

A CRITICAL REVIEW OF THE PROPOSED LAW TO REMOVE THE MAIN RESIDENCE EXEMPTION FOR NON-RESIDENTS

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ABSTRACT

The Australian government is in the process of introducing new laws to remove the main residence exemption from income tax on the capital gain for non-resident home owners. This has been initiated on the basis that it will make housing more affordable for resident Australians. The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 has serious implications for Australians wanting to work and live in an overseas country and change their residency status from that of Australia. In some cases, Australian residents for taxation purposes need to live and work overseas for employment opportunities or career enhancement, or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's main residence will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Moreover, if a main residence is sold at a loss, the capital loss may not be disregarded by the former owner. Main residence owners faced with paying income tax on their real property may be deterred from working and living overseas. This paper critically reviews the consequences that flow from this proposed law and what it means for Australian residents for taxation purposes wanting to work or live in another country. The paper will also make recommendations on how the proposed law may be amended so that certain Australian residents who own their own main residence may avoid paying income tax on a capital gain that is exempt for every other person who maintains their Australian residency for taxation purposes.

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I INTRODUCTION

The Australian government has introduced new laws to remove the main residence exemption from income tax on the capital gain for non-resident real property owners. This has been initiated on the basis that it will make housing more affordable for Australian residents. The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 ('Treasury Bill 2018') has serious implications for Australian residents for tax purposes wanting to work and live in an overseas country and change their residency status from that of Australia.¹ In some cases, Australian residents for tax purposes need to live and work overseas for employment opportunities or career enhancement, or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's main residence will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Moreover, if a main residence is sold at a loss, the capital loss may not be disregarded by the former owner. Main residence owners faced with paying income tax on their real property may be deterred from working and living overseas. In the Second Reading speech, then Treasurer Scott Morrison stated the objective of the new law:

The government wants all Australians to be able to buy a home, where they can, and access housing that is affordable. Housing is fundamental to the wellbeing of all Australians and is a driver of social and economic participation, promoting better employment, education and health outcomes. This bill implements measures announced in the government's 2017-18 budget housing package to improve housing affordability, encourage investment in affordable rental housing and improve the integrity of the tax system. The measures in this bill support those already introduced by the Turnbull government as part of the Treasury Laws Amendment (Housing Tax Integrity) Bill 2017 and the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 1) Bill 2017. This bill is an important step to ensuring homeownership is more achievable for Australians.²

These new measures have implications for those Australian residents who are faced with the prospect of living or working overseas and changing their residency status from that of Australia. The date of effect of the Treasury Bill 2018 was 7:30pm legal time in the ACT on 9 May 2017. At the time of writing this paper, the Bill had not passed both Houses of Parliament, so the law will be applied retrospectively when it finally receives Royal assent. There was a transition period for non-residents who sold their main residence before 30 June 2019. The main residence exemption will apply during this period to an

¹ In this paper reference is made to Australian residents for tax purposes who may dispose of their main residence while living overseas as a non-resident of Australia. The use of the term 'Australian' in this context does not distinguish between Australian nationals, Australians with permanent residency or Australians for tax purposes that are living in Australia. They are all potentially affected by the proposed law to remove the main residence exemption.

² Australian Government, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 Second Reading*, House of Representatives, 8 February 2018, 710 (Scott Morrison, Treasurer)

<<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansardr%2F31776340-cbfd-4793-af0f-753ff0be0a7d%2F0013%22>>.

individual non-resident taxpayer whose main residence dwelling was subject to a capital gains tax ('CGT') event. They will not be subject to income tax on their capital gain but equally they will not be able to claim a capital loss if the main residence is disposed of at a loss. The submission made by CPA Australia to the Standing Committees on Economics, Economics Legislation Committee suggested that this may have an impact on the supply of housing as non-residents dispose of their dwelling before the end of the transition period.³ This proposed law does not affect a foreign investor who does not live in their taxable Australian real property, because any capital gain on the sale of their dwelling has never been exempt from income tax, and nor would they have received the 50 per cent discount on any capital gain, as that concession was abolished for foreign owners after 8 May 2012.⁴

The objective of this paper is to critically analyse the implications for Australians faced with the need to move to another country for work purposes or retirement. There are two subsidiary implications that flow from this proposed law: first, will these measures actually make housing in Australia more affordable, as the Australian government contends; and second, will this impact on how an Australian resident will be assessed as a 'resident' or 'non-resident' when this law takes effect. The Board of Taxation has published their own review of the residency rules, and has called on the public to provide submissions. If *Income Tax Assessment Act 1936 (Cth)* ('ITAA 36') s 23AG had not been repealed, then in certain circumstances the salary or wage being earned by an Australian resident would have been exempt from further income tax in Australia, and they may not have wanted to change their residency status from that of Australia.⁵ These implications will be examined in detail later in this paper.

The next section of this paper will examine what constitutes a 'main residence' for taxation purposes. Section III of this paper will provide an overview of the proposed changes to the CGT main residence exemption. Section IV will critically review the intended and unintended consequences that flow from this proposed law, and what they means for Australians wanting to live or work in another country. This will include a detailed examination of what it means to be considered a 'resident' or 'non-resident' of Australia for taxation purposes. Section V will briefly examine the issues facing Australia in terms of housing affordability and whether this new measure will make any difference to house prices and affordability. Section VI will make recommendations on how the proposed law may be amended so that certain Australian residents who own their own family home may either avoid or reduce the income tax on a capital gain that is exempt for every other Australian who maintains their Australian residency. Section VII will draw a conclusion as to the merits of amending the main residence CGT exemption.

³ CPA Australia, Submission No 10 to Senate Standing Committees on Economics, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018* (5 March 2018).

⁴ *Income Tax Assessment Act 1997 (Cth)* ss 115-105 and 115-115.

⁵ ITAA 36 s 23AG allows certain foreign service income to be exempt from income tax in Australia if the Australian resident earned the income for a continuous period in excess of 91 days. From 1 July 2009 the exemption was restricted to foreign employment only with a recognised non-government organisation or as an aid worker or specified government employee such as a police officer or defence worker engaged overseas.

II WHAT IS A 'MAIN RESIDENCE'?

The starting point for this paper is to determine what exactly is a 'main residence' for the purposes of the CGT provisions. If a property is not a main residence for taxation purposes, then any capital gain is subject to income tax with or without a discount applying. This depends upon the circumstances of the taxpayer.

Currently, the main residence is exempt from income tax on the capital gain for all Australian residents for tax purposes, irrespective of their immigration status. As a result, the main residence is the most tax-effective investment in Australia.⁶ In many instances, though not all, the main residence is the family home. In order to satisfy the main residence exemption, the dwelling must consist of residential accommodation contained in a building or a caravan, houseboat or mobile home.⁷ The main residence exemption applies not just to a family home or family apartment, but to other forms of residential accommodation. *Income Tax Assessment Act 1997* (Cth) ('ITAA 97') s 118-100 refers to a 'dwelling' that is your main residence. The definition of what constitutes a dwelling is contained in s 118-115:

- a) a unit of accommodation that:
 - (i) is a building or is contained in a building; and
 - (ii) consists wholly or mainly of residential accommodation; and
- b) a unit of accommodation that is a caravan, houseboat or other mobile home; and
- c) any land immediately under the unit of accommodation.

This means that the new law relating to the main residence exemption applies not only to real property but also to a wider group of dwellings.

The definition of a dwelling as a unit of accommodation has been extended to a shed containing a bed, mains water and a toilet.⁸ A legal or equitable interest in the dwelling is sufficient for it to be a main residence, and joint ownership of the dwelling is exempt if used as the main residence.⁹ The main residence exemption is only available to individuals and not companies or trustees.¹⁰

ITAA 97 s 118-110 states that a capital gain or capital loss you make from a CGT event that happens in relation to a CGT asset is disregarded if you are an individual and the dwelling was your main residence throughout your ownership period. This section makes it clear that it is a requirement to disregard any capital gain or capital loss. The taxpayer is not given a choice under this subsection. If a main residence is disposed of by

⁶ The capital gain on the sale of the main residence is not subject to income tax, whereas any other form of investment in equities or bank interest is subject to income tax.

⁷ ITAA 97 s 118-115.

⁸ *Summers and Federal Commissioner of Taxation* (2008) 71 ATR 279.

⁹ See ATO, *Income Tax : Capital Gains : Jointly Owned Property : Not the Principal Residence of All Joint Owners* (IT 2485, 14 July 1988).

¹⁰ ITAA 97 s 118-110(1)(a).

the individual owner at a loss, then that loss cannot be utilised to offset a capital gain. If the proposed law to change the main residence exemption was enacted by Parliament then the non-resident taxpayer would be able to utilise a capital loss from the sale of their main residence. In that situation, they would not have to disregard the gain or loss.

However, s 118-110 further states that this exemption may not apply in full if:

- it was your main residence during part only of your ownership period, or
- it was used for the purpose of producing assessable income.

If the main residence is rented for the purpose of producing assessable income during the period of ownership, then that portion of time during which it was rented will be subject to income tax on any capital gain. However, ITAA 97 s 118-145 states that a main residence will maintain its exemption from income tax if it is only used for income-producing purposes for a maximum of six years. These six years do not have to be consecutive. Section 118-145(2) states that you are entitled to another maximum period of six years each time the dwelling again becomes and ceases to be your main residence. If the main residence is not used to produce assessable income and the owner is not residing in the main residence, then it maintains its exemption during the period of absence. The six-year time limit only applies if the main residence is producing assessable income.

III THE PROPOSED AMENDMENT TO THE CGT PROVISIONS

The proposed amendments to the CGT provisions have implications for three groups of individuals that become non-residents of Australia while owning a 'main residence'. The first group are the existing non-residents or potential non-residents who own a main residence in Australia. If the main residence dwelling is not subject to a CGT event while the non-resident is living overseas, then no income tax implications arise. The disposition of the main residence is only subject to income tax if the owner is a non-resident at the time of sale. If the main residence is not sold and the non-resident returns to Australia and takes up Australian residency, then no liability to tax arises on the subsequent sale of the main residence.

The second group affected by the proposed law are those non-residents who own a main residence in Australia but pass away while a resident of an overseas country. They may have retired to their country of birth but maintained the family home in Australia. The home loses its main residence exemption and income tax is paid on the total capital gain at the non-residence rate of tax.

The third group are beneficiaries who are currently non-residents of Australia and have inherited a main residence in Australia. The main residence dwelling loses its main residence exemption when bequeathed to the non-resident beneficiary.

All of these circumstances are discussed in detail below. The Explanatory Memorandum to the Treasury Bill 2018 provides a number of examples as to how the proposed law will operate. These examples are discussed below.

A CGT event A1 — sale of the main residence

In the first example, the owner of the main residence is entitled to the exemption. James, a New Zealander, moves to Australia in July 2017 and obtains a special category visa. He

purchases a dwelling in Australia and establishes it as his main residence. He is a resident of Australia for taxation purposes while he resides here. James continues to reside in the dwelling for several years. He signs a contract to sell the dwelling, departing Australia several months later (to return to live in New Zealand).

James was an Australian resident for taxation purposes at the time CGT event A1 occurred to the dwelling — that is, when he signed the contract to sell it. As James was not a foreign resident at the time CGT event A1 occurred, he is entitled to the main residence exemption in respect of his ownership of the dwelling.¹¹

In the next example, the main residence exemption is denied. Vicki acquires a dwelling in Australia on 10 September 2010, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 1 July 2018 Vicki vacates the dwelling and moves to New York. Vicki rents the dwelling out while she tries to sell it. On 15 October 2019 Vicki finally signs a contract to sell the dwelling, with settlement occurring on 13 November 2019. Vicki is a foreign resident for taxation purposes on 15 October 2019.

The time of CGT event A1 — the sale of the dwelling — is the time the contract for sale was signed, that is 15 October 2019. As Vicki was a foreign resident at that time she is not entitled to the main residence exemption in respect of her ownership interest in the dwelling.

This outcome is not affected by:

- Vicki previously using the dwelling as her main residence
- the absence rule in ITAA 97 s 118-145 that could otherwise have applied to treat the dwelling as Vicki's main residence from 1 July 2018 to 15 October 2019 (assuming all of the requirements were satisfied).

If Vicki had signed the contract for sale prior to the end of the transition period (30 June 2019), then the exemption would have applied.¹²

In the next example, the owner of the main residence returns to Australia and then disposes of the family home. Amita acquires a dwelling in Australia on 20 February 2003, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 15 August 2020 Amita signs a contract to sell the dwelling and settlement occurs on 12 September 2020.

Amita uses the dwelling as follows during the period of time in which she owns it:

- resides in the dwelling from when she acquires it until 1 October 2007
- rents it out from 2 October 2007 until 5 March 2011 while she lives in a rented home in Paris as a foreign resident (assume the absence provision applies to treat the dwelling as her main residence)
- resides in the dwelling and uses it as a main residence from 6 March 2011 until 15 April 2012

¹¹ Explanatory Memorandum, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 (Cth) 17.

¹² Ibid 18.

- rents it out from 16 April 2012 until 10 June 2017 while she lives in a rented home in Hong Kong as a foreign resident (assume the absence provision applies to treat the dwelling as her main residence)
- resides in the dwelling from 11 June 2017 until it is sold.

The time of CGT event A1 is the time the contract for sale was signed, that is 15 August 2020. As Amita was an Australian resident for taxation purposes at that time (as she had re-established her Australian residency) she is entitled to the full main residence exemption for her ownership interest in the dwelling, as it is, or is taken to be, her main residence for the whole of the time that she owned it.¹³

B Main residence sold due to the death of the non-resident owner

If a deceased person was a foreign resident at the time of their death, then the portion of the main residence exemption accrued by the deceased in respect of the dwelling is not available to the beneficiary. The beneficiary continues to be entitled to the main residence exemption for any part of the exemption that they accrue in their own right (provided that they are not a foreign resident at the time the CGT event for the ownership interest in the dwelling occurs).

The main residence exemption does not apply if:

- the deceased person was a foreign resident at the time of their death
- the beneficiary that inherits the ownership interest in the dwelling was a foreign resident at the time the CGT event occurred. If the main residence exemption does not apply, the beneficiary must account for the whole of the capital gain or loss that accrues on the ownership interest in the dwelling.

The following example taken from the Explanatory Memorandum to the Treasury Bill 2018 illustrates how the above provisions will operate.

Edwina acquires a dwelling on 7 February 2011, moving into it and establishing it as her main residence as soon as it is first practicable to do so. Edwina uses the property as follows:

- resides in the dwelling until 25 September 2016
- rents the property out from 26 September 2016 at which time Edwina moves to Johannesburg.

Edwina passes away on 20 January 2018. At this time, she is a foreign resident for taxation purposes. Rebecca inherits the dwelling from Edwina. Rebecca moves into the dwelling and establishes it as her main residence on 21 January 2018. She continues to reside in it and use it as her main residence until she sells it. She signs the contract to sell the dwelling on 2 February 2020 (at which time she is a resident of Australia for taxation purposes) with settlement occurring on 2 March 2020.

The deceased estate main residence exemption provisions apply to Rebecca's sale of the dwelling as follows:

¹³ Ibid.

- the period that Edwina owned the dwelling (2,539 days) is treated as non-main residence days (as Edwina was a foreign resident at the time of her death)
- the period from when Rebecca moved into the property until she signed the contract for sale (the date of CGT event A1) of 742 days is treated as main residence days, as she used the property as her main residence for the whole of this time.

The capital gain or loss amount is the amount that the capital gain or loss would be if no main residence exemption applies. It is assumed, for the purposes of this example, that the capital gain amount for the dwelling is equal to AUD100,000.

Therefore, Rebecca's capital gain or capital loss from the dwelling is equal to:

$$\begin{aligned} &= \text{CG or CL amount} \times \frac{\text{Non-main residence days}}{\text{Days in ownership period}} \\ &= \text{AUD100,000} \times \frac{2,539}{3,281} \\ &= \text{AUD77,385} \end{aligned}$$

Rebecca then reduces the capital gain by any current income year and prior income year capital losses and any capital gains discount. She then adds to the resulting capital gain the amount of any other capital gains she has realised during the income year (if any). The result is her net capital gain, which she must include in her assessable income for the 2019–20 income year.¹⁴

C Main residence bequeathed to a non-resident

The following example taken from the Explanatory Memorandum to the Treasury Bill 2018 illustrates the implications for a non-resident beneficiary inheriting a main residence. In this example, a foreign resident beneficiary inherits a main residence from a deceased person who was an Australian resident at the time of their death.

Con acquires a dwelling on 7 February 2001, moving into it and establishing it as his main residence as soon as it is first practicable to do so. He continues to reside in the property and it is his main residence until his death on 9 August 2017.

Jacqui, Con's daughter, inherits the dwelling following Con's death. Upon inheriting the dwelling, Jacqui rents it out. It is not her main residence at any time. On 25 January 2021 Jacqui signs a contract to sell the dwelling and settlement occurs on 23 February 2021. Jacqui resides in Buenos Aires and is a foreign resident for the whole of the time she has an ownership interest in the dwelling.

Jacqui is entitled to a partial main residence exemption for the ownership interest that she has in the dwelling at the time she sells it, being the exemption that accrued while Con used the residence as his main residence (7 February 2001 until 9 August 2017). She is not entitled to any main residence exemption that she accrued in respect of the dwelling (9 August 2017 until 25 January 2021). This is because she was a foreign

¹⁴ Ibid 25.

resident on 25 January 2021, the day she signed the contract to sell her ownership interest (CGT event A1). Note that Jacqui will need to apply ITAA 97 s 118-200 to work out the amount of the capital gain or loss that she realises from the sale of the ownership interest in the dwelling.

If Jacqui had sold the dwelling on or before 9 August 2019, she would have been entitled to a full main residence exemption. This is because the whole of the main residence exemption would have, or would be taken to have, accrued from Con's use of the residence. This includes the two-year period following Con's death.¹⁵

D Effect of the transitional rules

The following example illustrates how the transitional rules apply to a disposition of a main residence. A main residence that was owned before 9 May 2017 is disposed of on or before 30 June 2019. Samantha acquires a dwelling on 13 April 2013, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 10 January 2019, Samantha signs a contract to sell the dwelling, and settlement occurs on 7 February 2019.

Samantha uses the dwelling as follows when she owns it:

- resides there until 15 September 2016
- rents the property out from 16 September 2016 until it is sold (assume the absence provision applies to treat the dwelling as her main residence during this later period).

From 16 September 2016, Samantha resides in rented accommodation in Bahrain, and is a foreign resident. CGT event A1 for the sale of the dwelling occurs when the contract for sale is signed, that is 10 January 2019. As Samantha held her ownership interest in the dwelling on or before 9 May 2017, she continued to own it until it was sold and as it was sold before 1 July 2019 she is entitled to the main residence exemption under the transitional rule.¹⁶

IV RESIDENCY AND THE IMPACT OF THE PROPOSED LAW

How the proposed amendments to the CGT provisions will affect Australians moving overseas for employment or retirement and becoming non-residents will only become clear after 30 June 2019, the end of the transition period. The full impact of the proposed law will apply when the main residence is sold outside of the transition period.

One of the major considerations of this proposed law is whether Australians living and working overseas should maintain their status as a resident for tax purposes, so that any future sale of their main residence will still be exempt from CGT. For example, an Australian living overseas for a number of years decides to sell their main residence but does not include any of the capital gain in their Australian assessable income. The Australian Taxation Office ('ATO') then issues an assessment, but the Australian claims

¹⁵ Ibid 22.

¹⁶ Ibid 30.

that they are still a resident for taxation purposes and that they had no intention of changing their residency status.

In practice the reverse usually happens. In most situations Australians working and living overseas in a low-tax country go to extraordinary lengths to prove that they are not a resident of Australia for tax purposes. For example, individual income tax rates in countries such as Singapore, Hong Kong and many Middle Eastern countries are considerably lower than those applied in Australia, and therefore the attraction of becoming a non-resident taxpayer is obvious.¹⁷ In that case, there is a distinct advantage in not being taxed in Australia as a resident, particularly if the period of employment is for several years. However, if that same taxpayer was deriving considerable income from investments in Australia, then by maintaining their Australian tax residency they would not be subject to the higher rates of personal income tax that apply to non-residents on their Australian sourced income. Similarly, they would not face the effect of CGT event I1 applying to their assets.¹⁸ For example, a resident is entitled to the tax-free threshold of AUD18,200, whereas a non-resident pays income tax at the rate of 32.5 per cent on each dollar of taxable income up to AUD87,000, where the tax rate increases to the next marginal rate of 37 per cent.

However, with the introduction of these proposed CGT amendments, taxpayers may be arguing the opposite case. Namely, that they have maintained their Australian residency for taxation purposes. In order to examine this issue, it is necessary to review the current law relating to what constitutes 'residence' in Australia.

The common law in relation to the issue of residency of an individual was relatively settled in Australia with very few decisions by the Full Bench of the Federal Court of Australia, the Federal Court of Australia and the Administrative Appeals Tribunal ('AAT') on the meaning of 'resides in Australia', 'domicile', 'permanent place of abode' and 'usual place of abode'. According to Michael Dirkis, this was due to the fact that employment income was generally exempt from further income tax pursuant to ITAA 36 s 23AG.¹⁹ This section now requires the Australian resident to be employed in foreign service for a continuous period of at least 91 days, provided the employment was as an aid worker, charitable worker or government employee (such as a peacekeeper with the Australian Defence Force). Prior to 1 July 2009, the employment was not restricted to the above categories, so all Australians were exempt on their employment income provided they paid income tax in the country where the income was earned.²⁰

¹⁷ In Singapore, the maximum personal rate of income tax is 17 per cent, whereas in the UAE the income tax rate is zero.

¹⁸ CGT event I1 applies to all assets that the individual owns, except any 'taxable Australian real property', at the date they become a non-resident. At that time, they can either pay any income tax on the unrealised capital gain or elect to pay Australian income tax on realised capital gains in the future.

¹⁹ Michael Dirkis, 'The Ghosts of Levene and Lysaght Still Haunting 90 Years On: Australia's "Great Age" of Residence Litigation?' (2018) 47 *Australian Tax Review* 41, 45.

²⁰ *Tax Laws Amendment (2009 Budget Measures No 1) Act 2009* (Cth).

Dirkis has examined over 30 new cases since 2010 relating to the application of the 'resides' and 'domicile' tests;²¹ the determination of 'permanent place of abode';²² the application of the 183 day test;²³ the application of the superannuation test;²⁴ the application of the treaty tie-breaker test;²⁵ and related matters with the onus of proof in the context of the former s 23AG,²⁶ and the impact that this litigation has had on the understanding of the concept of residency in Australia. These observations are incorporated into the following examination of residency in Australia.

An individual will be considered to be a resident of Australia for tax purposes if they satisfy any one of four statutory tests, described below.

A Statutory tests for residency

The Explanatory Memorandum to the Treasury Bill 2018 para 1.21 states that an individual is a foreign resident if they are not an Australian resident for taxation purposes,²⁷ as defined in ITAA 36 s 6(1). Individuals who are Australian residents for taxation purposes at the time a CGT event occurs to a dwelling are not affected by this measure. ITAA 36 s 6(1) states that 'resident' or 'resident of Australia' means:

- a) a person, other than a company, who resides in Australia and includes a person:
 - (i) whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia;
 - (ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his

²¹ *Re Mynott and Commissioner of Taxation* [2011] AATA 539; *Iyengar and Commissioner of Taxation* [2011] AATA 856; *Gunawan and Commissioner of Taxation* [2012] AATA 119; *Sneddon and Commissioner of Taxation* [2012] AATA 516; *Sully and Commissioner of Taxation* [2012] AATA 582; *Re Bezuidenhout and Commissioner of Taxation* [2012] AATA 799; *Ellwood and Commissioner of Taxation* [2012] AATA 869; *Re Pillay and Commissioner of Taxation* [2013] AATA 447; *ZKBN and Commissioner of Taxation* [2013] AATA 604; *Murray and Commissioner of Taxation* [2013] AATA 780; *Re Dempsey and Commissioner of Taxation* [2014] AATA 335; *Agius and Commissioner of Taxation* [2014] AATA 854 (appeal on source issue dismissed in *Agius v Commissioner of Taxation* [2015] FCA 707); *The Engineering Manager and Commissioner of Taxation* [2014] AATA 969; *Hughes and Commissioner of Taxation* [2015] AATA 1007; *Landy and Commissioner of Taxation* [2016] AATA 754.

²² *Re Boer and Commissioner of Taxation* [2012] AATA 574; *Mayhew and Commissioner of Taxation* [2013] AATA 130.

²³ *Re Clemens and Commissioner of Taxation* [2015] AATA 124; *Re Jaczenko and Commissioner of Taxation* [2015] AATA 125; *Re Koustrup and Commissioner of Taxation* [2015] AATA 126; *Groves and Commissioner of Taxation* [2011] AATA 609; *Guissouma and Commissioner of Taxation* [2013] AATA 875.

²⁴ *Baker and Commissioner of Taxation* [2012] AATA 168.

²⁵ *Re Tan and Commissioner of Taxation* [2016] AATA 1062.

²⁶ *Shord v Commissioner of Taxation* [2016] FCA 761 (s 23AG(7) & onus — Appeal lodged 29.7.16) (being an appeal from *Re Shord and Commissioner of Taxation* [2015] AATA 355 (resident test)); *Boyd and FCT* [2013] AATA 494 (s 23AG); *Horrocks v Commissioner of Taxation* [2010] AATA 307; *Mulherin v FCT* [2013] FCAFC 115 (dismissed appeal from *Murray and Commissioner of Taxation (No 3)* [2012] AATA 557) (on onus of proof); *Commissioner of Taxation v Seymour* [2015] FCA 320 (reversing order allowing video evidence in *The Overseas Applicants and Commissioner of Taxation* [2014] AATA 788); *Seymour and Commissioner of Taxation* [2016] AATA 397.

²⁷ Explanatory Memorandum to the Treasury Bill 2018.

usual place of abode is outside Australia and that he does not intend to take up residency in Australia; or

(iii) who is: ... (A) a member of the superannuation scheme established by deed under the Superannuation Act 1990; or (B) an eligible employee for the purposes of the Superannuation Act 1976; or the spouse, or a child under 16, of a person covered by sub-subparagraph (A) or (B).

1 *Meaning of 'resides'*

The residence test concerns the individual who resides or lives in Australia, whereby the 'ordinary' meaning of the term 'resides' is applied to the taxpayer. This test is also referred to as the 'ordinary concepts' test, whereby the common law is used to describe what is meant by the term 'reside'. The judgment of Viscount Cave LC in the UK case of *Levene v IRC* ('*Levene*') is the most quoted statement on the interpretation of 'residence':²⁸

[T]he word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live at a particular place'. ... In most cases there is no difficulty in determining where a man has his settled or usual place of abode, and if that is ascertained he is not the less resident there because from time to time he leaves it for the purpose of business or pleasure.

The facts in *Levene* help to illustrate what is meant by the term 'reside'. *Levene* had been a resident of the UK, but when he retired and sold his business he lived for five years in hotels in the UK and abroad. He returned to the UK each year for a period of four months to receive medical treatment and attend religious ceremonies. The House of Lords held that it was only when he obtained a lease of a flat in Monte Carlo some five years later that he ceased to be a resident of the UK for taxation purposes. He exhibited ongoing ties with the UK, and his stays abroad were seen as being of a temporary nature.

The ATO issued a ruling, TR 98/17, which is designed to cover the situation with individuals entering Australia.²⁹ The ruling only applies to:

- migrants
- academics teaching or studying in Australia
- students studying in Australia
- visitors on holiday
- workers with pre-arranged employment contracts.

The ruling examines the common law factors that are taken into consideration when determining whether or not an individual living in Australia is considered a resident for taxation purposes. A period of residence of six months or more may be a determinant, but also factors such as: the purpose of the visit; the location and maintenance of assets; family ties; and social and living arrangements. Foreign students are considered to be residents because virtually all courses last for more than six months. Many of the common

²⁸ [1928] AC 217.

²⁹ ATO, *Income Tax: Residency Status of Individuals Entering Australia* (TR 98/17, 25 November 1998).

law factors discussed below in relation to Australian residents ceasing to live in Australia and becoming non-residents apply to those individuals covered by TR 98/17.

A number of factors need to be taken into account when determining if an Australian taxpayer has changed their residency. The broad factors, outlined below, should be considered in that determination:

- (i) The physical presence in Australia and the frequency of visits to Australia by a taxpayer are of vital importance because if they continually return to Australia for family, business or personal reasons then they may not be exhibiting the type of conduct necessary to show that they reside in a foreign country. This was the situation in the case of *Re Shand and Federal Commissioner of Taxation* ('*Re Shand*'),³⁰ where the AAT affirmed an Objection decision to treat the taxpayer as a resident of Australia, even though during the disputed years he spent considerable time in Kuwait and Canada for business purposes. The taxpayer had a family home in Queensland, where his wife, children and grandchildren lived. The taxpayer: maintained his medical insurance; took out Australian citizenship; set up a self-managed superannuation fund; stated on his immigration form when departing and returning to Australia that he was a resident departing and arriving; paid his money from his overseas business into his Australian bank account; and gave his address in Australia as his address for all banking details. The maintenance of a home in Australia may be a strong indication that the taxpayer intends to remain an Australian resident.³¹ In terms of the proposed amendments to the CGT provisions relating to the main residence, the fact that the taxpayer has not sold the family home may work in their favour that they are still an Australian resident for taxation purposes.

A further example of the importance of 'physical presence' is found in the case of *Joachim v Federal Commissioner of Taxation* ('*Joachim*'),³² where the AAT held that once a person has established a home in a particular place their physical presence in that country during the income year is a relevant factor. However, it is not necessary that they are physically present for a particular part of the year. It is sufficient that they have an intention to return and to continue to treat that place as home. In the recent case of *Iyengar v Commissioner of Taxation* ('*Iyengar*'),³³ Senior Member Walsh considered 'physical presence' as the first item of a checklist to be considered in determining the residence of the taxpayer. In this case, Iyengar maintained a limited physical presence in Australia and in the Middle East, but he retained a continuity of association with Australia through his family home in Perth during the relevant income years, and intended to return to Australia on completion of his contract of employment. In his judgment, Senior Member Walsh noted that weight should be given to each factor in the checklist, and that it varies with the individual and no one factor is decisive. Other than physical presence,

³⁰ (2003) 52 ATR 1088.

³¹ This situation may be revisited in light of the decision of the Full Bench of the Federal Court in *Harding v Federal Commissioner of Taxation* [2019] FCAFC 29.

³² (2002) 50 ATR 1072.

³³ [2011] AATA 856.

those factors included: nationality; history of residence and movements; habits and 'mode of life'; frequency, regularity and duration of visits; purpose of visits to or absences from a country; family and business ties with a country; and maintenance of a 'place of abode'.

There is a danger in relying on a list of factors when determining the residency of a taxpayer. This was pointed out by Justice Logan, Presidential Member Hack and Senior Member Kenny in the case of *Re Dempsey and Commissioner of Taxation*:³⁴

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.

- (ii) Family or business ties in Australia may be such that the taxpayer is still regarded as being a resident even though they live and work in a foreign country. This is particularly so when a taxpayer leaves their spouse and children in Australia while they work overseas. In the case of *Joachim*,³⁵ the AAT held that, even though the taxpayer spent more than 80 per cent of his time on ships outside Australia, the fact that his family resided in Australia and he spent his leave with them meant that he was still a resident of Australia according to the ordinary concepts of residency. A similar finding can be found in the case of *Re Shand*,³⁶ where Deputy President Muller held that:

[T]he evidence shows that although Mr Shand spent a significant amount of time in Kuwait during the relevant tax years, he spent almost as much time in Australia. His personal effects and emotional ties were within Australia, whereas the only factor which tied him to Kuwait was his business.

- (iii) The quality of the accommodation in the foreign country will also be taken into account when determining the status of the taxpayer. For example, in the case of *Re Shand*,³⁷ the taxpayer lived in a furnished apartment and only took with him sufficient clothing for his brief stays. It was therefore very difficult for him to show that he resided outside Australia in a permanent home environment when his accommodation was not consistent with his situation in Australia. This situation is also reinforced by the AAT decision in the case of *Re Crockett and Federal Commissioner of Taxation ('Re Crockett')*,³⁸ where the taxpayer was unable to show that he had a sufficiently 'permanent place of abode' outside Australia in order to overcome the evidence that: his family home was in Australia; his family lived in Australia; and he took out Australian citizenship. In the case of *Iyengar*,³⁹ Senior Member Walsh held that Iyengar had not demonstrated that his 'permanent place of abode' was in fact Dubai, and later Doha, but that his 'family home' was in

³⁴ [2014] AATA 335.

³⁵ *Joachim* (n 32).

³⁶ *Re Shand* (n 30).

³⁷ *Ibid.*

³⁸ (1998) 41 ATR 1156.

³⁹ *Iyengar* (n 33).

Australia with his wife, and that he sent almost all of the income he earned back to Australia in order to pay the mortgage. He had only taken a few personal items with him overseas, such as clothing and other household items.

It can be seen from the above analysis of the concept of 'resides' that maintaining the main residence and close ties with Australia, and not having substantial accommodation in another country, may be sufficient evidence that the taxpayer maintains their Australian residency. Therefore, any subsequent sale of the main residence while the taxpayer is living overseas may not attract a CGT liability.

2 Australian domicile

The 'domicile' test refers to a person whose domicile is Australian, and as a result demonstrates strong ties with Australia, unless the Commissioner of Taxation is satisfied that their 'permanent place of abode' is outside Australia. The term 'domicile' is a legal concept defined under the *Domicile Act 1982* (Cth) and the common law. The term 'domicile' must be read with reference to a particular country, in that the laws of that country will apply to the particular person, together with legal rights and duties. There are three types of domicile: domicile of origin, domicile of choice and domicile of dependency. For example, a person born in a particular country acquires a domicile of origin and may at a later time acquire a new domicile, a domicile of choice, when they move to another country with the intention of permanently living there, as stated in the *Domicile Act 1982* (Cth) s 10.

For taxation purposes, a taxpayer who was born in Australia, or has moved to Australia with the intention of living there permanently, will have an Australian domicile and is regarded as being a resident for tax purposes. However, pursuant to the above definition, if the Commissioner is satisfied that their 'permanent place of abode' is outside Australia, they may not be regarded as being an Australian resident for taxation purposes. Franki J of the Full Bench of the Federal Court of Australia, in the case of *Federal Commissioner of Taxation v Applegate*,⁴⁰ provides the best statement of what is meant by 'permanent place of abode': '[T]he phrase "permanent place of abode outside Australia" is to be read as something less than a permanent place of abode in which the taxpayer intends to live for the rest of his life.'

In this case, the taxpayer was held to be a non-resident for tax purposes during their period of absence from Australia. The taxpayer had: a permanent job in another country; no home in Australia; no Australian source income; and established a permanent home in the other country. He returned after only being away for two years due to an illness. In the similar case of *Federal Commissioner of Taxation v Jenkins*,⁴¹ the taxpayer returned to Australia due to illness after only 18 months of living and working in the New Hebrides. He had not been able to sell the family home in Australia, but had leased it out. He originally had no fixed time to return to Australia when he commenced work for a bank in the New Hebrides.

The ATO issued a ruling, IT 2650, to provide guidelines for determining whether individuals who leave Australia temporarily to work or study in a foreign country cease

⁴⁰ (1979) 9 ATR 899.

⁴¹ (1982) 12 ATR 745.

to be Australian residents for taxation purposes.⁴² The Commissioner outlined the factors that are taken into account when determining residency each financial year:

It is clear from *Applegate* and *Jenkins* that a person's permanent place of abode cannot be ascertained by the application of any hard and fast rules. It is a question of fact to be determined in the light of all the circumstances of each case. Some of the factors which have been considered relevant by the Courts and Boards of Review/Administrative Appeals Tribunal and which are used by this Office in reaching a state of satisfaction as to a taxpayer's permanent place of abode include:

- (a) the intended and actual length of the taxpayer's stay in the overseas country;
- (b) whether the taxpayer intended to stay in the overseas country only temporarily and then to move on to another country or to return to Australia at some definite point in time;
- (c) whether the taxpayer has established a home (in the sense of dwelling place; a house or other shelter that is the fixed residence of a person, a family, or a household), outside Australia;
- (d) whether any residence or place of abode exists in Australia or has been abandoned because of the overseas absence;
- (e) the duration and continuity of the taxpayer's presence in the overseas country; and
- (f) the durability of association that the person has with a particular place in Australia, ie, maintaining bank accounts in Australia, informing government departments such as the Department of Social Security that he or she is leaving permanently and that family allowance payments should be stopped, place of education of the taxpayer's children, family ties and so on.

The Commissioner contends that his office would regard a stay of two years or more to be a substantial period, however, if the taxpayer had no fixed place of abode while absent from Australia for two or more years then they would still be regarded as having an Australian domicile. The Commissioner considers that the home that is established overseas should be relatively substantial and not such a thing as a mining town, barracks or oil rig. Similarly, maintaining bank accounts and having children attend schools in Australia may be factors that weigh against a finding that the taxpayer was a non-resident during the period of absence. It should be noted that tax rulings are binding on the Commissioner, but not on taxpayers.

In the recent AAT decision in *Re Mynott v Commissioner of Taxation* ('*Re Mynott*'),⁴³ the tribunal held that the taxpayer was not a resident of Australia for taxation purposes, even though he moved extensively around the world in order to obtain work as an electronics engineer. The decision by Senior Member Dunne was based on the fact that the taxpayer had sold his assets in Australia prior to leaving, except for a few personal items that were left with his parents in Adelaide. He maintained a bank account with a credit union in

⁴² ATO, *Income Tax: Residency — Permanent Place of Abode outside Australia* (IT 2650, 8 August 1991).

⁴³ [2011] AATA 539.

Adelaide. Even though he had no substantial home associated with his work, he maintained rented premises for his de facto partner and her children from a previous marriage in the Philippines. He did not stay for lengthy periods in the Philippines, but this was sufficient for him to establish a 'permanent place of abode'.

The recent case of *Harding v Commissioner of Taxation* ('*Harding* [2019]')⁴⁴ supports the above AAT decision in *Re Mynott*. The Full Bench of the Federal Court, per Logan, Davies and Steward JJ, held that during the 2010–11 financial year, Harding was a non-resident for taxation purposes. This was because 'place of abode' refers to a town or country and, in this case, it was Bahrain.⁴⁵ Davies and Steward JJ rejected the contention made by the Commissioner of Taxation as to the temporary nature of Harding's accommodation in Bahrain. They held that living in a serviced apartment and temporary rented accommodation for many years was relatively commonplace for Australians who seek to make their life in another country before they obtain a permanent home.⁴⁶ The judges confirmed the decision of the primary judge at first instance, Derrington J,⁴⁷ that even though Harding had maintained the family home and had significant financial ties with Australia, that was not sufficient to find that the taxpayer was a resident, because his intention all along was to leave Australia indefinitely.⁴⁸

These two cases do not appear to assist an Australian resident now living in another country to claim that they have maintained their residency status by living in temporary accommodation and maintaining significant financial ties with Australia, including maintaining the family home. In fact, the *Harding* [2019] decision would appear to contradict the ATO ruling IT 2650, as discussed above. It appears that the decision in *Harding* [2019] was strongly influenced by the intention of the Australian taxpayer to permanently leave Australia for career purposes, even though he maintained close personal and financial links to Australia. Perhaps an Australian wishing to maintain their Australian residency while living and working overseas should at all times intend to return to Australia within a set timeframe. This may counter the *Harding* [2019] decision and safeguard the main residence CGT exemption.

3 The 183 day test

The 183 day test refers to an individual who has actually been in Australia, continuously or intermittently, for more than half the year of income, unless the Commissioner is satisfied that their usual place of abode is outside Australia, and that they do not intend to take up residency in Australia.⁴⁹ This test has been applied to taxpayers living in Australia, rather than Australian residents living in a foreign country for more than half a year. The important thing to note with this test is that it is based on the year of income.

Migrants moving to Australia are regarded as satisfying this test if they live in Australia for more than 183 consecutive days and have no 'usual place of abode' in another country.

⁴⁴ *Harding* [2019] (n 31).

⁴⁵ *Ibid* para 26.

⁴⁶ *Ibid* para 55.

⁴⁷ *Harding v Commissioner of Taxation* [2018] FCA 837.

⁴⁸ *Harding* [2019] (n 31) para 64.

⁴⁹ ITAA 36 s 6(1)(a)(ii).

The first part of the test is regarded as being purely mathematical.⁵⁰ The second part of the test provides an exception for the taxpayer: if they have their 'usual place of abode' outside Australia and do not intend to take up residency, then they are not regarded as a resident for tax purposes.⁵¹ The reference to 'usual place of abode' rather than 'permanent place of abode' indicates that the government intended a less stringent test to apply to the taxpayer so that they could be considered a resident even if they were just working in Australia. The Commissioner issued a tax ruling, IT 2681, to cover business migrants.⁵²

This test is only relevant for the purposes of this paper if the Australian owner of a main residence living and working overseas is able to spend more than 183 days of each financial year in Australia. However, if they have an Australian domicile, then they would have to consider satisfying that test of residency.

4 *Commonwealth superannuation fund membership*

The Commonwealth superannuation test refers to Australian public servants who are attached to foreign embassies and foreign government offices (and on secondment to foreign government agencies) being residents of Australia by virtue of being members of a Commonwealth superannuation fund, which is compulsory for public servants employed by the Australian government. In many cases the public servant may be absent from Australia for many years, but retain their obligation to pay income tax as a resident of Australia for taxation purposes.

B Board of Taxation review of the residency rules for individuals

The Board of Taxation is currently reviewing the income tax residency rules for individuals.⁵³ The Board's core finding was that the current individual tax residency rules were no longer appropriate and required modernisation and simplification. The Board completed its *Review of the Income Tax Residency Rules for Individuals* in August 2017, and provided a copy to government. The government supported the view of the Board that further consultation was required, and in September 2018 the Board produced a consultation guide seeking responses to specific questions based on their earlier recommendations.⁵⁴ The Board of Taxation stated in its report that the government would receive a final report in November 2018.⁵⁵

It is important to briefly examine the recommendations of the Board of Taxation in order to assess their likely impact on the proposed changes to the main residence exemption. These proposed rules for determining the residency of an individual may be critical in

⁵⁰ K Sadiq et al, *Principles of Taxation Law* (Thomson Reuters, 2019) 100.

⁵¹ *Ibid.*

⁵² ATO, *Income Tax: Residency Status of Business Migrants* (IT 2681, 14 May 1992).

⁵³ Board of Taxation, Australian Government, *Review of the Income Tax Residency Rules for Individuals* (August 2017) <<http://taxboard.gov.au/consultation/self-initiated-review-of-the-income-tax-residency-rules-for-individuals>>.

⁵⁴ Board of Taxation, Australian Government, *Review of the Income Tax Residency Rules for Individuals: Consultation Guide* (September 2018) <<https://cdn.tspace.gov.au/uploads/sites/70/2018/09/BoT-Residency-Consultation-Guide-FINAL.pdf>>.

⁵⁵ *Ibid* 27.

imposing income tax on the capital gain derived from the sale of the main residence, if there is doubt as to the status of that individual when the family home was sold.

The following statement by the Board illustrates the approach being taken in determining residency:

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.⁵⁶

The Board is focusing on the time spent both in and out of Australia as a primary test that provides a 'bright-line' for most individuals. They believe that if the test is based on days it will take the complexity out of the current tests and provide certainty.⁵⁷ Having a 'bright-line' test is similar to the UK, but it has been adopted for an Australian context. The number of days has not been specified at this stage, but it will differ for those individuals coming into Australia and those individuals previously residents of Australia.⁵⁸

If an individual does not satisfy any of the 'bright-line' tests, the Board contends that the preferred approach would be to apply a secondary test, called the 'factor test'. The factors are set out and described in Table 1.

Table 1: The 'factor test'

Factor	Description
Time spent in Australia	<p>An individual must spend sufficient time in Australia, that is:</p> <ul style="list-style-type: none"> – a set number of X days or more if previously a resident – a larger set number of Y days or more if never an Australian resident. <p>Both must be fewer than 183 days for this factor to be useful (otherwise the individual would automatically be a resident). The number of days for an individual previously a resident should also be lower than a non-resident, in line with the adhesive principle.</p>
Immigration status	An individual must be an Australian citizen or permanent resident.
Family	An individual's family (or relevant social grouping) must be largely located in Australia.
Australian accommodation	An individual must have readily accessible Australian accommodation (owned or rented) that they actually use throughout the income year.

⁵⁶ Ibid 8.

⁵⁷ Ibid 9.

⁵⁸ Ibid 11.

Economic ties	An individual must have substantial Australian economic ties (such as employment or business interests).
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The Board suggests that these factors reflect the key issues covered in the case law and ATO determinations.

For an Australian resident moving to another country to work and live, this may make it easier to maintain their Australian residency status and not affect their main residence if it was subsequently sold while they were living and working overseas. The Board seems determined to stop Australians reducing their income tax by moving to low-tax jurisdictions and tax havens by tightening the residency rules. However, their approach may be greatly advantageous for an Australian working and living overseas for a number of years but not wanting to put at risk their main residence exemption. The approach being considered by the Board is set out below:

A rule could be adopted to impose tax on income and gains that arise during short term absences from Australia. In essence, this rule targets schemes that rely on brief periods of non-residency where the individual never intends to actually cut ties with Australia. ... [E]mployment income would be excluded from such a tax.⁵⁹

If the government eventually adopted this approach to Australians changing their residency in order to take advantage of low-tax jurisdictions, then it may present an opportunity for taxpayers with a main residence to continue maintaining their Australian residency without a great deal of difficulty. They would need to plan extended holidays in Australia and maintain a connection with Australia. The main residence is a good example of their connection with Australia.

V HOW DOES THIS PROPOSED LAW MAKE HOUSING MORE AFFORDABLE?

A number of public submissions on the proposed law to remove the main residence exemption from CGT were received by the Economics Legislation Committee in 2018.⁶⁰ The report from the Committee notes that the submissions that they received in relation to housing affordability did not express any assurance in these CGT measures having any effect on housing affordability. In fact, the submissions expressed the opposite.⁶¹ A non-resident Australian owning a main residence would now be less inclined to sell their family home until they returned to Australia as a resident, otherwise they would be paying a substantial amount of income tax on the capital gain.⁶² The submission made by CPA Australia to the Committee suggested that this proposed law may have an impact on

⁵⁹ Ibid 19.

⁶⁰ Submissions to Senate Standing Committees on Economics, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018* (5 March 2018) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/HousingandforeignCGT/Submissions>.

⁶¹ Economics Legislation Committee, Australian Government, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 [Provisions]/Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018 [Provisions]* (Senate Report, March 2018) 12.

⁶² Ibid 13.

the supply of housing, as non-residents disposed of their dwellings before the end of the transition period (30 June 2019).⁶³ If an Australian non-resident does not sell their main residence when they are living and working in another country, then this will have a neutral impact on the supply of housing and housing affordability. But, if the property has not been sold and therefore is not available for purchase, it may be rented while the owners are living overseas, and this may help the supply of property for rental purposes, but again this does not necessarily make housing more affordable. In this respect, any assessment would have to have waited until after 30 June 2019 and indeed longer.

Housing affordability is a complex issue and it is not intended in this paper to undertake a substantial discussion of the current situation in Australia. However, given that the basis for introducing this new law is to make housing more affordable, it is necessary to briefly examine the factors involved and to assess the government's assertions. Otherwise, why not simply present these amendments to the CGT main residence exemption as a tax reform measure, which may herald other reforms to the CGT provisions. It would appear that housing affordability is related to the cost of housing, and currently, in some parts of Australia, the price of housing is falling.

The latest CoreLogic *Housing Affordability Report for Australia* makes the following observation on the current situation:⁶⁴

Although housing affordability has recently started to improve, due to falling prices while incomes inch higher and mortgage rates remain low, the longer run view has seen housing affordability across the nation deteriorate. While this trend is clearly evident cumulatively across most regions of Australia over the past two decades, the past ten years has seen worsening housing affordability being fuelled primarily by strong growth in property prices across Sydney, Melbourne, Regional NSW and more recently Hobart. While Sydney and Melbourne are the two largest cities and have a strong influence over the national trends, outside of these markets property price growth has been limited and in many instances housing affordability has been improving as incomes rise and mortgage rates have reduced.⁶⁵

Housing affordability relates to the cost of housing in terms of purchase price, mortgage payments or rent as a proportion of the income being derived by Australian individuals. The Reserve Bank of Australia ('RBA') made a submission to the Standing Committees on Economics, *Inquiry into Home Ownership*, in June 2015, and that report provides an insight into the complex issues that relate to housing affordability:⁶⁶

While it is undeniable that more younger households would be able to purchase a home if housing prices were significantly lower relative to their incomes, there are no examples internationally of large falls in nominal housing prices that have occurred other than through significant reduction in capacity to pay (eg recession and high

⁶³ CPA Australia (n 3).

⁶⁴ CoreLogic, *Housing Affordability Report for Australia* (June Quarter, September 2018) <<http://reports.corelogic.com.au/CL-HOUSING-AFFORDABILITY/CL-HOUSING-AFFORDABILITY-5261534F.pdf>>.

⁶⁵ Ibid 4.

⁶⁶ RBA, Submission No 21 to House of Representatives Standing Committee on Economics, *Inquiry into Home Ownership* (June 2015) 25 <<https://www.rba.gov.au/publications/submissions/housing-and-housing-finance/inquiry-into-home-ownership/pdf/inquiry-into-home-ownership.pdf>>.

unemployment). There is no mechanism to get a large and sustained level shift down in prices while a substantial fraction of the population can — safely and sustainably — service the obligations involved in paying the higher price. Additional housing supply ought to dampen housing prices, and more probably will reduce the growth rate of housing prices that occurs in response to increases in demand for housing. There is, therefore, an argument for government policy to avoid creating unnecessary barriers to supply. However, there is no example in Australia or internationally where supply expansion on its own generated housing price declines of a similar order of magnitude to the increases in prices seen in some Australian cities in recent years; some academic work on this issue suggests that removing supply constraints in a single population centre might not reduce prices significantly.

It is very difficult to see how this new law will make any substantial difference to housing affordability in Australia. It is apparent from the above authorities on housing that purchase price is a major issue for affordability. Some main residences in Australia may have been sold prior to the expiry of the transition period and some main residences may be sold earlier than expected if the owners decide to live and work overseas for a substantial period. But, it may be that governments may want to consider imposing income tax on capital gains made from the sale of all real property in Australia, including the main residence. This could be the first step in such a programme.

VI OPTIONS AND RECOMMENDATIONS

CPA Australia's submission to the Economics Legislation Committee on the views of their members to the proposed amendments to the main residence exemption formulated the following improvement options to be considered by the Committee:⁶⁷

- persons who retain their Australian citizenship or permanent residency should be excluded from the provisions of the Bill — regardless of their tax residency
- the proposed regime should only apply to property acquired from 9 May 2017
- the cost base of the property should be reset to its market value on the day the taxpayer becomes a non-resident, so that the capital gain is calculated on the increase in value since the taxpayer ceased to be a resident
- there should be a partial exemption for the number of days the taxpayer was a resident and lived in the dwelling as their main residence.⁶⁸

The proposed law effectively takes into account any capital gain that has accrued to a non-resident from 20 September 1985, the date that the CGT requirements commenced in Australia. The CPA Australia submission stated that many Australian taxpayers may not have sufficient records or other details to be used in the cost base calculation when the home is sold, given that it is the main residence and not, as far as they are concerned, subject to income tax on the capital gain.

If this proposed law comes into effect, then the following recommendations should be considered for an Australian resident for tax purposes faced with the prospect of living and working overseas for an extended period of time:

⁶⁷ CPA Australia (n 3).

⁶⁸ Ibid.

- They could continue to maintain their Australian residency by lodging a tax return each year and paying income tax in both the foreign country and Australia. They may be entitled to claim a tax credit for income tax paid in the foreign country. They would continue to pay the Medicare levy, but at the same time avail themselves of the tax-free threshold as a resident. By doing this, the main residence exemption may be maintained. The fact that they still maintain a main residence in Australia is strong evidence of their continued ties to Australia in support of this contention. However, residency is a question of fact and not a choice that a taxpayer can exercise to suit their own purposes.
- They could sell the family home to a family member, or at arm's length to the public, before the end of the transition period, and pay no income tax on the capital gain.
- They could become a resident of another country for taxation purposes but not sell the family home until they return to live in Australia, and pay a lesser amount of income tax on the capital gain accrued while living overseas.
- They could not accept the employment opportunity being offered overseas or not consider retirement in an overseas country. In other words, stay in Australia and claim the main residence exemption.
- They could sell the main residence before contemplating living in another country in retirement or leaving the family home to a non-resident beneficiary.

One major concern about the proposed CGT amendment is that there will be Australian citizens living in other countries that still have a main residence in Australia that is rented, and these citizens will have no knowledge of the changes to the main residence exemption. They may be living in their country of birth, having retired from employment in Australia, and they may decide to sell the former family home, or they may pass away, leaving the main residence to a relative still living in Australia. How are these citizens of Australia, but non-residents for taxation purposes, going to be informed about these CGT amendments? They may no longer have a professional relationship with their accountant or lawyer in Australia. This situation must be given careful consideration, and the Australian government or the ATO should try to inform as many former residents of Australia about the proposed CGT amendments as they feasibly can.

VII CONCLUSION

In some cases, Australians need to live and work overseas for employment opportunities or for their career enhancement or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's family home, the main residence, will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Home owners faced with paying income tax on the family home may be deterred from working and living overseas, especially if they are unsure about their future living arrangements.

This paper has reviewed the consequences that flow from this proposed law and what this means for Australians wanting to work and live in another country. Moreover, there are serious consequences for Australian non-residents currently living in retirement overseas who may have retained their main residence in Australia and are totally unaware of the proposed changes to the CGT provisions. Furthermore, all lawyers and accountants must become aware of these proposed amendments if involved in estate

planning, due to the consequences of leaving a main residence to a non-resident beneficiary.

This paper has also made recommendations on how the proposed law may be amended so that certain Australian residents who own their own family home may reduce or even legally avoid paying income tax on a capital gain that is exempt for every other Australian who maintains their Australian residency.

A further concern of this proposed amendment to the CGT provisions relating to the main residence is that it could be the precursor to other CGT amendments affecting the family home. While some Australian taxpayers may be of the view that the main residence exemption should be repealed, the fact that home ownership in Australia is on the decline is one good reason for maintaining the taxation benefit. If the home ownership rate continues to decline, then older Australians facing retirement may need greater financial support from the government in the form of an increased age pension. Perhaps the answer is to leave the main residence exemption alone.

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