

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

Response to selected questions in the consultation guide

Robert Breunig, Director, Tax and Transfer Policy Institute (TTPI)

Kristen Sobek, Senior Research Officer, TTPI

Question 3. To what extent does a bright-line test provide balance between certainty, simplicity and integrity? Are other measures needed to provide integrity – for example, those discussed under design principle 5?

Objective criteria, like the number of days in a country, are clear, but very easily avoided; they potentially sacrifice fairness for simplicity. At the same time, while “easy” to avoid, thresholds (typically 183 days) that exceed half a year seem to suggest ties with a specific country. Another interpretation is that an individual’s presence in a country for more than half a year represents a significant enough period for which they should help contribute to the cost of their use of a country’s infrastructure, goods and services, schools, clean environment, sound institutions, etc.

Secondary criteria, on the other hand, can cater to specific circumstances, but at the cost of more complexity. Moreover, some of the secondary criteria, like those currently in the resides test, are subject to the interpretation of an individual, a tax adviser or a judge. This interpretation not only results in a costly process, but also in potentially different outcomes for individuals with similar circumstances.

Overly complex and overly simplistic systems can compromise the horizontal equity of the tax system. For this reason, the application of objective and secondary (potentially more subjective criteria) are necessary to ensure both simplicity and fairness.

The bright-line test proposed by the Board of Taxation seems to provide a balance between certainty, simplicity, and integrity, if it will be complemented by additional secondary criteria for more complex cases, as has been proposed (“...where an individual does not satisfy any of the bright-line tests...” p.13).

Question 6. What consequences (if any) will arise for the temporary residency and working holiday maker rules if these changes were adopted? How should these issues be addressed?

This response closely links to our response to question 12 below.

There is a need to consider aligning the definitions of tax residency with visa status and the transfer system. Explicitly aligning visa class with tax residency status, and ideally with eligibility for government transfers, would ensure equity within the tax system. Households with similar incomes and assets would not only pay the same amount of taxes, but also have the right to the same benefits. The current system is quite complex and the design and implementation of such an undertaking would require careful consideration. Implementation should also be done in a way that increases the transparency of the system for employers and workers regarding their tax status and subsequent obligations.

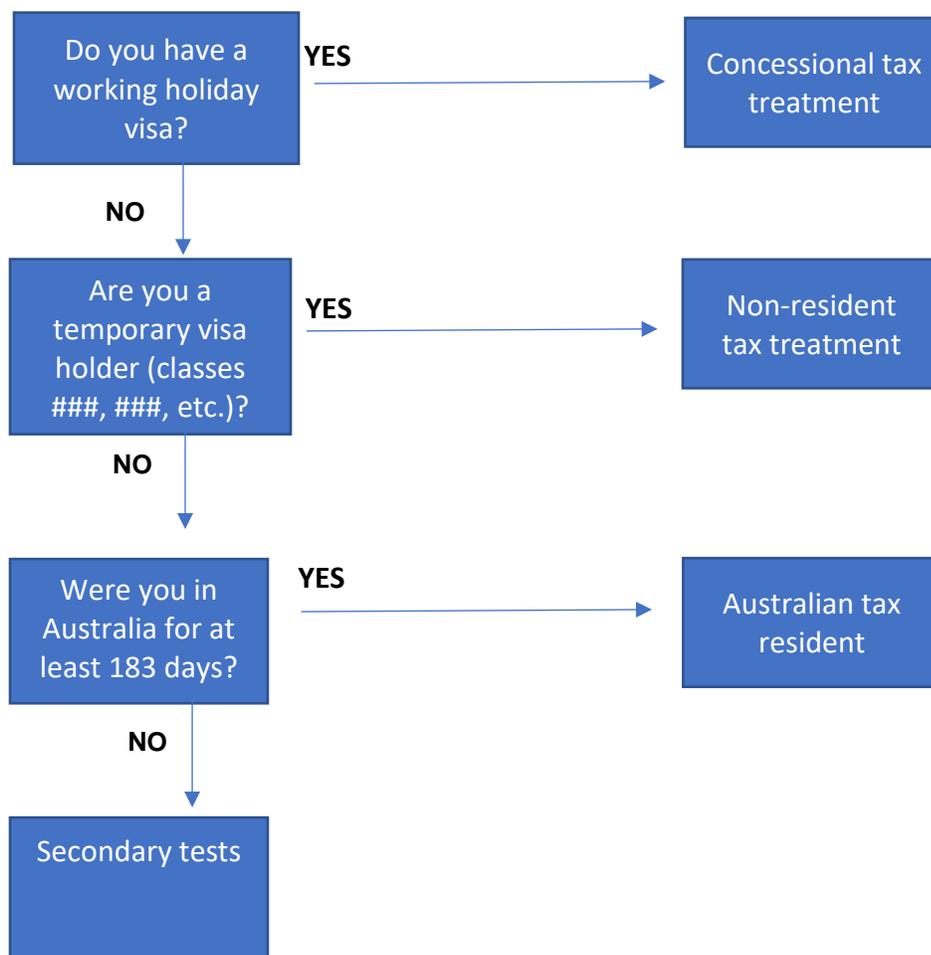
In practice, certain visa classes already differentiate between taxpayers’ entitlements to public services and their tax residency. For example, some temporary visa classes bestow working privileges, but preclude

access to government transfer payments and Medicare (in exchange for other tax concessions). These individuals are considered non-residents for tax purposes even though they are physical residents who would pass the bright-line test. By contrast, other benefits, like access to Medicare, seem to be tied to citizenship or permanent residency, rather than tax residency. In other cases yet again, receipt of a transfer payment, like the age pension, does not depend on tax residency in the current year, but Australian residency for a number of specified years in the past.

These examples highlight some of the challenges with linking receipt (or lack thereof) of transfer payments with tax residency since not all transfer payments are conditional on tax residency. For this reason, transfer payments which depend on tax residency should be identified as part of the design and implementation process.

Since this strategy is potentially more long-term, a shorter term solution would be to define the tax residency status of a selected number of specific visas, like the working holiday visa and/or certain temporary visa classes, while requiring the remaining individuals to self-identify using the bright-line and secondary tests (see diagram below).

Figure 1. Potential tax residency determination flow chart



Question 12. Are there any key matters that should be adopted in preference to, or addition to, the listed factors?

An individual's "level of connection" to Australia, for the purposes of defining their tax residency in Australia, should, in principle, also include the extent to which they benefit directly from the services provided through tax revenue. Benefits of tax residency extend to access to tax offsets, tax-free thresholds, tax expenditures/exemptions like the capital gains tax exemption for the primary residency in Australia. They also include access to social services like health care, education, benefits from the transfer system, domestic rates (like domestic, as opposed to international, university tuition fees), etc.

For this reason, another subjective criterion to determine tax residency should, in principle, include (e) "whether a taxpayer informs government departments such as the Department of Social Security of leaving permanently and stopping social security payments (ie, family allowance payments)".

However, as cautioned in the response to question six, the interrelationships between the eligibility for transfer payments, physical residency (i.e. passing the bright-line test), tax residency, and the immigration system are quite complex and convoluted. For this reason, while determination of tax residency should aim to include an individual's access (and/or that of their dependent family members) to the benefits of services provided through the tax system, careful consideration would be required for the purposes of implementation since not all transfer payments are conditional on tax residency.

An individual's "level of investment in Australia (both passive and active)" might also be considered as part of the secondary test criteria for similar reasons as the transfer system. High levels of investment in Australia benefit from its institutions, infrastructure and skilled labour force (all made possible to maintain through tax revenue). This could also be particularly relevant for cases where an individual does not declare another tax residence.

Question 19. An individual working overseas may automatically be a non-resident, but under the secondary test would likely have otherwise been a resident. Does this interaction provide appropriate results?

Potentially, depending upon the evaluation of the criteria used in the secondary test. For example, citizenship or permanent residency in isolation is insufficient to qualify a person as a tax resident. However, if that person has a dependent child and partner who reside in Australia (and benefit from the services provided through tax revenue), then they could potentially be considered a tax resident.

In general, however, TTPI suggests that a more quantitative analysis be undertaken in order to understand the potential tax revenue implications of changing the tax residency rules. The Board of Taxation's report refers to the increase in litigation relating to the residency rules since 2009, as well as in the number of private ATO rulings, as some of the evidence in favour of the need to reevaluate the existing tax residency rules. It does not however, seem that there has been an attempt to quantify or analyse the number of individuals or the profiles of taxpayers which have questioned the residence rules (i.e. is it just the wealthiest of the wealthiest or is there a particular employment profile or investment profile which tends to have the most trouble assessing their tax status). This type of analysis would help to inform the formulation and modernization of the current subjective residence rules and attempt to measure the magnitude of the problem. In the future, it would also be beneficial to estimate the number of potential taxpayers affected by any policy changes considered in order to assess the potential revenue impact of such changes.