? Residency and Source Analysed' (2005), *Australian Tax Research Foundation*, 41.
[71] Michael Dirkis (n 70), Richard Edmonds, 'A judicial perspective on tax reform', (2011) 35(1) *Melbourne University Law Review*, 243, and John McLaren, 'Should the international income of an Australian resident be taxed on a worldwide or territorial basis?', (2006) *Faculty of Business - Papers (Archive)*, 72.
[72] Asprey Review (n 69) [3.7].
[73] Nicole Wilson-Rogers and Dale Pinto, 'Tax Reform: A Matter of Principle? An Integrated Framework for the Review of Australian Taxes' (2009) 7(1) *eJournal of Tax Research*, 94.
[74] Asprey Review (n 69) [3.27].
[75] Asprey Review (n 69) [3.7], Michael Dirkis (n 70) 112.
[76] McLaren (n 71) 76.
[77] Asprey Review (n 69) [3.9].
[78] Michael Dirkis (n 70) 42.
[79] McLaren (n 71) 74.

transaction.[80] The focus of this paper is on assessing Australia's residency rules as they operate within Australia's jurisdictional claim.[81] Hence, for the purposes of this paper, 'individual' equity is a more appropriate criterion than 'inter-nation' equity in evaluating the Proposed Reforms. 'Inter-nation' equity will not be covered in this paper. Vertical equity is less relevant to the issue of residency. This is because both residents and non-residents are subject to the progressive tax system in Australia, albeit on different amounts,[82] and at different rates.[83]

Horizontal equity is a more appropriate criterion than vertical equity when evaluating the Proposed Reforms. When analysing the residency status of individuals, it is important that individuals are treated equally. For instance, individuals should be considered to be a resident if they satisfy factors that are commonly associated with being a resident.

Therefore, this paper will assess the current residency tests and the Proposed Reforms based on the criterion of horizontal equity.

2 *How is equity measured?*

Equity is measured by comparing individuals. However, there are a number of difficulties in determining the basis on which individuals should be compared. For instance, in terms of horizontal equity, it is difficult to determine when individuals are in similar circumstances.[84] Moreover, there is also debate as to whether a comparison should be undertaken on an individual or family unit basis.[85]

Nevertheless, despite the challenges associated with measuring equity, Dirkis asserts that 'it is possible to identify where there is a failure to achieve equity or where the system in operation results in inequitable outcomes'.[86] This paper will therefore measure horizontal equity based on whether individuals in like circumstances are treated alike under the existing residency rules and the Proposed Reforms.

B *Efficiency*

1 *What is efficiency?*

Efficiency has been historically defined in terms of economic efficiency and administrative efficiency.[87] Economic efficiency involves minimising distortions to economic activities, so as not to impede genuine commercial transactions.[88] In contrast, administrative efficiency is

[80] Ibid, Michael Dirkis (n 70) 42.
[81] Ibid. The paper adopts the same approach as Michael Dirkis.
[82] *Income Tax Assessment Act 1997* (Cth) ss 6-5 and 6-10. An individual who is a tax resident of Australia is taxed on their worldwide income, whereas a non-tax resident is only taxed on income derived from sources in Australia.
[83] *Income Tax Rates Act 1986* (Cth) sch 7. Non-tax residents are taxed at higher rates.
[84] Michael Dirkis (n 70) 44.
[85] Wilson-Rogers and Pinto (n 73) 78.
[86] Michael Dirkis (n 70) 45 – 46.
[87] Michael Dirkis (n 70) 47.
[88] Wilson-Rogers and Pinto (n 73) 78. Economic efficiency is also referred to as tax neutrality.

focused on minimising the cost of administering and complying with the law.[89] This paper will focus on administrative efficiency since an evaluation of the current residency rules against the criterion of economic efficiency has been extensively considered by Dirkis.[90]

There are differing views as to whether administrative efficiency can be viewed as a subset of simplicity. For instance, Wilson-Rogers and Pinto note that the tax policy objective of simplicity is sometimes referred to as administrative efficiency.[91] On the other hand, Dirkis considers that simplicity is often treated as a separate objective from administrative efficiency despite the fact that the minimisation of administrative and compliance costs is also a function of simplicity.[92] In this paper, administrative efficiency will be examined separately to simplicity.

2 *How is efficiency measured?*

Administrative efficiency can be measured in terms of the cost of compliance and administration. Compliance costs includes direct financial costs, opportunity costs and non-financial compliance costs incurred by the taxpayer.[93] Administration costs includes 'the costs of tax policy planning, resolving taxation disputes (including taxation litigation), and the costs of administering the law including taxpayer education, rulings, circulars and the provision of other types of ATO information'.[94]

This paper will analyse the current residency tests and the Proposed Reforms based on whether it reduces the compliance and administrative costs incurred in determining an individual's tax residency status.

C *Simplicity*

According to the Asprey Review, '[a]fter equity, simplicity is perhaps the next most universally sought after of qualities in individual taxes and tax systems as a whole'.[95]

1 *What is simplicity?*

In the Asprey Review, simplicity is defined broadly: 'a tax will be called simple, relatively to others, if for each dollar raised by it the cost of official administration is small, and if the

[89] Michael Dirkis (n 70) 47, Asprey Review (n 69) [3.7].
[90] Michael Dirkis (n 70) Chapter 3.
[91] Wilson-Rogers and Pinto (n 73) 79.
[92] Michael Dirkis (n 70) 49 citing Michael J Graetz 'Taxing international income: Inadequate principles, outdated concepts, and unsatisfactory policies' (2001) 26 *Brooklyn Journal of International Law*, 310.
[93] Wilson-Rogers and Pinto (n 73) 79. Includes 'Direct financial costs include the costs to the taxpayer of engaging tax experts for managing their tax affairs. Opportunity costs include the time spent by the taxpayer complying with their tax obligations that may have been spent doing other activities (such as leisure or work). Non-financial compliance costs include any mental stress that may result from uncertainty placed on the taxpayer about whether they have discharged their tax obligations.'
[94] Wilson-Rogers and Pinto (n 73) 79.
[95] Asprey Review (n 69) [3.19].

"compliance costs", the costs in money and effort of all kinds to the taxpayer, are also small'.[96]

Simplicity is the most difficult criteria to define.[97] Based on the literature, it is clear that simplicity is a multifaceted concept,[98] and it is therefore necessary to determine what constitutes simplicity.

Tram-Nam notes that a commonly accepted definition of simplicity is 'the ease by which a body of a tax law can be read and correctly understood and applied to practical situations'.[99] This definition contains several essential requirements:

- *Clarity*: tax legislation and rulings should be expressed in plain language and developed in a logical manner.
- *Consistency*: tax legislation and rulings should be consistent, both internally and externally and well coordinated.
- *Certainty*: any particular tax situation covered by the law must give rise to a unique tax liability.[100]

This paper will adopt the definition posited by Tran-Nam, and will evaluate the current residency tests and the Proposed Reforms based on whether the tests can be easily understood and applied by taxpayers.

2 *How is simplicity measured?*

According to Tran-Nam, simplicity can be measured in the following ways:

- how simple is the tax legislation written; or
- how simple is the content of the tax legislation; or
- how taxpayers and tax administrators respond to the tax law; or
- how expensive it is to operate the tax.[101]

The first two measures can be classified as legal simplicity, and the remaining two measures can be referred to as economic simplicity.[102]

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[96] Ibid [3.20].
[97] Wilson-Rogers and Pinto (n 73) 78.
[98] Joel Slemrod 'Complexity, compliance costs and tax evasion' in JA Roth and JT Scholtz, *Taxpayer Compliance: Social Science Perspectives* (1986), 156 cited in Binh Tran-Nam, 'Tax reform and tax simplicity: a new and 'simpler' tax system?' (2000) 23(2) *The University of New South Wales Law Journal*, 242; Graeme Cooper, 'Themes and issues in tax simplification', (1993) 10(4) *Australian Tax Forum* 417, 424. According to Slemrod, there are four concepts embodied in the notion of simplicity: predictability, enforceability, difficulty and manipulability. On the other hand, Cooper suggests that simplicity encompasses seven concepts: predictability, proportionality, consistency, compliance, administration, coordination, and expression.
[99] Binh Tran-Nam, 424.
[100] Binh Tran-Nam (n 98) 424.
[101] Ibid 244.
[102] Ibid 244 – 245.

There is an overlap between economic simplicity and administrative efficiency as they can both be measured by examining the operating costs of complying with, and administering the residency rules. Since the operating costs of the current residency rules and the Proposed Reforms will be examined under the criterion of efficiency, this paper will focus on measuring simplicity based on legal simplicity – whether the residency rules are written in a way that can be easily understood by taxpayers, and whether the content of the rules can be simplified.

VI AN EVALUATION OF THE PROPOSED REFORMS

This section will evaluate the Proposed Reforms against the criteria of equity, efficiency and simplicity in how the tests operate with respect to expatriates.

A *Ways in which the Proposed Reforms will meet the key policy objectives*

1 *No weighting of the individual's circumstances is required under the Proposed Reforms*

Expatriates usually have to consider the 'resides' test and the domicile test.[103] Both the 'resides' and domicile tests involve fact-heavy analyses that require weighting of the individual's circumstances. Under the 'resides' test, the individual has to determine whether they reside in Australia according to the ordinary meaning of the word 'reside'.[104] This is a holistic analysis that requires examining whether the individual has maintained a 'continuity of association' with Australia.[105] This involves comparing the individual's connections overseas with their connections to Australia to determine whether the taxpayer's behaviour is consistent with residing in Australia.[106]

It was noted in *Handsley* that determining whether the individual 'established a permanent place of abode outside of Australia requires the same or substantially the same analysis as required to determine whether he resided outside of Australia under ordinary principles'.[107] Therefore, this paper will focus on the weighting of factors under the 'resides' test since the analyses under the 'resides' and domicile tests are similar.

(a) Weighting of factors under the 'resides' test

In *Joubert*, AAT Senior Member Mrs J C Kelly identified the following objective factors that are frequently taken into account in determining the residency status of an individual:

physical presence; nationality; history of residence and movements; habits and "mode of life"; the frequency, regularity and duration of visits; the purpose of visits to or absences from

[103] The Board of Taxation 2017 Report (n 15) [1.65].
[104] *Federal Commissioner of Taxation v Miller* (1946) 73 CLR 93.
[105] *Harding* (n 46) [33] quoting *Hafza v Director-General of Social Security* (1985) 6 FCR 444, 449–50 (Wilcox J).
[106] Australian Taxation Office, *Income tax: residency status of individuals entering Australia* (TR 98/17) 4.
[107] *Handsley* (n 60) [23].

a country; family and business ties with a country; and the maintenance of a place of abode in a country even when absent from that country.[108]

However, the weight to be accorded to each factor varies from case to case.[109] No single factor is determinative.[110] Furthermore, in *Harding*, Logan J warned against the use of checklists, stating that 'however useful such checklists may be, they are no substitute for the text of the statute and the recollection that ultimate appellate authority dictates that the word 'resides' be construed and applied to the facts according to its ordinary meaning'.[111] Thus, checklists are merely an evaluative tool to assist the taxpayer in determining whether they reside in a particular location.[112] Therefore, under the current rules, the focus is on the ordinary meaning of the word 'resides'. There is no certainty over the weight that is to be accorded to each factor and the number of factors that have to be satisfied before the taxpayer is considered to reside in Australia.

Recent cases demonstrate the inconsistent approach taken by judges in determining the residency status of the taxpayer. In *Pike*, *Hughes*, *Joubert*, and *Landy*, the court viewed the following factors as indicative of maintaining a continuity of association with Australia:[113]

- Maintaining a home in Australia[114]
- Having dependent family in Australia[115]
- Making trips to Australia to visit family[116]
- Fixed term employment contract overseas[117]
- Occupying temporary accommodation overseas[118]

In *Harding*, the Commissioner argued that the taxpayer was a resident because in the relevant income year, he maintained the following objective connections to Australia:

- Despite living in the Middle East, Mr Harding maintained a house in Australia where his wife and children lived.[119] Mr Harding returned to live in that house during his trips back to Australia to visit his family.[120]

[108] *Joubert* (n 62) [62].
[109] *Joubert* (n 62) [63].
[110] Ibid.
[111] *Harding* (n 46) [7] (Logan J).
[112] Ibid [47].
[113] Michael Dirkis, 'The Ghosts of Levene and Lysaght Still Haunting Ninety Years on: Australia's 'Great Age' of Residence Litigation?' (2018) 47(1) *Australian Tax Review*, 46 – 47.
[114] *Pike* (n 63) [62], *Hughes* (n 63) [26], *Joubert* (n 62) [80], *Landy* (n 63) [12].
[115] *Pike* (n 63) [62], *Hughes* (n 63) [26], *Joubert* (n 62) [72], *Landy* (n 63) [12].
[116] *Pike* (n 63) [43], *Hughes* (n 63) [10], *Joubert* (n 72) [62], *Landy* (n 63) [12].
[117] *Hughes* (n 63) [4], *Joubert* (n 62) [74], *Landy* (n 63) [10].
[118] *Pike* (n 63) [15], *Hughes* (n 63) [28], *Joubert* (n 62) [75], *Landy* (n 63) [11].
[119] *Harding* (n 45) [59].
[120] Ibid [60].

- Mr Harding also had a fixed-term employment contract that had a duration of less than two years.[121] Any extension of his employment contract required the approval of his employer.[122]
- In the Middle East, Mr Harding also lived in a fully furnished serviced apartment, a type of accommodation that is usually regarded in Australia as temporary.[123]

Despite the existence of factors that were taken in previous cases to indicate a continuity of association with Australia, in *Harding*, those factors were given less weight due to the unusual circumstances of the case.[124] It was unusual that Mr Harding had previously worked in the Middle East for 15 years, and valued his employment overseas over his relationship with his wife and children.[125] Accordingly, those factors were viewed to be coextensive with his intention to leave Australia permanently, and should not be seen as an intention to maintain a continuity of association with Australia.[126]

Therefore**,** the different approaches to weighting of the individual's circumstances raises implications for the ability of the tax system to meet the policy goals equity, efficiency and simplicity.

(b) Implications of the weighting of factors under the current residency rules

(i) Equity

The factors are weighted differently based on the circumstances of each taxpayer. This can lead to inequitable outcomes 'since minor variations in taxpayers' circumstances may result in taxpayers in similar circumstances being taxed differently'.[127]

Furthermore, the approach of Derrington J in *Harding* introduces additional subjectivity when applying the 'resides' test. According to Derrington J, in unusual cases, objective factors that are usually considered to indicate a continuity of association with Australia can also support an intention to leave Australia permanently.[128] There is subjectivity involved in determining whether the circumstances of a case are unusual. For instance, in *Joubert*, the taxpayer argued that the facts are strongly aligned with *Harding*.[129] However, AAT Senior Member Mrs J C Kelly held that the circumstances of the case were not unusual.[130] Hence, the subjectivity involved in determining whether there are unusual circumstances can also result in inequitable outcomes.

[121] *Harding* (n 45) [73].
[122] Ibid.
[123] Ibid [75].
[124] Ibid [86].
[125] Ibid [51].
[126] Ibid [85].
[127] Michael Dirkis (n 70) 112.
[128] *Harding* (n 45) [56].
[129] *Joubert* (n 62) [65].
[130] Ibid [69].

(ii) Efficiency

The uncertainty involved in determining whether the individual resides in Australia necessitates taxpayers litigating or seeking guidance from the ATO in order to determine their residency status. This is supported by the large number of cases and PBRs, which suggests that there is a problem with how the individual residency rules operate with respect to expatriates. Since the tax system requires taxpayers to seek guidance to determine their residency status, it is clear that the current residency rules do not operate to minimise the cost of administering and complying with the law.

(iii) Simplicity

There is uncertainty as to the weight that is to be accorded to each factor. *Harding* illustrates that the process is not simple, and that the facts are open to many different interpretations. In *Harding*, both the primary judge and the Commissioner engaged in the same process of weighting the factors, but reached a different conclusion.[131] It was also noted by Derrington J that the Commissioner's conclusion that Mr Harding was a resident was 'far from being unreasonable'.[132] However, Derrington J emphasised that the unusual circumstances of the case warranted the conclusion that Mr Harding was not a resident. This inconsistent weighting of the individual's circumstances creates uncertainty for taxpayers and makes it difficult for individuals to apply the residency rules to their own circumstances.

The uncertainty faced by taxpayers is exacerbated by the fact that previous cases do not carry any precedential value. Each case has to be decided on its own facts.[133] It was noted by Logan J in *Harding* that 'it is of cardinal importance not to elevate into matters of principle in a later case particular facts found decisive in the different circumstances of an earlier case'.[134] The lack of guidance from previous cases makes it difficult for taxpayers to apply the 'resides' test.

Weighting under the current rules is excessively complex and results in numerous undesirable effects; '[i]t creates uncertainty for taxpayers, and reduces the system's integrity and transparency ... [, undermining] trust in the fairness of a tax system.'[135] Therefore, the current rules fail to meet the criterion of simplicity due to the complexity involved in weighting of the individual's circumstances.

[131] Australian Taxation Office, '*Decision impact statement Harding v* Commissioner of Taxation' <https://www.ato.gov.au/law/view/document?LocID=%22LIT%2FICD%2FQUD442of2018%2F00001%22&PiT=99991231235958>.
[132] *Harding* (n 45) [87].
[133] *Joubert* (n 62) [65].
[134] *Harding* (n 46) [8] (Logan J).
[135] Cindy Chan, 'A case for statutory simplification' (2016) 19(3) *The Tax Specialist*, 119.

C *The Proposed Reforms promotes simplicity and efficiency*

The Proposed Reforms do not involve weighting of the individual's circumstances.

(i) Factor test

The proposed factor test does not involve weighting of the individual's circumstances. Under the factor test, only four factors need to be considered.[136] This is a more targeted approach as compared to the current residency rules. Furthermore, taxpayers need to satisfy a fixed number of factors to determine if they are a resident under the proposed tests. Under the commencing residency test, taxpayers need to satisfy two or more of the factors to be a resident.[137] On the other hand, under the short-term ceasing residency test, taxpayers need to satisfy less than two factors to be a non-resident.[138] This also provides taxpayers with certainty as to the number of factors that have to be met in each case. Therefore, by removing the need to engage in a weighting process and by prescribing a fixed number of factors that have to be satisfied, the proposed tests are written in a way that can be easily understood by taxpayers.

The proposed factor test is only focused on Australian connections.[139] The test does not involve comparing the individual's connections to Australia with their connections overseas. In *Harding*, Derrington J emphasised that care must be taken when examining the nature of the taxpayer's residence overseas, and that it is important to not assess it from an Australian perspective.[140] In that case, the taxpayer lived in fully furnished apartments in Bahrain.[141] Derrington J noted that such form of accommodation is usually regarded in Australia as temporary accommodation,[142] but that may not be the case in Bahrain. Therefore, by focusing only on Australian connections, the Proposed Reforms avoids situations in which the relevant decision-maker imposes their views on the nature of the taxpayer's residence overseas based on standards observed in Australia. Hence, focusing on objective Australia-only factors reduces the complexity involved in determining the taxpayer's residency status, and also promotes efficiency by reducing the costs involved in gathering evidence on the individual's connections overseas.[143] This satisfies the tax policy objectives of simplicity and efficiency.

(ii) Overseas employment rule

The overseas employment rule targets a subset of individuals who leave Australia in the given income year to work overseas. The overseas employment rule provides certainty to those taxpayers since they will only need to consider whether four objective requirements

[136] The Board of Taxation 2019 Report (n 3) 97.
[137] Ibid 43.
[138] Ibid 65.
[139] Ibid 97.
[140] *Harding* (n 45) [75].
[141] Ibid [22].
[142] Ibid [75].
[143] Letter from The Law Council of Australia to Ms Karen Payne, The Board of Taxation, 9 November 2018 <https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2019/11/TRRI-Law-Council-of-Australia.pdf>.

have been met for them to cease being a resident in the year that they leave Australia.[144] Such an approach is a simplification of the current rules since no weighting of factors is required to determine the taxpayer's residency status in the year they leave Australia.

2 *The Proposed Reforms provide a simpler and more efficient pathway to determine the taxpayer's residency status*

(a) Pathway under the current rules

If the taxpayer satisfies one of the four tests of residency, the taxpayer will be a tax resident of Australia. The primary test for determining residency is the 'resides' test; if an individual is a tax resident under the 'resides' test, the other three tests do not have to be considered.

As mentioned above, the 'resides' test involves weighting of the individual's circumstances to determine whether the individual is a resident of Australia. Such weighting is highly subjective and leads to uncertainty. Due to the uncertainty involved, the parties raise arguments under both the 'resides' and domicile test.[145]

Although raising alternative arguments can be seen as a matter of good practice, it is unnecessary to do so if the taxpayer is a resident under the 'resides' test. Both the AAT and the ATO have concluded that the individual is a resident of Australia solely under the 'resides' test.[146] Similar sentiments were expressed by the Federal Court in *Pike*, in which Logan J stated that since the taxpayer was a resident under the 'resides' test, it was strictly unnecessary to consider whether that conclusion was additionally supported by the individual being a resident under the domicile test.[147]

Therefore, due to the uncertainty involved in the 'resides' test, the parties spend resources to apply the domicile test although it may be unnecessary to do so. This undermines the ability of the tax system to satisfy the policy goal of efficiency.

(b) Pathway under the Proposed Reforms

Under the Proposed Reforms, the primary test is the 183-day test.[148] The 183-day test is a pure day-count test, and only involves determining the duration of the individual's physical presence in Australia in the income year.[149] The test is objective and does not require consideration of the intention of the taxpayer.[150]

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[144] The Board of Taxation 2019 Report (n 3) 66.
[145] *Joubert* (n 62) [10], the Commissioner argued that Mr Joubert should be characterised as a resident of Australia in the 2015 income year under the "ordinary concepts" test and/ or the "domicile" test.
[146] *Joubert* (n 62), Australian Taxation Office, 'Edited version of private advice 1051604179669' (Web page) <https://www.ato.gov.au/law/view/document?src=hs&pit=99991231235958&arc=false&start=1&pageSize=10&total=1&num=0&docid=EV%2F1051604179669&dc=false&stype=find&tm=phrase-basic-1051604179669>.
[147] *Pike* (n 63) [68].
[148] The Board of Taxation 2019 Report (n 3) 30.
[149] Ibid [3.3].
[150] Ibid [3.9].

The 183-day test is simple to apply. Under the 183-day test, the test period is limited to an income year, rather than a rolling 12-month period.[151] This provides certainty to individuals since in each year, they will be aware of the duration of the test period.[152] Furthermore, the 183-day test does not require identifying and comparing an individual's connections to Australia with their connections overseas. This is especially important for expatriates since expatriates often have connections both overseas and to Australia.

Therefore, the 183-day test is a simplification of the current residency rules. There is less uncertainty involved in the application of the primary 183-day test. It is clear when an individual will be a resident under this test, and in turn, whether the individual has to consider the secondary tests. Hence, the Proposed Reforms provides clarity over which tests taxpayers are required to apply. This leads to more efficient outcomes since taxpayers are no longer spending resources on tests that do not have to be argued.

3 *Taxpayers are no longer required to determine if they have acquired Australia as a domicile of choice*

(a) The domicile test

Under the current residency rules, if the individual does not reside in Australia under the 'resides' test, they have to apply the domicile test if they are domiciled in Australia. An individual is domiciled in Australia if they either acquired Australia as their domicile of origin at birth, or as a domicile of choice by having an intention to make Australia their home indefinitely.[153]

In most cases, Australia is the domicile of origin for the individual.[154] However, there are also cases that involve determining whether an individual acquired Australia as a domicile of choice. *Pike* demonstrates that it can be difficult to determine when the individual acquired Australia as a domicile of choice.[155] Mr Pike was born in Zimbabwe,[156] and moved to Australia in 2005.[157] In 2006, Mr Pike left Australia to work in Thailand.[158] Mr Pike was granted Australian permanent residency in 2009,[159] and obtained Australian citizenship in 2014.[160] An issue in the case was whether Mr Pike abandoned Zimbabwe as his domicile of origin and acquired Australia as his domicile of choice.

Although Mr Pike was an Australian tax resident under the 'resides' test, Logan J still considered the domicile test since the question of whether Mr Pike was a resident under the

[151] Ibid [3.32].
[152] Ibid [3.35].
[153] Australian Taxation Office, *Income tax: residency - permanent place of abode outside Australia* (IT 2650) [10].
[154] *Handsley* (n 60), *Harding* (n 46), *Landy* (n 63), *Hughes* (n 63), *Shord* (n 63).
[155] *Pike* (n 63).
[156] Ibid [4].
[157] Ibid [8].
[158] Ibid [12].
[159] Ibid [23].
[160] Ibid [35].

domicile test was fully argued by the parties.[161] Logan J held that Mr Pike did not acquire Australia as a domicile of choice upon his initial arrival to Australia because he did not completely cut ties with Zimbabwe.[162] Upon his arrival to Australia, Mr Pike still retained his Zimbabwean citizenship, and ownership of his home in Zimbabwe.[163] Although he intended to make Australia his home, Logan J regarded that Mr Pike's stay in Australia was conditional upon his partner's employment in Australia; their ability to remain in Australia was linked to the duration of her visa.[164] Accordingly, the Commissioner was incorrect in regarding that Australia was Mr Pike's domicile of choice from his arrival.[165]

Logan J held that Mr Pike acquired Australia as a domicile of choice when he became an Australian citizen.[166] However, there was uncertainty over whether Mr Pike acquired Australia as a domicile of choice earlier, when he became an Australian permanent resident.

Logan J stated that there were 'mixed signals … sent by Mr Pike's conduct since his arrival in Australia in 2005'.[167] There were indicators that Mr Pike severed ties with Zimbabwe; in 2010, he sold his home in Zimbabwe and purchase land in Australia.[168] Furthermore, in 2010, his partner and his sons became Australian citizens, and he also enquired about obtaining Australian citizenship. Despite working in Thailand, Mr Pike also consistently returned to Australia to be with his partner and children. However, his length of stay in Australia varied between 32 days in one year and 155 days in another year.[169] Mr Pike also acted in ways that indicated that he still had ties to Zimbabwe. Notably, Mr Pike renewed his Zimbabwean passport in 2012, and used his Zimbabwean driver's licence when he worked overseas.[170] Therefore, Logan J could only definitively conclude that Mr Pike acquired Australia as a domicile of choice when he obtained Australian citizenship, but acknowledged that it is possible that he may have acquired it earlier while he was an Australian permanent resident.[171]

Pike demonstrates that there is difficulty in determining the exact moment in which an individual acquires Australia as their domicile of choice. This has implications for individuals who were not born in Australia, but moved to Australia before eventually leaving to work overseas. This results in uncertainty as to when they have acquired Australia as a domicile of choice, and accordingly, when they will be treated as residents under the domicile test.

(b) The Proposed Reforms

The Proposed Reforms will help to reduce the uncertainty faced by individuals like Mr Pike. By removing the need to determine whether the individual has acquired Australia as a

[161] *Pike* (n 63) [68].
[162] Ibid [75].
[163] Ibid [75].
[164] Ibid [75].
[165] Ibid [75].
[166] Ibid [79].
[167] Ibid [77].
[168] Ibid.
[169] Ibid.
[170] Ibid.
[171] *Pike* (n 63) [79].

domicile of choice, the Proposed Reforms will help to simplify the process of determining the individual's residency status.

Under the Proposed Reforms, the nationality or permanent residency of the taxpayer is only relevant if the taxpayer has to apply the factor test. One of the factors in the factor test is whether the individual has a right to reside permanently in Australia for immigration purposes.[172] This factor is satisfied if the individual is an Australian citizen or an Australian permanent resident.[173] There is no reference to antiquated terms such as domicile. This makes it easier for taxpayers to determine their residency status.

B *Ways in which the Proposed Reforms will not meet the key policy objectives*

The factor test requires individuals to determine if they satisfy any of the four factors.[174] The factor test raises implications for the ability of the Proposed Reforms to meet the key policy objectives in how the tests impact expatriates.

1 *Australian bank account*

Under the factor test, one of the factors is whether the individual has Australian economic connections.[175] The taxpayer will have Australian economic connections if any one of these factors are met:

- Employment located in Australia;
- Active participation in the carrying on of a business in Australia; or
- Directly or indirectly having interests in Australian assets.[176]

An Australian bank account with significant cash deposits constitutes holding an interest in Australian assets.[177] Having an interest in Australian assets is of direct relevance to Australian expatriates because many expatriates maintain a bank account in Australia while living overseas.[178]

(a) Implications for simplicity

The factor test contains a qualifier that the bank account must contain significant cash deposits. There is subjectivity involved in determining what amounts to 'significant cash deposits'. This makes it more difficult for expatriates to determine if they satisfy this factor.

[172] The Board of Taxation 2019 Report (n 3) 100.
[173] Ibid.
[174] Ibid [7.15].
[175] The Board of Taxation 2019 Report (n 3) 97.
[176] Ibid [7.41].
[177] Ibid [7.50].
[178] *Pike* (n 63), *Harding* (n 46), *Handsley* (n 60), *Landy* (n 63), and *Joubert* (n 62).

The qualifier is also a departure from the current treatment under the case law. Although the courts and tribunals examined whether the taxpayer has a bank account in Australia, the value of the balance in the bank account was not in issue.[179]

(b) Implications for equity

The cases illustrate that expatriates maintain a bank account in Australia for a variety of reasons.

(i) Bank account as a relic of the past

In *Handsley* and *Harding*, the taxpayer's Australian bank account was seen to be a relic of the taxpayer's past life in Australia, and was maintained as a matter of convenience to meet ongoing familial commitments in Australia.

Handsley concerned an individual who separated from his wife and left Australia. His former home in Australia was sold as part of his divorce, and the proceeds were deposited in his bank account. His only Australian assets were his superannuation fund balances and bank accounts. Mr Handsley intended to leave Australia permanently to live predominantly in the Philippines with his new partner. AAT Deputy President F D O'Loughlin considered that the taxpayer's 'life was outside of Australia'.[180] Therefore, maintaining an Australian bank account was not considered to be an ongoing connection to Australia. AAT Deputy President F D O'Loughlin considered that Mr Handsley's Australian bank account was maintained as a matter of convenience, so that he could meet his ongoing commitments in Australia to pay for school fees and make family allowance payments.[181] Accordingly, Mr Handsley's investment and bank accounts were 'relics of the past and not indicators of [an] ongoing association with Australia'.[182]

A similar view was expressed by Derrington J in *Harding*.[183] His Honour's statements were subsequently approved by Davies and Steward JJ on appeal.[184] In *Harding*, the taxpayer transferred money into a joint bank account in Australia.[185] The money was used to maintain and support his family.[186] He also held a bank account in his own name.[187] Derrington J stated that ordinarily, financial ties to Australia would weigh in favour of the conclusion that the individual resides in Australia.[188] However, given the unusual circumstances of the case,

> the financial arrangements which remained in place, or which were put in place subsequent to his departure, are more properly regarded as the *remnants of his prior residency* and the fact that he retained ongoing responsibilities to Mrs Tracy Harding and her children for whom Mr

[179] Ibid.
[180] *Handsley* (n 60) [45].
[181] Ibid [44].
[182] Ibid [43].
[183] *Harding* (n 46).
[184] *Harding* (n 46).
[185] *Harding* (n 45) [82](a).
[186] Ibid.
[187] Ibid [82](c).
[188] Ibid [83].

Harding provided. They should not be seen as indicators of a continuing intention to maintain residency in Australia.[189]

Therefore, *Handsley* and *Harding* illustrates that a bank account in Australia does not necessarily mean that the individual has an ongoing connection to Australia. In cases where the taxpayer has a strained relationship and ongoing familial commitments in Australia, maintaining a bank account can be indicative of the taxpayer's past life in Australia, and should not be treated as a continuing association with Australia.

(ii) Better interest rates in Australia

The case of *Joubert* is an example of how expatriates may decide to hold an Australian bank account due to higher interest rates in Australia. *Joubert* concerned an Australian expatriate working in Singapore.[190] Despite working in Singapore, Mr Joubert maintained two joint bank accounts in Australia.[191] Mr Joubert's reason for having a bank account in Australia was due to the fact that the interest rates were higher in Australia than in Singapore.[192]

Hence, the cases demonstrate that expatriates maintain a bank account in Australia for a variety of reasons; maintaining a bank account does not necessarily mean that the individual has a connection to Australia.

(iii) Globalisation

Moreover, it was noted in *Handsley* and *Harding* that given the growing internationalisation of investment markets, where an individual maintains investments should be less relevant in the weighting process.[193]

Therefore, by taking into account the taxpayer's Australian bank account, it is possible that the Proposed Reforms may apply too broadly. This can lead to inequitable outcomes.

2 *The right to reside permanently in Australia*

As mentioned earlier, one of the factors under the factor test is whether the individual has a right to reside permanently in Australia for immigration purposes.[194] This factor is satisfied if the individual is an Australian citizen or an Australian permanent resident.[195]

Although this factor provides certainty to individuals, there is a risk that this factor will apply too broadly. This is because nationality has not been considered as a strong indicator of residency. In the context of the 'resides' test, Logan J in *Pike* stated that '[n]owhere does the definition in s 6(1) posit a nationality test'; although the acquisition of Australian citizenship

[189] *Harding* (n 46) [84]–[85] (emphasis added).
[190] *Joubert* (n 62) [13].
[191] Ibid [39].
[192] Ibid [39].
[193] *Handsley* (n 60) [43], *Harding* (n 46) [85] accepted in *Harding* (n 45) [63(d)].
[194] The Board of Taxation 2019 Report (n 3) 100.
[195] Ibid.

is relevant in determining whether the individual is a resident, it is far from being determinative.[196] Moreover, Logan J stated that '[i]t is trite that a person might hold Australian citizenship yet reside abroad and only abroad'.[197] Therefore, Logan J's statements indicate that although the nationality of an individual is a relevant factor, it should not be treated as a determinative factor.

Furthermore, it was noted by the American Chamber of Commerce in Australia that the right to reside permanently in Australia may be inappropriate given that it is now common for individuals to be a citizen or permanent resident of more than one country.[198]

Therefore, by adopting such a factor, there is a risk that the Proposed Reforms may lead to inequitable outcomes by expanding the scope of individuals who will be caught by the proposed rules. This is especially so for expatriates since from the 2016 to 2021 income year, all the cases concerning expatriates involved an Australian citizen.[199]

VI THE PROPOSED REFORMS ARE A STEP IN THE RIGHT DIRECTION

The current tax residency rules are outdated and require modernisation. Taxpayers are required to apply inherently complex tests to determine their residency status. The large number of cases and PBRs involving expatriates indicates that there is a problem with how the current individual residency rules operate with respect to expatriates. *Harding* does not adequately address the challenges faced by expatriates, and reform of the current individual residency rules is required.

The Proposed Reforms are based on a two-step model; a simple bright-line test as the primary test of residency, followed by more complex secondary tests if the primary test does not apply. A key focus of the Proposed Reforms is simplicity. The Proposed Reforms introduces a more targeted approach through the use of day-count tests, and four objective Australia-only factors. By removing the need to determine whether they have acquired Australia as a domicile of choice, as well as any weighting of factors, the Proposed Reforms makes it easier for expatriates to determine their residency status.

The simpler tests also result in more efficient outcomes since less resources are spent on tests that do not have to be argued. Since the Proposed Reforms do not involve weighting of the individual's circumstances, there is less subjectivity in the application of the proposed tests, which help to ensure that like cases are treated alike. However, by taking into account the taxpayer's Australian bank account, and taxpayer's right to reside permanently in Australia, there is a risk that the proposed factor test will apply too broadly. This is problematic for

[196] *Pike* (n 63) [65].
[197] Ibid.
[198] Letter from American Chamber of Commerce in Australia to Ms Karen Payne, The Board of Taxation, 26 October 2018 <https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2019/11/TRRI-AmCham.pdf>.
[199] *Joubert* (n 62), *Pike* (n 63), *Handsley* (n 60), *Harding* (n 46), *Landy* (n 63), *Hughes* (n 63), and *Shord* (n 63).

expatriates as they will be taxed on their worldwide income, and may be exposed to double taxation.

The Proposed Reforms result in a trade-off between simplicity and equity. Nevertheless, the Proposed Reforms will still meet the key policy objectives of equity, efficiency and simplicity to a large extent. The Proposed Reforms makes it easier for expatriates to determine their residency status and are a step in the right direction.