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22 September 2023

Assistant Secretary, Personal and Small Business Tax Branch
Personal and Indirect Tax and Charities Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: individualtaxresidency@treasury.gov.au

Dear Sir/Madam,

CONSULTATION PAPER – MODERNISING INDIVIDUAL TAX RESIDENCY

BDO refers to the invitation by The Treasury to provide comments and feedback in response to the consultation paper in relation to "Modernising individual tax residency" (**Consultation Paper**). BDO is pleased to provide feedback and comments in response to select questions from the Consultation Paper. It is appropriate that the Government has responded to the Board of Tax's 2019 report and has proposed to make changes to the individual residency regime in Australia given the complexity in applying the current tax residency rules.

Please see the BDO comments in the attached Appendix

Should you have any questions, or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

Lance Cunningham
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BDO National Tax Technical Leader

Appendix

BDO Submission to the Treasury
Consultation Paper - Modernising individual tax residency

BDO has considered the government's consultation paper on *Modernising individual tax residency* (**Consultation Paper**). The Consultation Paper aims to seek feedback to assist in the potential development of robust principles that will underpin an enduring framework for individual tax residency. Below is BDO's feedback and comments to selected questions from the Consultation Paper.

45 Day Test

1. **How many days in an income year should an individual with strong connections to Australia be able to spend in Australia before they are considered a tax resident?**

An individual's physical presence in Australia is generally a reasonable indicator of their connection to Australia. BDO notes the government's justification of implementing a 45-day threshold including:

- the period being longer than the standard annual leave period of four weeks;
- this period being significantly longer than the typical period for tourism (11 days) and short-term visits (less than 2 months); and
- the period being comparable to those included in tax residency rules for New Zealand and the United Kingdom.

With the above in mind, BDO proposes that Government may wish to consider increasing the proposed 45-day period to 90 days. Our reasoning for this increase is set out below.

- Whilst the standard annual leave accrual for full-time employees in Australia is four weeks, individuals living overseas may intend to visit Australia for longer periods given the physical distance from many of the major economies. In these instances, such individuals could only be present in Australia for a further 17 days in addition to the standard 28-day period.
- In the event that arrival and departure dates are included in the days present in Australia, individuals arriving and departing Australia on multiple occasions in a year may be disadvantaged, particularly where their presence is minimal on a given day. For example, travellers arriving in the late evening or departing in the early morning.
- The ease at which an individual may be deemed to be commencing residency, subject to the application of the Factor Test, particularly where the individual has no intention to take up residency in Australia.
- Where individuals flying in and out of Australia for business purposes may be subject to the commencing residency rules, this may prove unattractive to businesses overseas in sending skilled workers to Australia for special projects or short-term employment. As an example, mergers and acquisitions, change management, global expansions, and specific short-term projects. Example – individual, particularly ex-Aussie resident who may be ideally skilled to return to Australia for short term project but reluctant due to fears of being deemed a resident due to satisfaction of 45 day requirement along with 2 factors (right to reside, legacy Australian economic interests)

Increasing the 45 day period to 90 days will provide an incentive for business travellers and holiday makers to stay in Australia for longer without fear of compromising their tax residency status. Longer stays may result in an increased economic contribution to the Australian economy, particularly tourism expenditure.

2. **Do you consider that days spent in Australia under certain circumstances should be disregarded for the purposes of the 45-day count? If so, why should days be excluded in some circumstances and not others. Who would decide?**

BDO suggests that the removal of days spent in Australia for specific purposes in determining an individual's tax residency may not align with the objective of simplicity per the consultation paper. The simpler approach would be an increase in the threshold (say 90 days) with no requirement to carve out days present satisfying certain criteria.

In the event that the Government were not to increase the 45-day threshold, BDO urges the Government to consider an exclusion in calculating days present in Australia for the date of arrival in Australia and the date of departure from Australia. This is particularly relevant for individuals visiting Australia for business purposes on a regular basis with no intention of residing in Australia. This should provide some relief to individuals being inappropriately considered to be tax residents (subject to the other elements of Secondary Tests) where their presence in Australia is regular but transient during an income year.

Exclusion of the date of arrival and departure achieves the Government's objectives of improving certainty and simplicity with an objective exclusion which can be evidenced through travel documents and/or immigration records.

By way of example, a business traveller visits Australia on a monthly basis. Each trip covers a period of five days including the date of arrival and departure. The traveller flies into Australia late at night and departs early in the morning to maximise working hours while in Australia. Without any adjustment, the traveller's total days spent in Australia is 60 days for that income year. In this example, the individual spends 3 full days in Australia per month, being 36 days per year and 2 days in transit per month, being 24 days per year. Where travel days are excluded, the individual does not breach the 45-days threshold. In this situation the individual is clearly not intending to reside in Australia and assumedly has very little connection to Australia, other than for business reasons. Where transit days are included in the calculation of the 45-day threshold, it appears likely that individuals may be required to consider the Factor Test, notwithstanding a minimal presence in Australia during the income year.

BDO holds some concerns in applying the Factor Test in situations such as this. These are detailed in our response to question 3 below. Relevant to this example, the individual above may be a tax resident in situations where residential accommodation has been made available to the individual (whether for employees generally or specifically to them) and holds cash deposits in Australia for convenience purposes. This individual's connection with Australia is transient at best and classification as an Australian tax resident appears unreasonable.

3. **Could any of the four factors be defined differently to better achieve the design goals whilst remaining objective and identifiable?**

Right to permanently reside in Australia

The Government's approach in considering individuals with a permanent right to reside in Australia, including Australian citizenship or permanent residency appears broadly sound.

BDO suggests that the Government may like to consider an exclusion from this criteria for Australian citizens by birth. BDO appreciates that citizenship is generally a sound indicator of a connection to Australia but do note that there may be some scenarios where Australian citizenship may result in the Factor Test being satisfied in circumstances where Australian tax residency status may be inappropriate.

As an example, an individual is born in Australia and permanently relocates overseas with their spouse. The individual is employed by a business with a business in Australia who regularly travels to Australia for business and tourism purposes, including to visit family and friends and spends 50 days in Australia during the income year. As an Australian citizen by way of being born in Australia, an individual in this scenario need only satisfy one further factor to satisfy the Factor Test. The Factor test may be satisfied in this situation if the individual held legacy investments or cash reserves in Australia following their departure, even if these are not substantial in the scheme of the individual's total wealth. This places citizens of Australia at a disadvantage compared to non-citizens where both have significantly identical other attributes in relation to the proposed residency tests.

Australian family

BDO acknowledges the Government's intention to limit the application of this factor to an individual's spouse and children under the age of 18 (i.e. the individual's direct household). Confining the definition of Australian family to an individual's direct family or household seems appropriate given that these are indicators of permanence and connection with Australia. This is a welcome departure from the subjective considerations in the existing residency tests particularly those in relation to social and living arrangements.

Australian accommodation

The availability of accommodation to an individual in Australia generally indicates a connection to Australia. BDO broadly agrees with this factor in principle but notes that there are some areas where more concrete definitions are required. Further detail is required in relation to the types of accommodation to which this factor might relate. BDO's comments in relation to the qualifications and appropriate criteria are set out below.

a) The accommodation must be residential in nature

Residential accommodation covers a broad range of accommodation options. A clear definition of what is meant by "accommodation must be residential in nature" and examples of residential accommodation will be required if the Government's objectives of simplicity and clarity are to be achieved. The term ''accommodation that is residential in nature" could be interpreted as including accommodation in a hotel or motel etc. It is assumed that such accommodation is not to be included in this factor. However, we note that the *Goods and Services Tax Act 1999* (**GST Act 1999**) contains a definition in relation to

'commercial residential premises', which is defined it includes hotels, motels etc. Consideration needs to be given to how to appropriately define "accommodation that is residential in nature" to appropriately exclude accommodation that is, of its nature, short term accommodation such as in a hotel or motel.

b) It would include a licence to occupy residential accommodation

We request that the Government also clarify what type of accommodation is considered to be included as 'residential accommodation' within the phrase "a licence to occupy residential accommodation" and provide examples.

c) It would include property owned by an individual who moved overseas and retained access to the property, regardless of having an intention to sell or rent it

d) It would exclude property owned but rented out for the entire income year (refer to Australian economic interests below)

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e) It would exclude a mere expectation of living with a parent or other relative when visiting Australia for short periods. However, an individual could still meet the factor notwithstanding the absence of a legal right to accommodation, if the nature of their arrangement was such that accommodation was available to them.

BDO submits that the Government may wish to provide more detail in defining a relevant "other relative". In addition, we would request clarification and examples of the type and nature of an individual's arrangement was such that accommodation was available to them.

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Australian economic interests

a) Employment in Australia – they commonly (not infrequently) carried out their employment duties in Australia, regardless of whether their employer was an Australian resident or foreign resident.

BDO acknowledges that an individual with their economic centre in Australia by virtue of their employment being in Australia is indicative of a significant connection with Australia.

Definitions in respect of this element will be important, particularly given the increasing popularity of remote working arrangements, and particularly those that cross borders. Accordingly, we request that the Government clarify what is mean by the phrase "*commonly (not infrequently) carried out their employment* and *in Australia*". We would also request the Government clarify how these proposed rules correspond to the current rules for individuals who carries out their employment duties in Australia in circumstances where their employer was either an Australian resident or foreign resident.

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b) ***Active participation in carrying on a business in Australia – they controlled (directly or indirectly), or played a significant role in, the operations or management of a business in Australia***

Active participation in carrying on a business in Australia can be an indicator of an individual having a presence and connection with Australia. However BDO suggests that this factor should require the active participation in carrying on the business take place while the individual is present in Australia. Otherwise it would include situations where an individuals who participates in the running of a business located in Australia, but such participation is carried out while located in a foreign location. Such an individual may decide not to holiday in Australia (i.e. not doing any work on the business) for fear of being deemed to be a resident of Australia under this test.

c) ***Direct or indirect interests in Australian assets – they had an interest in taxable Australian property, a bank account with significant cash deposits, an interest in a family trust, or they received Australian social security payments in the preceding year***

Whilst we acknowledge an individual holding taxable Australian property (TAP) may indicate a level of connection with Australia, BDO does hold concerns that there may be good commercial reasons why an individual holds TAP assets, and this should not affect the individual's residency status. As an example, an individual born in Australia departs Australia as a middle-aged adult having invested in various Australian investments some of which are TAP. It would be generally unreasonable to expect such a individual to have to divest their TAP assets just to satisfy the ceasing to be an Australian resident test when there are good commercial reasons for holding onto these TAP assets.

4. **How would any additional factors affect the proposed Factor Test, in particular the operation of the two-out-of-four aspect of the rule?**

No comments

Commencing residency

5. **Does having three points of connection (i.e. being physical present in Australia for more than 45 days in an income year, together with two factors) strike the right level of connection to commence residency?**

No comments

Ceasing short-term residency

6. **Does maintaining two points of connection to Australia (i.e. meeting two factors) strike the right level of connection to maintain residency in income years during which an individual is physically present for less than 45 days?**

No comments

Consultation questions 7 – 9

No comments

Overseas Employment Rule

10. **The Overseas Employment Rule allows individuals with enduring connections to Australia to immediately cease being a tax resident, thereby reducing the tax and compliance burden for those individuals and their employers. Do the settings strike the appropriate balance between facilitating the skill development of Australians through international experience while maintaining sufficient integrity?**

The overseas employment rule provides an opportunity for individuals to be employed overseas short term. This option provides individuals with the opportunity to:

- Gain exposure to foreign markets
- Develop knowledge and skills that may not be readily available or common place in Australia
- Build relationships with individuals and organisations overseas
- Apply the skills, knowledge and capabilities developed overseas in employment or business in Australia on their return
- Development of in-demand skills, particularly those in the fields of science, technology, engineering and mathematics.

The proposed minimum overseas employment period of more than two years is a reasonable time period. However, BDO is concerned that this rule will continue to cause uncertainty for Australian expatriates assigned overseas for over two year won't be certain of their tax status until the end of the overseas employment period. Particularly where individuals who apply the overseas employment rule and are subsequently found ineligible will be treated as never having ceased to be a tax resident under this rule. This creates uncertainty, particularly where there are genuine unforeseen consequences which may arise that lead to the minimum overseas employment period of more than 2 years not being fulfilled. Some options for additional flexibility include:

- Where due to illness or misadventure, an individual is unable to complete their minimum overseas employment period;
- allowing employment contracts to be renegotiated or extended where the minimum two-year requirement was not satisfied under the initial arrangement;
- allowing flexibility for employees to change employers overseas under genuine employment arrangements, providing the total term of employment overseas exceeds the minimum term of two years; and
- transitional provisions to allow individuals currently employed overseas under ineligible arrangements to extend their current arrangement or achieve a two-year minimum employment term to satisfy the two-year requirement.

11. **The effect of the Overseas Employment Rule is to cause the individual to become a non-resident (and provide certainty for employees and their employers) rather than to exempt the overseas employment income. Is this the appropriate outcome?**

No comments

Other matters

12. There will be a need for transitional rules when moving from the existing residency rules to the new framework. How would you suggest these transitional rules operate? For example, how should the Overseas Employment Rule apply to individuals who are already part-way through their overseas employment at the time the new residency rules come into effect?

No comments