Law Council
OF AUSTRALIA

Business Law Section

24 November 2022

Ms Ruth Geary
Australian Taxation Office
GPO Box 9990
SYDNEY NSW 2001

By email: IAIPAG@ato.gov.au

Dear Ms Geary,

Draft Taxation Ruling TR 2022/D2: Income Tax: residency tests for individuals

The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to comment on Draft Taxation Ruling TR 2022/D2 (**Draft Ruling**).

The Draft Ruling represents a positive step in providing up-to-date guidance to individuals and their advisers as to the Australian Taxation Office's (**ATO**) views on the operation of the individual residency tests in subsection 6(1) of the *Income Tax Assessment Act 1936* (**ITAA 1936**). The inclusion in the Draft Ruling of examples covering a variety of circumstances aids in clarifying the ATO's views.

The Draft Ruling does not address double-tax agreements (**DTAs**) (see paragraph [6]) except to the extent of the comment in paragraph [102] that tie-breaker tests may apply where a person is a resident in more than one country but that a person may be taxed in Australia to the extent it is not inconsistent with the allocation rules in the DTA. Disputes concerning residency often occur where there are factors that point both towards and against a conclusion that a person is resident in Australia. A significant number of residency disputes are ultimately determined by the tie-breaker provisions in a DTA. The Committee recommends that public guidance be issued as a matter of priority dealing with the application of both the tie-breaker provisions and the scope of any inconsistencies between DTA and domestic law residency concepts that may be relevant to the application of those provisions.

As to aspects of the test addressed in the Draft Ruling, the Committee notes the inherent tension in the disapplication of deemed residency provisions (the "Domicile Test" and the "183-day" test) being conditioned upon the Commissioner forming a state of satisfaction, and the self-assessment regime. Only the legislature can resolve that tension. Indeed, paragraph [1] of the Draft Ruling should make it clear that the Draft Ruling deals only with the law at the date of the Draft Ruling and not the adoption of the Board of Taxation's recommendations for reform of individual tax residency, which the former government announced would be implemented, but the current government is yet to indicate whether it will proceed.

Nonetheless, as observed below, the ATO can adopt an administrative approach, particularly as regards the imposition of penalties, that provides greater certainty and increases fairness in the operation of the tests.

Telephone +61 2 6246 3737 • ***Fax*** +61 2 6248 0639 • ***Email*** jessica.morrow@lawcouncil.asn.au
GPO Box 1989, Canberra ACT 2601, DX 5719 Canberra • 19 Torrens St Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.asn.au

Set out in the body of this letter are our principal comments on the approach to the application of the law suggested in the Draft Ruling. The Schedule to this submission sets out specific comments on the examples.

The law

The Committee considers that the Draft Ruling is largely consistent with the operation of the provisions and with the explication of the law in recent appellate decisions.

There are however aspects of the Draft Ruling that the Committee considers should be revised in the interests of clarification.

Ordinary concepts test

The introductory paragraphs to the "Ordinary concepts test" (paragraphs [17] to [24]) appear to conflate and unduly narrow the relevant aspects of the test. The Committee takes no issue with paragraphs [17] to[19]. Those paragraphs are consistent with the concept of ordinary residence being concerned with where an individual resides in the sense of where he or she "sleeps and lives" (*Miller*[1]), "eats and sleeps and has his settled or usual abode" (*Koitaki*)[2] or lives and "keep house and do business" (*Harding*)[3].

However, the comments in paragraph [19] as to what the test *looks* to are made without reference to the aspects of the test identified by Wilcox J in *Hazfa v Director-General of Social Security* (1985) 6 FCR 444 (***Hazfa***) with the result that the Draft Ruling confusingly refers to "factors that commonly inform [the] connection [to Australia]" without providing context for how those factors may be relevant in a particular circumstance.

In *Hazfa*, Wilcox J recognised that the concept of ordinary residence has two elements, *viz* physical presence and intention to treat that place as home. His Honour then observed that the test of whether a person remains resident of a place where they are not physically present for a period "is whether the person has retained a continuity of association with the place [referring to *Levene v Inland Revenue Commissioners* [1928] AC 217 (***Levene***)], together with an intention to return to that place and an attitude that that place remains 'home'": at 449; considered in *FCT v Addy* (2020) 280 FCR 46 (***Addy***), [74]. The reference to *Levene* is to the concluding passage of Lord Chancellor Viscount's Cave's speech rejecting *counting days* as the test of where a person was ordinarily resident. The Lord Chancellor stated that ordinary residence connotes "residence in a place with some degree of *continuity* and apart from accidental or temporary absences". It follows that facts and matters that shed light on the following matters may be relevant to the determination of a person's residence: (a) presence in a place; (b) continuity of association with a place; (c) intention as to staying in or returning to a place that is "home".

The second sentence of paragraph [20] states that the test *looks* to a person's "connection" to Australia and proceeds to list "factors" said to "inform that connection". There are two principal problems with paragraph [20] of the Draft Ruling.

First, the Draft Ruling's focus on facts and matters directed to a person's "connection" with Australia unduly narrows the statutory inquiry which is informed not only by presence and "continuity of association" with Australia (or a particular place within Australia) but also by the person's presence and association with a place outside of Australia and that person's intention. The proposition underlying paragraph [20] is made explicit at paragraph [24] where the Draft Ruling states that a person's connection with or residency "of another

[1] In that case, on a boat in Papua New Guinea territorial waters, Cf the chef who lived on a ship on the high seas (*Duff and Commissioner of Taxation (Taxation)* [2022] AATA 3675 (2 November 2022)).
[2] *Koitaki Para Rubber Estates Limited v Federal Commissioner of Taxation* (1941) 64 CLR 241.
[3] *Harding v Commissioner of Taxation* (2019) 269 FCR 311.

country does not necessarily diminish any connection to Australia." The reference cited in support of that proposition is the following passage from the reasons of Logan J in *Pike v FCT* [2019] FCA 2185 at [57], where the learned primary judge stated:

> *The point is that it is no part of the ordinary meaning of reside in the 1936 Act that there be a "principal" or even "usual" place of residence. It is important that, as used in the definition in s 6(1) of the 1936 Act, "resident" not be construed and applied as if there were such adjectival qualifications. On the facts of a given case, the local dual residence examples given may find analogues in a conclusion that a person is a resident of more than one country, according to the ordinary meaning of the word "resident".*

That passage provides neither express nor inferential support for the proposition stated in paragraph [24] of the Draft Ruling which informs paragraph [20] of the Draft Ruling.

The proposition should be deleted from paragraph [24] of the Draft Ruling and paragraph [20] should be redrawn consistent with principle.

Second, for the reasons outlined above, mere "connection" of any nature with a place does not inform the application of the test. In particular, the incorporation of the concept of "continuity of association" into the test of ordinary residence does not invite an inquiry into any mere "connection" a person retains or creates with a place. It must be a "connection" that informs whether the person has retained a continuity of association in the relevant sense.

While the content of paragraph [20] is no doubt intended to be informed by the commentary that follows in paragraphs [25] to [52] of the Draft Ruling, in light of the above, the Committee suggests that paragraph [20] of the Draft Ruling is recast to reflect the law as stated above. In particular, the Committee suggests that it be recast to clarify that the factors enumerated in paragraph [20] are factors that inform the test articulated by Wilcox J in *Hazfa* which has been accepted as good law in subsequent appellate decisions.

Another reason for suggesting that paragraph [20] be recast is that it will clarify the comments at paragraph [29] of the Draft Ruling. There the Draft Ruling, in the context of outlining the Commissioner's views on the relevance of the period of physical presence in a place, states in the second sentence that where a person who has previously spent a long time in Australia spends a shorter time in the relevant income year, that "shorter period … assumes less relevance if the person has retained a continuity of association with Australia …". Nowhere in the Draft Ruling does the Commissioner clarify what he means by that reference to "continuity of association". As outlined above, paragraph [20] fails to distinguish "continuity of association" from mere connection and the concept is nowhere else explained. Footnote 18 to paragraph 29 of the Draft Ruling refers to paragraph [76] of the reasons of Derrington J in *Addy*. Subparagraph [76(d)] refers to the concept of "continuity of association" without explaining it, and identifies "relevant circumstances" that to a reader not immersed in tax law are not easily reconciled to paragraph [20] of the Draft Ruling.

These issues should be addressed in finalising the ruling.

Evidence of intention (paragraphs 30 to 38 of the Draft Ruling)

These paragraphs are directed to the relevance of a person's intention. Paragraph [35] of the Draft Ruling states (underlining added):

> *Importantly, subjective intention is not decisive and its <u>significance and weight will depend on the circumstances</u>. Residency is not established merely by asserting an*

intention to live in Australia permanently. Similarly, residency is not shed when departing Australia, merely asserting an intention to never live in Australia again. We will consider and give weight to objective circumstances surrounding your arrival or departure. This includes what pre-existing arrangements you had, what you take with you and what you leave behind.

Paragraph [35] appears to conflate two separate issues: the "significance" to be attributed in the circumstances to a person's intention as part of the test as outlined by Wilcox J in *Hazfa* (see above), and the "weight" to be afforded to "evidence" of a person's intention. A person's intention will always be of "significance", as will the person's physical presence. Neither is dispositive. The concern is that paragraph [35] of the Draft Ruling obscures the important point that the "weight" to be afforded to "evidence" of a person's stated intention "depends on the circumstances": those circumstances include both the context in which the statement is made and its contemporaneity or otherwise as to a person's intention at a particular point in time. Those circumstances and the effect they may have on weight were discussed by the primary judge in *Harding v FCT* at [42] to[45] in a passage that Davies and Steward JJ (Logan J agreeing at [2]) described as "plainly correct": *Harding v FCT* (2019) 269 FCR 311; [2019] FCAFC 29 at [61]. The Committee suggests that paragraph [35] be redrafted to separate the issues of the "significance" attributed to intention vis-à-vis physical presence on the one hand, and the weight to be afforded evidence of intention on the other hand.

In this regard, the Committee also draws your attention to an apparent inconsistency between the Draft Ruling ant the ATO website (page titled "Your tax residency"). In submissions to the Tribunal and courts and in the Draft Ruling the ATO has sought to give weight to statements or declarations made by individuals on passenger cards and similar immigration documentation: see Draft Ruling, paragraph [34]. However, the introduction to the ATO's "Your tax residency" webpage states (underlining added):

If you are coming to Australia or going overseas, you may need to work out your residency for tax purposes. You can use the residency tests to work out if you're:

- *an Australian resident for tax purposes*
- *a foreign or temporary resident for tax purposes.*

We <u>don't</u> use the same rules as the Department of Home Affairs. This means you:

- *can be an Australian resident for tax purposes without being an Australian citizen or permanent resident*
- *may have a visa to enter Australia but are not an Australian resident for tax purposes.*

That statement infers that statements or declarations made as to whether a person is a "resident" for the purposes of the entry into or exiting from the country are not directed to whether a person is a "resident" for tax law purposes. The Draft Ruling adopts a different approach.

Domicile Test—permanent place of abode

In the context of the determining whether a person has a "permanent place of abode" outside Australia, the Draft Ruling comments (at [76]) that temporary accommodation such "hotels, camp sites, barracks, dongas..." may indicate that the presence overseas is not permanent.

It is common for a person to move to a new country with the intention to reside there permanently but only be able to secure hotel or Airbnb accommodation under local rules

or once he or she is settled. Whether a hotel or an Airbnb accommodation is considered temporary must be determined by reference to how the individual uses the accommodation. This is also inconsistent with the comments of Williams J in *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241:

> *The place of residence of an individual is determined, not by the situation of some business or property which he is carrying on or owns, but by reference to where he eats and sleeps and has his settled or usual abode. If he maintains a home or homes he resides in the locality or localities where it or they are situated, but he may also reside where he habitually lives even if this is in* ***hotels or on a yacht*** *or some other place of abode.*

In this context it is notable that there is no example dealing with the circumstance of a person whose primary long-term abode is a yacht. The guidance would be improved by an example dealing with that topic[4].

References to non-binding authority

The Draft Ruling refers to reasons of a number of decisions that were reversed on appeal (examples below). The parts of the reasons referred to in the Draft Ruling were not reversed on appeal. Nonetheless, "[if] a decision of a court is reversed on appeal, the reasoning which led to the court's conclusion ceases to be binding both as to points on which the court was reversed but also points on which the appeal was not taken": P Herzfeld, T Prince, *Interpretation* (2020), p718 [33.580] referring to *FCT v St Helens (ACT) Pty Ltd* (1981) 146 CLR 336, 410 per Aickin J; *Cemex Australia Pty Ltd v Takeovers Panel* (2009) 177 FCR 98, [95] per Ryan, Jacobson and Foster JJ.

The Committee is a strong proponent of the principle that the Commissioner should administer the law as it is declared by the courts. Generally speaking, that includes administering the law as declared by a superior court where that decision is subject to an appeal that is not concerned with and/or does not disturb the relevant aspect of the decision from which the appeal was made. Such a decision may still be persuasive.

Nonetheless, in issuing public rulings, the Committee considers that it would aid clarity and certainty for the Commissioner to express principles of law primarily by reference to authorities that are binding precedents where possible. For example, rather than referring to the reasons of Derrington J in *Addy v FCT* (2020) 280 FCR 46; [2020] FCAFC 135 ((referred to in the Draft Ruling as "Addy Appeal") at [83] (reversed on appeal to the High Court: (2021) 394 214; [2021] HCA 34) as authority for the proposition in the second sentence of paragraph 25 of the Draft Ruling explaining the distinction between staying and residing in Australia, reference could be made to *Hazfa* and the binding authorities endorsing that decision.

The Committee also suggests that in paragraph 9 (n7) of the Draft Ruling that the reversal of the decision in the "Addy appeal" by the High Court be noted.

Examples of references to non-binding authorities

- *Addy appeal:* paras [24] (n14), [25] (n16), [29] (n18), and [34] (n23).
- *Harding v FCT* [2018] FCA 837 (reversed on appeal: (2019) 269 FCR 311): para 12 (n10).

[4] *Miller*'s case was distinguished in the AAT decision of *Duff*, principally on the basis that Miller lived on a boat exclusively in Papua New Guinea territorial waters, whereas Duff was largely in international waters.

Administration and penalties

In the context of the self-assessment regime, the Draft Ruling invites individuals to self-assess whether the Commissioner would form the necessary states of satisfaction in the 183-day test and the Domicile test: Draft Ruling, paras [103] to [104]. The Draft Ruling states that taxpayers should "take a reasonable view": para [104]. That statement is caveated however with the reference relegated to a footnote to penalties for adopting unarguable positions (see n57 referring to s 284–15 of Schedule 1 of the *Taxation Administration Act 1953* (**TAA**)) to the effect that a taxpayer will only be protected from a penalty "if it is about as likely as not that the Court will decide the discretion could be exercised in the way contemplated by the taxpayer".

The problem from an administrative perspective is that the Draft Ruling is couched in terms that give taxpayers no comfort that a fair reading of the Draft Ruling and attempt to apply to their facts will lead them to the same conclusion as the Commissioner or that a Court would conclude that it is as likely as not that the discretion could be exercised in the way contemplated by the taxpayer. This is highlighted by the emphasis in the introductory section to the Draft Ruling that "an outcome in one case does not govern the outcome in a different case, even where the facts are similar [and] …[h]aving similar facts to those in an example [in the Draft Ruling] will not always result in the same outcome": paras [7] to [8]; see also paragraphs [21] and [35].

This exposes taxpayers to an invidious choice between equally unattractive options.

First, the taxpayer lodges (or does not lodge) on the self-assessed basis that he or she is a non-resident. By doing so the taxpayer runs the risk of imposition of a penalty on the basis that the Commissioner, having concluded that the taxpayer is wrong in his or her self-assessment, (inevitably) concludes that the taxpayer's view is not reasonably arguable in the sense of being as likely as not to be correct.

Second, the taxpayer adopts the common approach of seeking to minimise exposure to penalties by lodging a return on the basis that the person is a resident and then object against the assessment issued by the Commissioner on the basis that he or she is a non-resident. This "conservative" approach has been undermined by the position adopted by the ATO in a number of recent reviews and audits that, notwithstanding that a "base penalty amount" may only be imposed where there is a "shortfall amount", the Commissioner has or has threatened to impose penalties referable to the amount of tax payable in accordance with the assessment that is in dispute per the objection. The prevalence of this approach in reviews and audits, and the limited resources of many of the individual taxpayers where this approach is taken, leaves taxpayers in a difficult position should they wish to avoid exposure to penalties.

Expecting all individuals to seek rulings, which often takes weeks if not several months, is not a practical answer, particularly in circumstances where many of the individuals will have limited resources and limited understanding of the tax law[5]. The Committee submits that an administrative solution should be found to provide individual taxpayers with a greater level of comfort as to their exposure to penalties.

[5] Anecdotally, the Committee understands the number of requests for private rulings since the effective repeal of s23AG ITAA 1936 was so significant it was placing considerable strain on the system. Indeed, the effective repeal of s23AG is why there have been increasing claims for non-residence. The Committee has made the point elsewhere that the foreign earned income exemption that was s23AG should be re-enacted in some form or another.

One potential solution is for the ATO to accept that a taxpayer whose circumstances can reasonably be said to fall within the scope of an example in the Draft Ruling has a "reasonably arguable" position[6].

Another potential solution is for a tool to be made available to taxpayers to make a straightforward assessment of their residency so that any statement in a return or objection lodged consistent with the accurate completion of such an assessment will be treated as being reasonably arguable such that the taxpayer is protected from penalties. This could be achieved by adapting the ATO "online tool" for this purpose. The "online tool" is currently accessible from the ATO publication "Residency for tax purposes" accessible from the ATO's webpage "Your tax residency".

Comments on examples

For the reasons referred to above, having regard to the comments at paragraphs [7], [8], [21] and [35] of the Draft Ruling, the utility that the examples in the Draft Ruling would otherwise have in assisting taxpayers to adopt the correct position or at least a reasonably arguable position is limited. There remains utility in this form of guidance; however, it provides no protection for taxpayers seeking to comply with the law but who bona fide arrive at an erroneous conclusion. As a matter of good public administration, this should be remedied in the final ruling.

The Committee provides comments on specific examples in the Schedule to this letter. It notes that suggestion above to include an example dealing with a person whose primary abode is a yacht or other vessel. It also suggests, in the interests of providing clarity, that examples be included dealing with the circumstances of aircrew (and similar employees) making multiple trips to Australia for work, persons who are in Australia against their will (e.g. for quarantine reasons (including COVID restrictions), detention, medical issues).

Conclusion and further contact

The Committee would be pleased to discuss any aspect of this submission. Please contact Chair of the Committee Angela Lee at angela.lee@vicbar.com.au or Committee Member Neil Brydges, on 0407 821 157 if you would like to do so.

Yours faithfully

Philip Argy
Chairman
Business Law Section

[6] The Draft Ruling does not suggest that the taxpayer seek suitable professional advice to minimize the risk of not having a "reasonably arguable position" but perhaps it should.

SCHEDULE

Set out below are comments on specific examples in the Draft Ruling.

Example 9 at [133]

This example deals with Stuart who has moved out of Australia indefinitely but determined to be a resident under the domicile test. Stuart leaves his family and forms a new relationship in China. He is said to have no assets in Australia and returns on special occasions, staying with family and friends. The Draft Ruling at [133] explains that he takes up a short-term employment contract in China to pursue his new relationship. He takes up further short to medium term contracts in "various countries in Asia and moves apartments as needed to fulfil these roles". He is not considered to be a resident under ordinary concepts.

The Draft Ruling considers him to be a resident because "he has not established his permanent place of abode outside of Australia, as evidenced by his shifting between a number of countries and apartments for employment purposes".

There are insufficient facts to explain why Stuart has not established a permanent place of abode outside of Australia other than his moving between countries and apartments.

The Draft Ruling should be specific about the nature of the connection to China and the "various countries", including the specific town or country. It should also have regard to the factors in [67] of the Draft Ruling including the length of stay in each place, the nature of the accommodation (although see [64] of the Draft Ruling and *Harding*) and the durability of association.

Moving to Australia Examples

These Examples have underlying assumptions that the person has never been an Australian resident or domicile, without saying so. This should be clarified and state whether, if the person had previously been an Australian resident, or had an Australian domicile, the conclusion in the Example would change.

Wealthier v less-wealthy individuals

The Draft Ruling does not acknowledge that a wealthier person may not need to dispose of Australian assets before leaving for overseas, while a less wealthy person may *have* to dispose of them. For instance, why would a wealthy person need to dispose of a share portfolio or investment properties that are good investments. Holding such properties may be justified for a resident or non-resident.

Relationship status

Where Examples discuss persons in relationships, would the conclusions change if the people in the Examples were living apart, but the relationship was not in "difficulties". For example, in Example 5 if the wife returned to Australia because of difficulties in the marriage and in Example 6 if the wife staying in Australia was not due to marriage difficulties?

Example 4 at [116]

The Draft Ruling refers to a "definite change or break" from Mexico. While the Example concludes that Conchita does not become an Australian resident, the phrase "definite change or break" has more relevance to ceasing residency than gaining residency. See, for example, *Glyn v Revenue & Customs* [2013] UKFTT 645 (TC).

Example 8 at [130]

When the Draft Ruling refers “remnants of prior residence”, from the example it is not clear what connections Brian maintained which were the “remnants”. The Draft Ruling states the conclusion without setting out the facts.

Example 10 at [138]

When the Draft Ruling refers to “regular order of his life”, what if Corey’s only work was in Spain? The example seems to assume Corey is retired or just an investor.