THE TAX INSTITUTE

The Breakfast Club

"Recent developments in the tax residence of individuals, companies and trusts"

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1. PRÉCIS

Residency has been a hot topic with the BOT Consultation Guide on the review of the rules for the tax residence of individuals released in September 2018, and now the full Federal Court decision in Harding's case in February 2019 (the ATO are seeking leave to appeal to the High Court); as well as the issue of TR2018/5 and PCG 2018/9, concerning the tax residence of companies following the High Court decision in Bywater. The guidance on the residence of companies also flows over into the residence of trusts.

This session covers:

- *The legislative provisions*
- *The cases interpreting those provisions over time, bearing in mind globalisation and the changes in work / travel patterns in more recent times*
- *The proposed changes to the legislation for residency of individuals*
- *The change in interpretation of the legislation for residency of companies following Bywater*
- *The flow-on consequences for the residence of trusts*

What are the blind spots in this area of practice?

Individuals

There is a wide-spread myth that leaving Australia for as short a period as two years, will necessarily suffice for an individual to become a non-resident for tax purposes. This has probably arisen due to para 25 of IT 2650 which actually only says that an absence of 2 years "would generally be regarded by this Office as a substantial period for the purpose of a taxpayer's stay in another country". However, since that ruling issued in 1991, the substantive limitation of the s23AG exemption for foreign source employment income in 2009 has resulted in many more individuals claiming they are not residents, resulting in many cases, in which only a limited numbers of taxpayers have been successful.

Companies

It may not have been appreciated by non-specialists, that the ATO has increased its focus on testing whether foreign incorporated companies, particularly those owned by Australians, are actually tax residents of Australia, following the Bywater case, the withdrawal of TR 2004/15 and its replacement with TR 2018/5. This tread started in the UK in the mid-1990s, which should have been a wake-up call to Australians.

Trusts

Like with foreign companies owned by Australian residents, there may not have been enough attention paid to the possibility that a trust will all non-resident trustees, may still be a resident due to the central management and control of the trust being with someone in Australia.

Case law or legislative developments that I'll be covering:

(i) Board of Taxation consultation on the tax residence of individuals (Sept 2018)
(ii) Full Federal Court in Harding [2018] FCAFC 29 (22 Feb 2019)
(iii) A summary of earlier cases on individual tax residence
(iv) Full High Court in Bywater [2016] HCA 45
(v) A summary of earlier cases on companies tax residence
(vi) TR 2018/5 & TR 2004/15
(vii) PCG 2018/9
(viii) Supreme Court of Canada in Fundy Settlement [2012] 1 SCR 520

What will delegates take away from the session that will help their clients and/or business?

It is a lot harder to become a non-resident individual, than many non-specialist practitioners appreciate.

The ATO has reversed its interpretation in TR 2018/5 from TR 2004/15, that the first test of residence for foreign incorporated companies is long longer that the central management & control be in Australia and that the company carries on business in Australia. Rather, TR 2018/5 specifies a one-tier test, that the company simply have its central management & control in Australia. This will cause considerable risk for Australian owned multinationals, particularly private groups.

The fact that the trustees of a trust are all non-resident of Australia won't give assurance that the trust in a non-resident, if there is a client in Australia that constitutes the trust's central management and control, on the same principles as set out for companies in the Bywater case.

2. BACKGROUND

Income Tax Nexus Generally

Like many countries, Australia's jurisdiction to levy income tax has been based on residence and source. Generally, residents are taxed on their world-wide income (subject to notable exceptions for companies under Div. 768-A and 768-G), whereas non-residents are only subject to income tax (on an assessment basis) on their Australian source income (subject to double tax agreements).

In relation to non-residents (other than those who have an Australian "permanent establishment"), who earn dividends, interest, or royalties from Australian payers (a proxy for source), they are only subject to withholding tax on gross income (as a final tax).

Residence Factors Generally

An initial observation is that the residence of individuals, companies and trusts is highly fact dependent, with parts of the statutory definitions highly dependent on Common Law concepts (developed by more than 100 years of case law[1]). What this has meant, is that determination of tax residence, is at the borderline, very uncertain. This together with the fact that the ATO's position has changed over time, has made giving advice in this area, very difficult.

3. INDIVIDUALS

Section 6(1) of the 1936 Act defines Australian resident as it relates to individuals as follows:

'"resident" or "resident of Australia" means -

(a) a person ... 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 usual place of abode is outside Australia and that he does not intend to take up residence in Australia; or
   iii. who is [a member, spouse or child under 18 of a member of certain Commonwealth public service superannuation funds]' (underlining added).

HARDING'S CASE AT FIRST INSTANCE

Soon after it first came out, I wrote:

"In the [first instance] decision of the Federal Court in *Harding v Commissioner of Taxation* [2018] FCA 837, it was found that Mr Harding, an Australian citizen who lived and works abroad for various periods, but focusing on March 2009 to February 2015, was a resident of Australia under the expanded definition of resident in s 6 of the *Income Tax Assessment Act 1936* (ITAA 36), in the year under consideration (2011).

Subsequent to the handing down of the decision in June 2018, the Government released the Board of Taxation's (BOT) self-initiated review into the topic, which they were given in August 2017.

The case provides a shining example of why the rules on tax residency for individuals in Australia need to change, as the BOT has recommended.

Background

Mr Harding, an aircraft engineer, lived with his first wife for about 7 years in Saudi Arabia while working for BAE Systems. Mr Harding and his wife had 2 children during this period.

Due to escalating geo-political instability across Saudi Arabia and the region, Mr and Mrs Harding relocated to Australia, where they built a house and had a third child.

[1] Starting in the UK. See below under heading "Starting Point: Common Law residence in the UK"

Mr Harding spent three years in Australia but, dissatisfied with his reduced salary and, as a result, more modest lifestyle, returned to the Middle East in March 2009 to live in Bahrain, leaving his family behind in Australia. While living in Bahrain, Mr Harding continued to commute daily to work in Saudi Arabia, across the causeway.

Mr Harding made return trips to Australia each year to visit his family, including one trip of 91 days where he tried, unsuccessfully, to persuade his wife to re-join him overseas. They subsequently separated and divorced. He then formed a relationship with a Ms Gonzales in Bahrain, but when he went to work in Oman in 2014, she would not go, and subsequently he married another woman who he met in Oman.

In December 2015, the Commissioner of Taxation issued Mr Harding a Notice of Amended Assessment, stating that he was a resident of Australia and therefore required to pay tax on his overseas sourced income. Mr Harding's objection to the Amended Assessment was disallowed in an Objection Decision made by the Commissioner in 2017, and the matter then came before Justice Derrington of the Federal Court.

Decision

"Ordinary Concepts test"

Justice Derrington held that Mr Harding did not reside in Australia under the "Ordinary Concepts test" in the relevant income year.

While Justice Derrington agreed with the Commissioner that there were many factors that indicated Mr Harding was a resident of Australia under this test, including the fact that he made return trips to Australia to visit his family, his financial affairs remained substantially located in Australia, including his continued ownership of the family home, and he stated on passenger cards that he was an "Australian resident departing temporarily", he was satisfied that on balance, the evidence established that Mr Harding's actual intention was to permanently or at least indefinitely leave Australia and resume living and working in the Middle East.

Mr Harding was therefore not a resident of Australia based on the "Ordinary Concepts test".

"Domicile test"

Ultimately, however, Justice Derrington found that Mr Harding was a resident of Australia. This was based on the expanded definition of "resident" in s 6(1)(a)(i) of the ITAA 36 (the "Domicile test"), which provides that a person is a resident if their domicile is in Australia, unless the Commissioner is satisfied that the person's "permanent place of abode" is outside Australia .

Note that the taxpayer conceded that his domicile was in Australia. His evidence was that he did not intend to stay indefinitely in any particular Middle Eastern country and that ultimately he may return to Australia[2]. Therefore, the Court was only required to consider the "permanent place of abode" limb of the "Domicile test".

[2] Whilst His Honour did not say so, Mr Harding would not have adopted a domicile of choice outside Australia, as Buckley LJ said in IRC v Bullock [1997] STC 409 at 415: "In my judgment the true test is whether he intends to make his home in the new country until the end of his days unless and until something happens to make him change his mind. … the question was whether the person whose domicile was in question had "determined" to make, and had in fact made, the alleged domicile of choice "his home with the intention of establishing himself and his family there and ending his days in that country." (underlining added). A domicile of origin is not lost easily, compared to a

After deliberating extensively on the proper construction of the test[3], Derrington J decided that the test is concerned with the "enduring quality" of the person's living arrangements in a foreign country.

In this case, Derrington J paid special consideration to Mr Harding's living arrangements, including the fact that Mr Harding lived in a serviced apartment in Bahrain, but was able to quickly relocate to one of the two other apartments leased from the same landlord in the building on a number of occasions, and appeared not to use his Bahrain residence as an address for important correspondence. These types of factors indicated, according to the Judge, that Mr Harding's accommodation was of a temporary nature, and lacked many of the accoutrements that demonstrate a permanent abode.

Accordingly, the Court held that Mr Harding failed the "permanent place of abode" limb of the "Domicile test".

This result is rather odd after the finding that he had a lease which governed his accommodation throughout the period[4]. It also seems to have made a value judgement on Mr Harding's lifestyle.

Our view

The decision in *Harding* is a prime example of why the law on tax residency of individuals needs to change in Australia. It illustrates how uncertain the law is in this area, with its overlapping, broad multi-tiered tests, as acknowledged by Derrington J himself, stating that, as with the "Ordinary Concepts test", the application of the "Domicile test" "is far from easy or straightforward", "lacks precision in a number of respects", and "reasonable persons may differ as to the correct interpretation".

The decision in this case, with respect, places undue stress on the nature of an individual's living arrangements, rather than his intention to remain abroad indefinitely, and the fact of him being in Bahrain for 6 years. This in our view, places too high a hurdle for individuals living or moving abroad to obtain non-resident status."

BOARD OF TAXATION CONSULTATION ON RESIDENCE OF INDIVIDUALS

The BOT Consultation Paper concluded that the existing residency rules for individuals are "no longer appropriate", and suggests separate rules for outbound and inbound residence, with the issue usually determined by "bright line" day count tests. For example, an outbound person going overseas to work full time will be a non-resident if they spend less than 31 days working, or 61 days total in Australia in a year of income, and for inbound, a person who has not previously been a resident, will not become a resident if they spend less than 46 days in Australia in a year of income. Such bright line tests are to be welcomed, however, it remains to be seen what changes, if any, will be made by the Government

change of residency, and is more often a once in a lifetime event, whereas residency may change several times in a lifetime. Many Australian expats might intend, and in fact do, return to Australia in retirement after their international career ends. The ability to adopt a domicile of choice in another country invariably must be tested against whether it would in fact be practically possible for a foreigner to live for the rest of their life in, for example, a Middle Eastern country that will only allow them to stay to work.

[3] Referring to the concept of "permanent" in the test of domicile as "incongruous" on the ordinary meaning of the word in the expression "permanent place of abode", but without discussing the many UK cases on domicile, which reveal HM Revenue and Customs (HMRC) dogged testing of assertions by UK Expats, that they have adopted a domicile of choice outside the UK, to avoid UK inheritance tax.

[4] See ¶23 of the decision. Such a finding will be important in a case that invokes the "tie-breaker" of a double tax agreement, as the OECD commentary on the model DTA says that a "permanent home" can even be a "rented room", but not if presence there is of a transitory nature.

after it considers the Board's further recommendations. The Minister in charge said she welcomed the report, but has asked the Board to consult further on key recommendations '"before the Government takes any position on these matters".

On 4 April 2019 the BOT notified that it has provided its Final Report to government, so the public release of the Final Report is now in the control of the relevant minister, and so this report is unlikely to be made public until after the May 2019 election.

The Law Council of Australia (the **Committee**) in its submissions (which I assisted with), starts by recording the purpose of the BOT review: certainty, simplicity and integrity. I assisted in the submission, which I set out in its entirety.

1. Preferred test

1. *A simplified bright line test*

   The test needs to be simple and certain and ensure that the vast majority of individuals, predominantly those with uncomplicated affairs, can apply the test and obtain the correct outcome.

   The bright line test should only focus on days present in Australia. It should clearly define the period over which the days are being counted and what constitutes a "day" for the purposes of the test.

   For the reasons identified in the Consultation Paper we agree that it is sensible to have a different bright line test for inbound and outbound individuals, and to distinguish between individuals who have never been a resident of Australia from those who have.

2. *A secondary test*

   If applying the bright line test an individual is regarded as a resident of Australia then the individual may choose to apply the secondary test. The secondary test would hopefully address a large number of the remaining individuals who apply the first bright line test and get what they believe is an inappropriate result.

   Following the adhesiveness concept, this test should focus on factors associated with the individual's connections with Australia (and not overseas) and should be both as objective as possible and easily verifiable. Such an approach should allow employers to make an accurate determination without an exhaustive fact gathering process requiring information they may not readily have access to.

   Rather than the "Factor Test" outlined in the Consultation Paper, we think a "points test" is the best way to give certainty to taxpayers as it would allow for a more flexible and appropriate allocation of weight to the relevant considerations. Clearly the identification of those factors and the weight to be allocated to each is a further discussion that should be had. We have provided an example of how such a set of factors and points could look below.

   This approach ensures that the multitude of problems arising from the current tests revolving around the concepts of intention, domicile, permanent or usual place of abode, and requiring something to the Commissioner's satisfaction are all avoided.

3. Commissioner's discretion

Where after applying both the primary and secondary test an individual is still considered to be a resident of Australia, and believes they should not be, then that individual should be able to ask the Commissioner to exercise his discretion to treat him or herself as a non-resident. The criteria for the exercise of the Commissioner's discretion, and examples of when it might be applied, should be set out in guidance issued by the Australian Taxation Office.

Consistent with any bright line test, the Committee believes that it is sensible to have either different factors, or preferably only different weighting of those factors, for inbound and outbound individuals.

2. Specified integrity measure

If the certainly and simplicity that the above primary and secondary tests provide is considered to result in an unacceptable level of risk to the Australian tax system, for example it allows some high net worth individuals to plan to become non-resident for the purpose of extracting funds from Australia without paying further Australian tax (by taking a large franked dividend once they are non-resident, or a large capital gain from an offshore trust) and then resuming residence, then those issues are best dealt with by targeted integrity measures, rather than overcomplicating the basis issue of tax residence of individuals as it applies for super majority of taxpayers.

Our further comments are set out below.

3. Bright line tests

Consider the following simple bright line test:

Inbound

Never previously a resident:

- Resident if physically present for 183 days or more in Australia in any 12-month period, starting on the first of those 183 days.

If a resident at any time in the preceding three years:

- Resident if physically present for 61 days or more in Australia in any 12-month period.

Residency would commence on the day of arrival and a split or part year treatment would apply (as set out in design principle 7 in the Consultation Paper).

…To the extent that the use of an Australian income year gives rise to potential manipulation, a day-count test that spans two or more years (such as the calendar day test in the US) could be used. The preferred measure is to test across any 12-month period and allow for part-year residence (discussed further below).

The general view is that a "day" in Australia for the purpose of the tests will include any day where the individual is physically present in Australia at any time during that day. Such a definition provides clarity and is simple to apply.

An additional bright line test involving the arrival of an individual in Australia holding an immigration visa could be considered further, although we note our opening remarks that the policy concerns of non-resident visa holders might best be addressed through changes to the relevant visa categories. This can also be worked into the secondary test as one of the factors to consider.

…specific alterations to the bright line tests that would be designed to avoid inappropriate results for certain classes of individuals in particular circumstances. For example, if an individual would otherwise be resident under the bright line test, but was in Australia for less than 273 days in a year of income, the taxpayer may elect to be tested under the Secondary Tests, but only for the first year, and only if the taxpayer is at least 30 years of age at the end of the Australian year of income. This might be particularly relevant for example to visiting academics, but to prevent abuse by others, such a test would need to be confined to a single year – "serial academics" and others shouldn't continue to get non-resident status.

Outbound

If always previously a resident:

- Resident if physically present in Australia at any time in any 12-month period, or physically present for more than 30 days in any 24-month period.

If not always previously a resident, but resident in the previous year of income:

- Resident if physically present in Australia for 61 days or more in any 12-month period or 122 days or more in any 24-month period.

The framework for the simplified tests should err on the side of "overreach", that is, catching more people than it potentially should. The reason for this is that under this model such individuals should be able to then rely on the secondary test to reach the correct result. Such an approach should assuage some of the integrity concerns.

Having a third and separate test of individuals who "work" overseas, whilst appealing, adds a degree of complexity back into the test. Such a test would potentially discriminate against those who are self-employed or contractors, and would be open to manipulation, for example, through the use of personal services companies. The Committee's preference was, on balance, therefore not to create a separate class of residence for individuals working overseas. The issue could be better addressed through reintroducing a standalone provision along the lines of the old section 23AG prior to its amendment.

Alternate test

An alternate test could be to have an upper and lower threshold that apply to determine an individual as either resident or non-resident, and then the secondary test would be applied only if you fall between those two. We think this adds an additional layer of complexity and so is not the preferred model for that reason. For example, such a test could look as follows:

<u>Inbound:</u>

Never previously resident:

1. Not a resident if present for less than 60 days in Australia in a year of income.

2. Resident if present for 183 days or more in Australia in a year of income, starting on the first of those 183 days. If resident under this test, but in Australia for less than 273 days in a year of income, the taxpayer may elect to be tested under the Secondary Test, but only for the first year, and only if taxpayer at least 30 years of age at the end of the Australian year of income.
3. Resident on arriving in Australia on an immigration visa.

If a resident at any time in the preceding 4 years:

1. Not a resident if present for less than 30 days in Australia in a year of income.
2. Resident if present for 91 days or more in Australia in a year of income, starting on the first of those 91 days.

Outbound

If always previously a resident:

- Not a resident, if not present in Australia in any period of 365 days.
- Resident if present in Australia for 183 days or more.

If not always previously a resident, but resident in the previous year of income:

- Not a resident if not present in Australia for more than 14 days in a year of income.
- Resident if present in Australia for 183 days or more.

4. Secondary "points" test

If a person is a resident under the bright line tests, then they can elect to apply the secondary test. Individuals applying the test will only be a non-resident if in the relevant testing period they have less than 100 points made up of points taken from a list of factors. This approach has been recently used in other areas of tax legislation, such as the Early Stage Investment Company rules[5], and in practice the predominant view is that the clarity and simplicity of such an approach outweighs the odd circumstance in which a points test (if properly drafted) can give an unfair result.

As noted above, adopting the adhesiveness concept, the secondary test should focus on factors associated with the individual's connections with Australia (and not overseas) and should be both as objective as possible and easily verifiable. Focusing on Australian connections also avoids much of the unfairness and difficulties that can arise when trying to assess, for example, whether or not someone has a permanent home in another jurisdiction or has financial interests in another country.

The factors also need to be sufficiently clear in order to avoid disputes over the meaning of any terms used in them. For this reason the use of concepts such as "domicile" or "permanent place of abode" should be avoided.

[5] Division 360 of the *Income Tax Assessment Act* 1997

A model for the secondary test is set out below:

Citizenship	30 Points
Holder of permanent resident visa	**15 Points**
Ownership of a residential dwelling in Australia by the taxpayer or an associate of the taxpayer, that is available to be occupied by the taxpayer	**50 Points**
Having a lease of at least one year, over a residential dwelling in Australia by the taxpayer or an associate of the taxpayer, that is available to be occupied by the taxpayer	**30 Points**
Spouse (from whom taxpayer is not legally separated), or de facto a resident of Australia under bright line tests	**20 Points**
Any dependent children who are residents of Australia under the bright line tests	**30 Points** *(regardless of how many)*
Director of an Australian company or self-managed super fund	**15 Points**
Each 30 days (or part thereof) physically present in Australia during the testing period	**8 Points**
On any electoral roll (Commonwealth or State)	**15 Points**

The key question to be addressed is clearly the weighting to each of the factors noted above. The outcomes need to be road tested and some basic scenarios worked through to ensure the correct outcome is reached

The points awarded for each factor could vary depending on whether it is an inbound or outbound analysis. However, the preference is to have one set of factors with the same points and to work through the various scenarios and to try and arrive at a weighting that gets the "correct" result in the vast majority of the cases.

Other factors that could be taken into account in the secondary test are too nebulous or are able to be manipulated. For example, how passenger cards are filled out, membership of clubs, driver's licences, holding of bank accounts and health insurance. One suggestion has been to include a factor capturing individuals under a certain age who have Australian resident parents (based on the notion that they will have a place available to stay when they return to Australia). The risk with such specific factors is that they can create arbitrary outcomes – for example if the relevant age is 30, then the day you turn 31 you could cease to be resident where there has been no objective change in your circumstances.

5. Examples

It helps to "roadtest" any model against simple scenarios in order to assess the outcomes. There are likely to be different views on what the outcomes should be under each scenario, so the ones explored below (using the simpler bright line test set out above) are really designed to tease out the underlying issues for discussion purposes. It is difficult to envisage any model where every set of circumstances will have what is broadly accepted as the right result. The importance is to ensure the model remains simple and clear, and deals with the vast majority of people. Australia's treaty network and the availability of the Commissioner's discretion are tools that can be used to address any extreme examples where clearly the wrong result is obtained under the two tests.

a) Backpacker or Student

Inbound

If they have never previously been a resident of Australia and are present in Australia for 183 days or more, then they will be resident under the bright line test. Many students or backpackers will come to Australia under a one-year temporary visa.

If they are in Australia for 300 days in a 12-month period, and are single with no minor children, no Australian house ownership or lease, they will have 80 points (10 periods of 30 days presence) and may elect to be a non-resident.

Allowing individuals to elect into the secondary test means that if individuals pass the bright line test and are regarded as residents they can simply stop there and are not forced to apply the secondary test. Such flexibility would potentially solve the problem of the shortage of seasonal workers currently being caused by the imposition of the 32.5% minimum tax on non-residents (reduced to 15% in some circumstances). The loss to the revenue of giving all or part of the $18,200 tax free threshold to seasonal workers who stay 183 days or more is justified economically to help agriculture.

Outbound

Consider an Australian who has always been an Australian tax resident and citizen, is single with no minor children, has no Australian home ownership or lease and goes overseas to backpack or study for 183 days or more.

If the person does not return to Australia at all in the first two years they will be a non-resident under the bright line tests.

If they come back to Australia for 7 days to attend a wedding after being away only 10 months they will be a resident under the bright line test. They can elect to apply the secondary test and have only 38 points (30 for citizenship and 8 for physical presence), therefore remaining non-resident.

If in year three they come back to Australia for 4 months over the Christmas break and stay with their parents then they will be a resident under the inbound bright line test. Applying the secondary test they will have 62 points (30 for citizenship and 32 for physical presence).

They could in theory return for up to 8 months in any 12-month period before breaching 100 points and therefore reaffirming Australian residence). Is this the correct result after a sustained period of non-residence and no other ties to Australia? Compare this to the circumstances of a visiting professional outlined below.

b) Professional or trades person

Inbound

A non-citizen without a permanent residence visa and who has never previously been a resident of Australia comes to Australia for 180 days accompanied by their spouse. They have no dependent children and no Australian house or long term lease.

They will be non-resident under the bright line test. And the secondary test is not required.

If they are in Australia for 300 days then they will be resident under the bright line test and resident applying the secondary test – 100 points (spouse 20 points and physical presence present 80 points). If they come by themselves then can stay longer and not breach 100 points (360 days), or can only stay a maximum of 270 days with their spouse before reaching 100 points.

Outbound

An Australian tax resident and citizen leaves Australia with their spouse to work overseas for 300 days before returning. They have no dependent children but own an Australian home which remains vacant and available for their use.

Under the bright line test for outbound individuals the person would be a resident. Applying the secondary test they would have 104 points (citizenship 30 points, home 50 points and 3 periods of physical presence 24 points).

If they were to rent their home out such that it was not available for their use and were absent from Australia for 18 months before returning then they would still be resident under the bright line test for outbound individuals. Applying the secondary test they would still have 128 points (citizenship 30 points, home 50 points and 6 periods of physical presence 48 points). The test period under the model would be the 24-month period that applies for outbound residents. Even though they lease their home out for 18 months, the fact they move back in for six months means they will be treated as having a home. Citizenship and physical presence would not alone amount to 100 points.

The overall outcome is that where the bright line test is failed, an Australian citizen who has always been an Australian resident cannot be regarded as a non-resident where they have a spouse and/or dependent children who remain in Australia and retain a residence that remains available to them for their personal use, regardless of whatever other factors are present.

It also accepts that someone who leaves a home and family behind in Australia and does not return for more than 30 days in any 24-month period is not a resident. The testing periods can be adjusted to alter the outcomes if they are deemed inappropriate.

6. Other Issues

The Committee believes that some of the integrity and fairness concerns that have been raised during the consultation process are not issues that should be dealt with by the residency test, but rather are broader policy issues that should be addressed by the review and, if necessary, reform of these other areas.

For example, one concern raised was that there is a subset of permanent visa holders that obtain visas for themselves and their families, yet never spend a significant amount of time in Australia, continue to conduct business predominantly overseas and leave their families in Australia to draw upon the education and healthcare benefits that Australia offers. If this is the case, then it would be an example of an issue that would be best dealt with by reviewing the relevant visa conditions rather than trying to solve the issue through the definition of a resident for tax purposes.

The concern is that trying to solve for every potential integrity concern, especially when those concerns have not to our knowledge been measured or modelled in terms of their impact on tax revenues, will make any attempt to improve the certainty and simplicity of the rules hopelessly conflicted.

There are clearly other parts of the Australian tax landscape that need to be considered in light of any changes to the individual resident test. In particular the residency rules need to work alongside the "temporary resident" regime. The gateway to the temporary residence regime is qualifying as a resident of Australia. The interaction and the outcomes needs to be carefully thought through. To the extent that inappropriate outcomes are identified, then careful consideration of whether those outcomes are a result of the residence rules or of the temporary residence rules is necessary.

As Australia has an "exit" tax regime for individuals ceasing to be tax residents of Australia, the general consensus is that there is no need to have a temporary absence regime, such as the UK, where any gains made while temporarily absent from the Australia are subject to tax. As noted above, a specific integrity rule could be used to address any deliberate manipulation of the residency rules.

The concept of part year tax residence can be dealt with by changing the question on page one of an Australian tax return form, "are you a resident of Australia", to "were you a resident of Australia at any time in the year of income" and requiring the foreign source income earned during the period of non-residence to be disclosed as exempt, which will allow some statistical record of the cost of the exemption, and potential early warning of what is at stake for the revenue in accepting that return at face value.

FULL COURT DECISION IN HARDING

1. The recent full Federal Court Decision (Davies & Stewart JJ; Logan J agreeing) [2019] FCAFC 29 reversed the single judge decision which had raised great concerns about the difficulty of satisfying the Commissioner that an Australian domicile will have a "permanent place of abode" outside Australia, unless they have been in the one residential accommodation for a number of years during which they claim to be a non-resident of Australia. The appeal court has now made it clear that the "permanent place of abode" might be a town or country, rather than a particular residential property (Logan J at [7], plurality particularly at [26], [40] & [55]).

2. The Commissioner appealed the decision at first instance, on the basis that Mr Harding was indeed a resident at Common Law, based on the following facts (reported at [59]):

> "The objective connections with Australia relied upon by the Commissioner which were said to evidence Mr Harding's ongoing residence in Australia were as follows:
>
> (a) he was born in Australia, was an Australian national and an Australian citizen;
>
> (b) he held an Australian passport and had an Australian domicile;
>
> (c) he built the family home in Queensland close to his parents and siblings;
>
> (d) he had lived in the family home, with his family, for approximately three years;
>
> (e) he worked in the Middle East pursuant to a contract which:
>
> (i) was for a limited period and could be terminated on notice;
>
> (ii) required his employer's approval before it could be extended;
>
> (iii) provided his employer with a contractual right to require him to leave Saudi Arabia at the end of his employment or move to a different location;
>
> (f) he retained joint ownership of the family home whilst away from Australia;
>
> (g) he continued to live in the family home for substantial periods of time during his regular returns to Australia while working in the Middle East, including four trips to Australia during the relevant year for 91 days;
>
> (h) he supported his family financially while he was in the Middle East;
>
> (i) he declared that he was an Australian resident returning home on his passenger cards;
>
> (j) he lived in rented, fully furnished apartments whilst in Bahrain, which bore the hallmarks of temporary accommodation, and did not make any substantial domestic acquisitions to use in those apartments;
>
> (k) he maintained the family home as his address for correspondence;
>
> (l) he purchased an investment property in Australia during the relevant year;
>
> (m) he maintained his own bank account in Australia and caused bank statements to be sent to the family home;
>
> (n) he maintained his Medicare account, Australian private health insurance, a Queensland driver's licence and a superannuation account in Australia;
>
> (o) he kept his financial affairs substantially located in Australia; and

(p) he made two substantial investments in Australia in 2013 with IOOF Holdings Limited ("IOOF")." (underlining added)

3. The Davies and Stewart JJ concluded (Logan J agreeing) at [65]:

> "His Honour's consideration of the objective connections with Australia, in our view, disclose no discernible error of law. The quality and nature of those connections either supported a finding that Mr Harding was not a resident of Australia, or were insufficient to overcome the significance of Mr Harding's intention to leave indefinitely. For these reasons, the Commissioner's Notice of Contention is rejected."

4. Whilst Logan J warned of trying to decide cases based on their similarity or difference from previously decided cases (at [7]), the fact that Mr Harding was in Australia for 91 days in the relevant year of income but was still found not to a resident under the Common Law test will be significant in many clients' cases. However, clearly minimising time in Australia in the future is in any client's best interests from a tax perspective.

MIGRATION TO AUSTRALIA

One long standing positive about Australian tax from a taxpayer's perspective was the absence since 1980 of any State or Federal death or gift duty, so that retirees or other wealthy migrants from countries with inheritance tax may have sought to adopt an Australian domicile of choice, to escape the clutches of their country of origin inheritance tax.

However, it is perhaps the abolition of Australian taxation on the foreign source investment income of "temporary residents" that has excited the imagination of many prospective potential wealthy migrants[6].

Ironically, non-domiciles of the United Kingdom, find it attractive to reside but not adopt a domicile of choice in the UK, in order to make use of the remittance basis of taxation applicable to non-UK domiciles. The *Finance Act 2008* made reliance on the remittance basis of taxation less attractive, after seven years of residence in any nine year period, by requiring the payment of £30,000 tax just for the privilege[7].

[6] From 6 April, 2006 (Div 768-R of the 1997 Act). Note however, that an immigrant that has an Australian citizen spouse will not be entitled to temporary resident status.

[7] Increasing to £60,000 tax when resident in at least 12 of the previous 14 years (for 2015-6); now s809H Income Tax Act 2007. For 2015-16 it is proposed to be £90,000 when resident in at least 17 of the previous 20 years. Labour's platform for the 7 May 2015 general election was to abolish the non-dom rules, while introducing a temporary residence rule for those genuinely in the UK for a short period of time, such as university students. As well as the remittance basis, the "transfer of assets abroad" provisions, which attribute foreign source income, do not apply to non-domiciles.

Starting Point: Common Law residence in the UK

The issue of common law residence[8] was considered in *Gains-Cooper v HMRC* [2006] UKSPC 00568 before the Special Commissioners in the UK, where the law was analysed, and as the stakes were very high, the case was argued with considerable resources[9]. As the appeals were limited to errors or law, and the appeal courts found none, the Special Commissioners decision stood. HMRC also had success in subsequent cases[10]. In recent years many cases dealing with residence of individuals in Australia have not moved past the AAT[11], until the recent Federal Court decision appealed to the full Court and reported as *FC of T v Harding* [2018] FCAFC 29 (22 Feb 2019).

Mr Gains-Cooper was found by the Special Commissioners to have remained a resident and domicile of the UK[12], whether or not he had become resident in the Seychelles, with which the UK does not have a double tax agreement (DTA).

Whilst Mr Gains-Cooper (and another's) administrative appeal was dismissed by the Supreme Court of the UK, reported as *Davies & Anor v HMRC* [2011] UKSC 47, the Supreme Court did say:

> 13. In the absence to date of any statutory definition of residence taxpayers and their advisers have had to turn to the guidance given by the courts – and, importantly, also by the Revenue – in relation to its meaning. But the courts have not – nor, as we shall see, has the Revenue – found it easy to formulate the guidance. For more than 80 years the leading authority has been *Levene v Inland Revenue Comrs* [1928] AC 217. Until 1919 Mr. Levene was resident and ordinarily resident in the UK. During the next five years he spent about five months (mainly in the summer) each year, staying in hotels in the UK and receiving medical attention or pursuing religious and social activities. He spent the remaining months staying in hotels abroad. The appellate committee declined to disturb the conclusion of the commissioners that Mr Levene had remained resident and ordinarily resident in the UK during those years. Viscount Cave, the Lord Chancellor, adopted, at p 222, the definition of "reside" given in the Oxford English Dictionary, namely "to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place"; and, of these three descriptions, the Lord Chancellor chose, no doubt as being the most helpful, that of a "settled or usual abode".
>
> 14. Since 1928, if not before, it has therefore been clear that an individual who has been resident in the UK ceases in law to be so resident only if he ceases to have a settled or usual abode in the UK. Although, as I will explain in para 19 below, the phrase "a distinct break" first entered the case law in a subtly different context, the phrase, now much deployed including in the

[8] For a discussion of the relevant matters that the Commissioner will take into account in determining whether a person is resident according to ordinary concepts see Taxation Ruling TR98/17. [worth of note the ruling where the Commissioner accepts that spouses won't necessarily be resident of the same country]

[9] Also see *Shepherd v HMRC* [2005] UKSPC 00484

[10] *Barrett v HMRC* [2007] UKSPC 00639; *Grace v HMRC* [2009] EWCA Civ 1082; *Genovese v HMRC* [2009] STC (SCD) 373; *Hankinson v* HMRC [2009] UKFTT 284 (TC); *Tuczka v HMRC* [2010] UKFTT 52 (TC); *Turberville v HMRC* [2010] UKFTT 69 (TC); *Broome v HMRC* [2011] UKFTT 760 (TC); *Ogden v HMRC* [2011] UKFTT 212 (TC); *Kimber v HMRC* [2010] UKFTT 107 (TC); *Rumbelow &Anor v HMRC* [2013] UKFTT 637 (TC); but not in *James Glyn v HMRC* [2013] UKFTT 645 (TC).

[11] See under heading "Australian Cases"" below.

[12] His substantive appeals to the High Court [2007] EWHC 2617 (Ch), and the Court of Appeal were dismissed [2008] EWCA Civ 1502.

> present appeals, is not an inapt description of the degree of change in the pattern of an individual's life in the UK which will be necessary if a cessation of his settled or usual abode in the UK is to take place (underlining added).

In the House of Lords in *Inland Revenue Commissioners v Lysaght* [1928] AC 234, the taxpayer lived in the "Irish Free State" having previously lived in England. He came to England monthly for directors' meetings and remained on each occasion about a week for business reasons. He usually stayed at a hotel. The Special Commissioners found that he was ordinarily resident in the United Kingdom. On appeal to the House of Lords it was found that the taxpayer's residence was a question of fact and that it was open to the Special Commissioners to arrive at the conclusion they had reached. As Viscount Sumner said in his speech at 245:

> My Lords, I think it is the shortness of the aggregate time during which Mr. Lysaght is here, that constitutes the principal, though by no means the only point in his favour, but the question of a longer or a shorter time, like other questions of degree, is one particularly for the Commissioners. I do not say that time might not be so short, or again so long, as to make it right to hold, no matter what other evidence there was, that, as the case might be, there was either no evidence of residence or that the evidence was all one way in favour of it, *but these questions are not before us*.

In recent years there have been several UK cases dealing with the issue of Common Law residence. It was comprehensively considered in *Glyn v Revenue & Customs* [2013] UKFTT 645 (TC). Like in Australia, the question of residence in the UK has until 6 April 2013 (when the UK adopted a statutory residence test), been a question of fact, so the analysis of what needs to be considered often took place in a Tribunal rather than the Courts. The UK cases have made considerable reference to concepts of "distinct break" and "settled purpose", which phrases have not yet been used in the Australian cases.

In *Glyn's* case, the Tribunal said:

> 118. ... we should concentrate predominantly on three tests, as follows:
>
> - first, on and after 5 April 2005, did the Appellant make a distinct break from his former way of life, by which we consider it important to assess whether he commenced a quite different and intended way of life in Monaco, and whether he can demonstrate not only the required substantial loosening of ties with family, friends and former business life, but whether his whole way of life changed;
> - secondly, having regard to the importance of 50 Circus Road [London] to the Appellant, did 50 Circus Road remain a habitual abode, and more particularly a habitual abode in the UK for a settled purpose, when the Appellant was fundamentally living in Monaco? And thirdly for how long was he in the UK; can those periods of presence realistically be described as "visits", and were they or were not for a settled purpose" (underlining added).

The Tribunal also said:

> 117. Since the Supreme Court's decision in *Gaines-Cooper*... it is virtually critical to demonstrate a "complete break", and that this requires it to be shown that the person has not necessarily severed family, social and business ties with the UK, but that at least there has been a "substantial loosening" of such ties. Much of our consideration of the facts in this case will revolve around whether there has been such a "distinct break", and whether there has been the required "substantial loosening" of ties. (underlining added)

Mr Glyn was a Jewish man who honoured most of the Jewish traditions. In 1993, he purchased a house with his wife in London. On the 5 April 2005, he and his wife departed to live in Monaco, in an apartment that they had acquired. Although the decision to emigrate was influenced by tax considerations, it was also in part to ensure a complete break from his former business life. Between April 2005 and May 2010, he spent approximately 200 days per year in Monaco. In the 2005/2006 year, he made 22 visits to the UK and spent approximately 65 days of the year there, staying (almost) every time at the house he owned. In the same year, he also spent approximately 65 days on foreign holidays. His visits to the UK were for various purposes, which were all non-essential. He never felt "at home" on these short visits. He saw his children and his friends much less frequently than when he lived permanently in London. He applied for a resident's parking permit and confirmed in that application that he was a resident in the UK. He retained the house in London because he knew that at some point he and his wife would return to live in London. In 2009, his daughter gave birth in London. His wife returned to London soon after. In May 2010, the taxpayer returned to living in London with his wife. It was found that Mr Glyn was not a UK resident in the 2005/2006 tax year.

It was found that Mr Glyn had acquired a habitual abode in Monaco for the settled purpose of living the life, accompanied by his wife, of a relatively rich man, enjoying the relaxation, the walking and swimming, and the countless attractions that Monaco offered. He demonstrated that he had substantially loosened his ties with family, friends and his business life in London.

There was no DTA between the UK and Monaco. As there is a DTA between the UK and Australia, with a "tie breaker", the disposal of a permanent home in the UK and the acquisition of one in Australia would be one of the steps that could be taken by a UK domicile, firstly, to ensure that dual residence is resolved in favor of Australia under the 'tie breaker", and secondly, as an assistance on the path to acquiring an Australian domicile of choice for UK IHT purposes.

CEASING AUSTRALIAN TAX RESIDENCE

A client who wishes to retain tax residence in Australia, but who proposes to spend a lot of time traveling needs to understand the risk of becoming a tax resident of any country where he is not a "mere traveller". For a client who is carrying on a business or is a director or executive of a corporate taxpayer, it is necessary to understand that the client's presence in another country be limited so as not to create a "fixed base" for the individual or "permanent establishment" of the company, in the host country.

Estate planning for some wealthy Australians may involve ceasing to be a tax resident of Australia.

Firstly, it should be noted that on ceasing to be an Australian tax resident, the taxpayer triggers CGT event I1 on all his CGT assets other than "taxable Australian property", unless he elects to pay tax only on realization. Holding assets in discretionary trusts or companies owned by discretionary trusts usually overcomes that issue. Secondly, a non-resident individual has a starting tax rate on Australian source income of 32.5% (if it is not subject to withholding tax, commonly at 10%) i.e. no tax free threshold or graduated rate up to 32.5%.

There is a wide-spread myth that leaving Australia for as short a period as two years, will necessarily suffice to become a non-resident for tax purposes. This has arisen due to para 25 of IT 2650 which actually only says that an absence of 2 years "would generally be regarded by this Office as a substantial period for the purpose of a taxpayer's stay in another country"[13]. IT 2650 discusses *Applegate*'s case[14], where the taxpayer was only out of Australia for two years. However, in that case he left the country indefinitely[37], and only returned from Vila, in two years, due to ill health.

More certainty of outcome can be achieved for tax planning, by the use of a suitable double tax agreement (DTA)[15], which contains a dual residence "tie-breaker".

For such a person, there is no point going to be resident in another high tax country, and so a country with a territorial system of taxation which also has a DTA with a "tie-breaker" fits the bill.

In S-E Asia, the more predictable results may follow in Singapore or Malaysia, which countries will also allow reasonable business infrastructure. As Hong Kong does not have a DTA with Australia, it is not suitable. Singapore is well known as an expensive place to live, although the tax position is quite positive. Malaysia is a lot cheaper, and on closer examination, may well be the best choice on the tax front as well[16].

[13] The importance of establishing residence in a particular foreign country can be seen from the case of the physiotherapist on a working holiday for 5 years, who was found to have remained a tax resident of Australia throughout that period: *AAT Case 12,511* (1998) 37 ATR 1263.

[14] 79 ATC 4307, followed by a statement about an absence of anything less than two years being "transitory" in IT2650 at [27].

[15] This will help avoid the result that occurred for the taxpayer in the UK case of *Gains-Cooper v HMRC*, who unsuccessfully argued that he had established tax residence in the Seychelles, to the exclusion of the UK. The UK does not have a DTA with the Seychelles.

[16] There is no CGT in Malaysia, except for real estate (which fades out after 5 years of ownership), but speculative profits are taxed as income. Whilst a Malaysian resident individual will pay a top marginal rate of 26% once taxable income reaches RM100,000, directors fees from a Labuan company are currently not taxed, and there is currently a 65% exemption from tax on managerial salaries from a Labuan company. Further, if the individual controls the Labuan company, there is nothing in the tax law to compel them to pay themselves a taxable salary (although RM10,000 per month "remuneration" must be specified in an application for a work visa from 1 July 2015, and there is a new requirement that such an employer company must have a minimum paid up capital of RM250,000). The Other Income Article of the Australia / Malaysia DTA, reserves the right to tax third country source income to the state of deemed sole residence: unlike Singapore.

DUAL RESIDENCE

1. Dual residence is often resolved in DTAs. For example, Article 4 "tie-breaker" of the Malaysia/Australia DTA provides:

2. Where by reason of the preceding provisions an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

> (a) he shall be deemed to be a resident solely of the Contracting State in which he has a permanent home available to him;
>
> (b) if he has a permanent home available to him in both Contracting States, or if he does not have a permanent home available to him in either of them, he shall be deemed to be a resident solely of the Contracting State in which he has an habitual abode;
>
> (c) if he has an habitual abode in both Contracting States, or if he does not have an habitual abode in either of them, he shall be deemed to be a resident solely of the Contracting State with which his personal and economic relations are the closer.

3. In determining for the purposes of paragraph 2 the Contracting State with which an individual's personal and economic relations are the closer, the matters to which regard may be had shall include the citizenship of the individual" (underlining added).

OECD COMMENTARY

Permanent Home

Under the tie-breaker, the first test to break the dual residence, is where the taxpayer has a "permanent home". As the terms of the tie-breaker usually follow the OECD model DTA, the Commentary on the model is relevant:

> "12…it is considered that the residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration.
>
> 13. As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room). But the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.)."

It will be observed that whilst nationality (and indeed dual citizenship) is relevant to the "tie breaker", it is not directly relevant to the domestic definition of Australian tax residence.

It should also be observed that the ATO is understood to have the view that DTAs don't deal with attributed income under the CFC or Transferor Trust regimes, and therefore that DTAs don't affect the operation of the Australian domestic law[17]. The DTA resolution of dual resident is only "for the purposes of the treaty" i.e. is only in relation to items of actual income covered by the treaty, and therefore not for actual income from third countries, unless there is an "Other Income" Article: in Canada most recently, that approach has found favour in relation to third country source income of the taxpayer, in 2002, before the Other Income Article (20A) of the Canada / UK DTA became operative: *Conrad Black v The Queen* 2014 TCC 12 see particularly at [62]. That the resolution of dual residence is only for "for the purposes of the treaty" explains why in TR97/17 at [66], the Australian Commissioner says a dual resident is entitled to the tax free threshold, to which a "pure" non-resident is not entitled.

The Australian Commissioner's approach would mean that a dual resident deemed non-resident for the purposes of the treaty, would still be attributed income of a Transferor Trust as the income would be deemed income of the transferor, not actual income. Whilst he might find support for that view by virtue of the High Court denial of special leave from the decision in Russell v FC of T [2011] FCAFC 10, the Canadian decision of *The Queen v Sommerer 2012 FCA 207* is more reasoned in its approach, and is to be preferred.[18]

For example, the first tier of the tie-breaker i.e. "permanent home" in Malaysia and no "permanent home" in Australia, then together with the fact that he doesn't need to be in Malaysia for all of the 183 days in the first calendar year he moves there, as he can travel on business (in the employ of his own Labuan company), so as to be "temporarily absent"[19] and count those days as "in" Malaysia for the 183 day test[20], there is a lot more flexibility in moving to Malaysia to achieve the overall objectives than available with other countries[21].

[17] So the argument would run, attributed income is "a purely notional sum", rather than actual income of the attributed taxpayer: there is authority for this proposition in the UK Court of Appeal decision of *Bricom Holdings Ltd v CIR* [1997] EWCA Civ 2193, although the that case is not referred to on the ATO website nor the argument recorded anywhere on the ATO website. This is in contrast to actual income of a taxpayer whose character is recast by the domestic law of the source country.

[18] see "Russell's case, Sommerer's case, and CFC Treaty Override", 24 July, 2012 at:
http://robertgordontax.com/documents/articles/Russell_'s case, Sommerer_'s case, and CFC Treaty Override.pdf

[19] As to which concept the UK cases should be relevant: *Re Young* (1875) 1 TC 57, *Rogers v Inland Revenue* (1879) 1 TC 225, *Reed v Clark* (1985) 58 TC 528, *Shepherd v IRC* [2006] STC 1821, *Barrett v Revenue & Customs* (2007) UKSPC SPC00639, *Revenue & Customs v Grace* [2008] EWHC 2708 (Ch). Also see *FC of T v Jenkins* 82 ATC 4098 at 4101

[20] s7(1)(b)(i) of the Income Tax Act 1967

[21] For seriously wealthy Australians who are not UK domiciled, the UK represents a tax haven for unremitted foreign source investment income, particularly where such income is retained in an offshore "entity".

AUSTRALIAN CASES

As the specific tests widen the concept of "residence" beyond whether a person "resides" in Australia in a particular year of income, it only becomes necessary to consider the specific tests if the individual does not "reside" in Australia within the ordinary (Common Law) meaning of that word, in a particular year of income.

It will be observed that whether a person's residence will be taken into account in deciding their domicile, the reverse is also true. That is, a person's domicile is taken into account in the first specific test of tax residency.

As noted above, there is a wide-spread myth that leaving Australia for as short a period as two years, will necessarily suffice to become a non-resident for tax purposes. This has arisen due to para 25 of IT 2650 which actually only says that an absence of 2 years "would generally be regarded by this Office as a substantial period for the purpose of a taxpayer's stay in another country".

Australian cases decided after IT 2650 issued and before the recent bout of cases starting in 2012

AAT Case 8892 (1993) 27 ATR 1136; Case 11/94 ATC 174 supports the general view taken in Ruling IT 2650. Residency in this regard is, as indicated in Ruling IT 2650, a question of fact, and a mere long absence (3 ½ years in this case) is not enough to divest oneself of resident status. The rule of thumb that an absence of 2 years or more is indicative of non-resident status (see Ruling IT 2650) should not be adopted as a matter of routine. In all cases, all factors must be considered. Finally, notwithstanding all the discussion on this issue, it must be acknowledged that an absence that is for a fixed and definite period only is a strong indicative factor supporting the conclusion that residency status has been retained even if it is a long-term contract e.g. 3 years.

In *AAT Case 12,551* (1998) 37 ATR 1263 the AAT decided that a physiotherapist did not cease to be a resident of Australia at any time during her lengthy stay overseas on a working holiday. She had not in their view, established a permanent place of abode outside Australia, essentially because she did not put down "roots" in any of the places where she worked.

In *Re Wessling and FCT* [2002] AATA 670; 50 ATR 1187, the taxpayer moved to Fiji with her husband who had been appointed principal of a school for 3 years. The taxpayer took special leave from her job, the family home was sold, and their belongings were put into storage. The AAT decided she had made her home in Fiji, even if not indefinitely, and therefore her permanent place of abode was outside Australia.

Re Shand and FCT [2003] AATA 279; 52 ATR 1098 concerned a Canadian who lived in Australia for almost 20 years, and then spent the majority of the next 5 years working overseas, predominately in Canada and Kuwait. The years in dispute where 1995 and 1996, in which the taxpayer was working in Kuwait. It was decided by the AAT that he did not have a permanent place of abode outside Australia in 1995 and 1996:

> 18. The 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. [*It should be noted that Mr Shand did not in fact have a business in Kuwait, but was an employee. See decision at [7[15]] that he had no shares in his employer, and at [7[98]] although he had some options*]
>
> 19. ... The El-Hoss apartment in Kuwait was a temporary or transitory place of abode ...

It is noted that Mr Shand became an Australian citizen at [7(24)]. Mr Shand regarded Kuwait as a "terrible place to live" at [7(63)]. Mr Shand was found to have a domicile of choice in Australia at [17(21)].

General Test – "resides"

Refer back under the heading "Starting Point: Common law residence in the UK", but note that the catch words , "distinct break" and "settled purpose" have not yet been adopted in Australia.

Almost all of the Australian cases on individual's tax residence deal with people who are mere employees rather than owners of businesses, usually living in temporary housing provided by their employer.

First Specific Test - domiciled but permanent place of abode outside Australia

Domicile

The first of the three specific tests refers to the domicile of the individual[22]. The concept of domicle was dealt with extensively in the *Harding* case.

Permanent Place of Abode

In relation to permanent place of abode, the most relevant expression of opinion by the Commissioner of Taxation is contained in Income Taxation Ruling IT 2650, which is headed "Residency – Permanent Place of Abode Outside Australia" (underlining added). That ruling is essentially directed at the question of whether persons absent from Australia for particular periods may become non residents of Australia during the period of absence.

Second Specific Test – in Australia more than 183-days but usual place of abode outside Australia

After the issue of IT 2650 and TR98/17, a further case was decided: *FC of T v Executors of The Estate of Subrahmanyam* 2002 ATC 4001 (Full Federal Court), and on remission to the AAT, 2002 ATC 2303. This case didn't deal with domicile, and a was fought on the basis of the second test. It appears that the evidence was always the taxpayer had intended to return to Singapore, and so it appears to have been conceded by the ATO that she was domiciled in Singapore.

[22] As to the question of domicile, see the discussion at [8-10] and [21] of IT 2650. Also see *Iyengar* at [87] -[101].

In this case, the deceased, who was a citizen of Singapore, had been in Australia for almost 4 years, essentially for medical treatment, and her lifestyle had been severely restricted by the health problems. She had closed her medical practice in Singapore, sold her house and transferred the proceeds of sale to Australia. However, she had left valued possessions in Singapore and maintained her Singapore medical registration and travelled back there on a few occasions. Ultimately on remission to the AAT, she was found not to have a usual place of abode outside Australia.

More recent cases

The question of residence of individuals in Australia has come into questions many times recently in reported decisions, after many years of little activity[23]. The cases since 2012 have not usually moved past the AAT. The cases since 2012 probably arose due to the substantive repeal of s23AG, which until 30 June 2009 provided that foreign source employment income was non-assessable non-exempt in relation to foreign continuous service of at least 90 days (where tax was paid at source). Until it was repealed, for many with only salary income, there was not such a great need to argue that the taxpayer had ceased to reside in Australia, although the effect of s23AG was to provide for an "exemption with progression"[24].

Middle East

The recent cases have often involved employees going to work as employees in the Middle East and staying in employer provided accommodation. The result has usually been that whatever their status in the Middle Eastern country[25], they would continue to be regarded as ordinarily residing in Australia[26]. As Australia has no double tax treaties with Middle Eastern countries, the potential dual residence was not resolved by a treaty.

Iyengar

Mr Iyengar left Perth *i*n May 2007 to move to Dubai and later Doha to work as a Site Engineering Manager pursuant to a two year contract which contained an option to extend the contract for one year. Since 2003, Mr Iyengar had jointly owned a house in Winthrop, Western Australia, with his wife. Except for the periods he had been absent from Australia, Mr Iyengar had resided at the Winthrop home and he regarded it as the "family home". Mr Iyengar left Perth with the intention of returning upon the completion of his contract. He did not lease or purchase a property in Dubai. The taxpayer was held to be a resident of Australia for the 2008 and 2009 tax years. Mr Iyengar maintained a place of residence in Australia which at all times remained his "family home". He maintained an intention to return to Australia when his contract of temporary employment ended. Mr Iyengar did not lease or purchase a property in Dubai (or later Doha), he did not purchase any substantial items of personal property whilst abroad and he returned to Australia upon completion of the contract. Mr Iyengar was a mere employee, working abroad, pursuant to his contract, for a finite period of time. Mr Iyengar was

[23] "Establishing Residence for Global Villagers" Ian Stanley , International Masterclass TI NSW Div 18 Sept 2013. "Establishing Residence in the Global Village", Tony Underhill et al, TI Nat Conv. 26-28 March 2014.

[24] so that income other than that the subject of s23AG was taxed at a rate which took into account the s23AG income i.e. the s23AG income pushed the other income into a higher tax bracket than would otherwise apply.

[25] Which would often have no or a very low income tax. Section 23AG would usually only be available if some tax was paid in the country of source.

[26] And all were Australian domiciles who generally could not establish a "permanent place of abode" outside Australia.

an Australian citizen. Mr Iyengar left many of his personal possessions in Australia, including two motor vehicles, furniture, appliances, clothing and other items.

Sneddon

Mr Sneddon who was born in Australia, purchased a property in 2007 in Western Australia. He was offered employment as a health and safety supervisor in Qatar. He was issued with a UAE residence permit and a work visa by the State of Qatar. He left several of his personal items, including a car, at his WA property when he left for Qatar. In Qatar, he lived in an apartment that was rented by Fluor, the company that employed him. During the 2008/2009 year, he returned to Australia on three occasions for a total of approximately seven and a half weeks. On 1 August 2010, he returned to Australia for over 12 months. Mr Sneddon was held to be an Australian resident for the income year ended 30 June 2009. Mr Sneddon left personal items at the property he owned in Australia, including various household items and a car. More than half of his earnings were used to cover expenses in Australia. Mr Sneddon was paid in Australian dollars. Mr Sneddon was born in Australia and is an Australian citizen. Mr Sneddon's main reason to go to Qatar was for work that was expected to be completed by 31 July 2010. He had no promised future employment in Qatar after that date and was working as an employee in Qatar. All of Mr Sneddon's personal ties were in Australia in the relevant year, and his only tie to Qatar was his employment.

In one of only two cases involving the Middle East in which the taxpayer was successful (before *Harding*), was one in which there was evidence that the taxpayer intended on living in New Zealand when his employment in Abu Dhabi finished; that he had initially occupied employer provided accommodation but subsequently found more permanent accommodation, and that he did not intend to re-occupy a house in Australia which his son had made his home: *Mayhew and FCT* [2013] AATA 130.

Mayhew

The *Mayhew* case is interesting because the Tribunal member was particularly unmoved by the ATO's arguments, but in as much as it is relevant in the current case, the taxpayer made few visits to Australia and spent little time here. The taxpayer only travelled to Australia for business purposes, he stayed in temporary accommodation, mostly hotels, and while he still owned a property in Australia which was occupied by his son, he did not keep it for his own use but instead leased it on commercial terms to his son. This being the case, the Tribunal decided it was likely the taxpayer had resolved to permanently leave Australia.

Planned use of Tie Breaker

Australia's double tax treaties generally have a "tie breaker" for individuals that provides as its first test, whether the individual has a "permanent home" in one country and not the other. Where an individual has a choice and wishes to be more certain that they will be treated as a non-resident of Australia, they should sell their Australian home, or at least let it out for a number of years so that it is not available to them during that period. At the same time, they should buy or at least take a lease for a number of years of accommodation in a treaty country. Whilst a number of recent cases have involved DTA countries, generally the taxpayer's accommodation in those countries, and a remaining

home in Australia, did not trigger the "tie breaker" in favour of the foreign country: *Murray and FCT (No 3)* [2012] AATA 557; *AAT Case 2012/4009* [2013] AATA 394.

Mynott

In *Mynott and FCT* [2011] AATA 539, the taxpayer was able to establish that he was a resident of the Philippines and not Australia, and did not rely on the "tie breaker" even though the Philippines is a DTA country. He established that he was a resident of the Philippines and not a resident of Australia in the 1999, 2000, 2001 and 2002 tax years.

Mr Mynott filled out his immigration passenger cards to indicate that he was an Australian resident, but little weight was given to this evidence, because the information was provided in a non-taxation context.

Although in *Mynott* (2011), the taxpayer did not have accommodation available to him in Australia, over a four year period in dispute, he did spend approximately 73 days per annum in Australia spread over two to three separate visits per annum. Whilst *Dempsey*'s case has warned against using a checklist approach to the question of residence, and favours what a layman might regard as simply asking the questions, when someone is in Australia, are they a visitor or do they live in Australia while they are here just like someone who lives in Australia as a general rule. Mr Mynott had a strong connection with the Philippines where he was in a relationship and did not have a spouse residing in Australia, nor did he carry on business or work in Australia. Further, whilst he left behind certain personal items, kept in contact with his parents, and maintained a banking facility, small investments and personal ties to Australia, he had disposed of his substantial assets, including his home. Accordingly, Mr Mynott was able to establish that he was not a resident Australia.

Murray (2013)

In a different case called Murray: *Murray v Commissioner of Taxation* [2013] AATA 780 (1 November 2013), the taxpayer (David Murray) decided to leave Australia in 2006 to live with his then partner in Thailand. The taxpayer was found to be a non-resident in the 2009, 2010 and 2011 income years.

When completing his immigration cards, Mr Murray indicated that he was an Australian resident and he received Medicare benefits which were only payable in respect of services rendered to an Australian resident. The tribunal did not give this evidence any great weight, as he was not turning his mind to the notion of residence according to ordinary concepts when completing the immigration forms, and was unaware that the Medicare benefits were only available to Australian residents.

Murray is another case where the Tribunal member (Deputy President Hack) was able to deal quickly with the ATO's arguments. Mr Murray was in Australia in each of the tax years 2009 -2011 for more than 183 days, but the Deputy President was of the view that his "permanent place of abode" was in Bali, Indonesia, and that he had established such residence in Indonesia from early 2008. In the year ended 30 June 2009, Mr Murray made four trips to Australia, and four trips in the year ended 30 June 2010. It appears that the reasons for the decision that he was in Australia for all of the year ended 30 June 2011 which had to do with his being in prison or on bail [at 19].

Mulherin

In relation to residence, firstly, the AAT decision in *Murray and FCT (No 3)* (anonymised - not David Murray) was appealed direct to the Full Federal Court, under the taxpayer's real name, *Mulherin v FC of T* [2013] FCAFC 115, which dismissed the taxpayer's appeal on the basis that it was incompetent, as it did not raised any issue of law, but only of fact. The taxpayer came and went regularly from Australia for work purposes. In relation to his raising the tie breaker argument too late, the Full Federal Court said the AAT did not make an error of law in refusing him leave to raise that point.

Pillay

In *Pillay v Commissioner of Taxation* [2013] AATA 447*,* Dr Pillay was employed as a doctor in East Timor. He stayed between 9 and 11 months of the year there, with the remainder of his time spent in Australia and Bali. Dr Pillay was found to be an Australian resident for the 2010, 2011 and 2012 tax years.

When in East Timor, he stayed in a two-bedroom apartment which was supplied by his employer. He and his wife had purchased a 55-year lease on a property in Bali which they called home. Dr Pillay had Australian bank accounts which he used to meet his living expenses. He is an Australian citizen and was present in Australia for between 6 and 8 weeks in each of the relevant years. Dr Pillay did not regard East Timor as home and his connection with East Timor was based almost entirely on his employment relationship. After his employment ended, he intended to divide his time between Bali and Australia. Dr Pillay was an Australian citizen. Dr Pillay and his wife owned a property in Australia which is described as the "family home". He kept a wardrobe of clothing at this house, and it was only occupied during the few weeks of the year when Dr Pillay was visiting Australia.

Nordern

In *Re Nordern and FCT* [2013] AATA 271 the taxpayer worked in China, Malaysia and PNG (all treaty countries) for 200 days in the 2011 tax year, but did not become a tax resident of any of them, and so the "tie breaker" was irrelevant.

ZKBN

In ZKBN and Commissioner of Taxation [2013] AATA 604 the taxpayer failed to persuade the AAT that he was a non-resident of Australian in the 2007 and 2008 tax years and placed some reliance on the way the taxpayer filled out his immigration cards when entering and leaving Australia. In contrast, in the *David Murray* and *Mynott* cases, the way the immigration cards were filled out was not regarded as important.

Brown & Guissouma

The cases of *Browne and Commissioner of Taxation* [2013] AATA 866; and *Guissouma and Commissioner of Taxation* [2013] AATA 875 involved persons from Ireland and France that had come to Australia for about one year, and in both cases they were found to be residents of Australia, which may have been a desirable outcome for them if they did not have foreign source income and they wanted the benefit of graduated rates of tax in Australia, rather than the flat 32.5% that currently applies to non-residents. In contrast to *Browne* and *Guissouma*, and without referring to them, in

three AAT cases heard together more recently, the ATO successfully argued for backpackers to be taxed as non-residents[27].

Engineering Manager

Engineering Manager (2014) is another favourable case as the taxpayer made four trips to Australia in the relevant period, spanning 62 days, each time to visit his four school-age children at a property that belonged to him and his estranged wife. In spite of these facts, the taxpayer was considered to be a foreign resident. The decision in this case appeared to turn on the fact that the taxpayer was very committed to his work in Oman, where he lived, rather than to his family. The Tribunal found that the taxpayer had established a life for himself in Oman, which was demonstrated by the fact that he rented and had exclusive use of a house there, and engaged in social and sporting activities in Oman. In relation to his house in Australia, which was occupied by his estranged wife, it is of particular relevance that, according to the Tribunal, the taxpayer did not regard it as his home during the relevant year. Further, while the Tribunal acknowledged that the taxpayer's connection with his children weighed against him in this case, according to the Tribunal, the taxpayer's priority was his work, and his career, to the point that his "work ties outweighed his family ties".

Dempsey

In *Dempsey and FCT [2014] AATA 335* the taxpayer, a project manager, was employed in Saudi Arabia where he lived in an employer-provided apartment for three years. His employment contract was for an indefinite duration and while he expected that he would move onto another project with the same employer in its group, this did not occur. While in Saudi Arabia, the taxpayer holidayed in Thailand and Australia, returning twice yearly to visit his former spouse and two children who lived in Canberra.

Although the taxpayer had significant connections in Australia, including a house on the Gold Coast (where he stored furniture and a car during his period abroad) a bank account and superannuation, he was considered not to have a permanent place of abode in Australia and was deemed a non-resident for the relevant period.

It is particularly noteworthy that the Full Bench of the AAT in *Dempsey*, composed of a Presidential Member, Deputy President and Senior Member, was critical of earlier decisions and their reliance on a checklist of factors. They noted that a checklist can distract from the real question of whether a person does in fact 'reside' in Australia. The taxpayer was employed in Oman was not a resident of Australia notwithstanding his family connections in Perth[28].

Dempsey can also be contrasted with the decision in *ZKBN* (2013), where the taxpayer's ownership of a house during the first half of the period in dispute, together with a vehicle and personal items, was considered by the Tribunal to be important to its decision that the taxpayer was an Australian resident

In *Dempsey* the taxpayer had retained his house in Queensland and some personal property, including two vehicles, furniture and a collection of firearms, paid the neighbour to maintain the lawn, and had two university-age children in Australia, who lived with their mother in another State. Further, there were a number of vitiating circumstances which diminished the significance of Mr Dempsey's retention of the house, including the fact that the taxpayer did not so much as keep it for his personal

[27] *Clemens and Commissioner of Taxation* [2015] AATA 124; *Jaczenko and Commissioner of Taxation* [2015] AATA 125; *Koustrup and Commissioner of Taxation* [2015] AATA 126

[28] The ATO has accepted since IT2681 (example one) that spouses can reside in different countries.

use and enjoyment, but rather, it seems, because he did not consider it worthwhile or convenient to sell (due in part to the unfavourable state of the property market at the time) or rent it. Moreover, Mr Dempsey never spent more than a few days at a time at the house when he was in Australia, and spent his time with his children at his former partner's house in Canberra.

Agius

In *Agius and Commissioner of Taxation* [2014] AATA 854 the Tribunal accepted Mr Agius was a mere visitor when he came to Australia from Vanuatu to see his family. Mr Agius was a citizen of Vanuatu and had lived there for many years. He was estranged from his wife and did not stay in the family home when he was in Sydney.

In *Agius*, whilst in the years in dispute, 1997-2006, in each year the taxpayer spent between 48 and 84 days in Australia, with many visits, the finding of fact is that Mr Agius had become a resident of Vanuatu as early as 1981, and so he had resided there for 16 years before the first year in dispute. Mr Agius had also established strong community and economic ties to Vanuatu.

Hughes

In *Hughes and Commissioner of Taxation* [2015] AATA 1007 (22 December 2015), *Dempsey* was cited as was *Agius,* but found that the Australian citizen airline pilot working for a South Korean airline led a temporary existence in South Korean while he was not flying, and returned to his Australian family at every opportunity, in reaching the conclusion that he was an Australian resident.

Landy

In *Landy and Commissioner of Taxation* [2016] AATA 754 Senior Member O'Loughlin preferred to go back to older court authorities, being *Commissioner of Taxation v Cooper* [1991] FCA 190; (1991) 29 FCR 177 ; *Commissioner of Taxation v Miller* [1946] HCA 23; (1946) 73 CLR 93; *Federal Commissioner of Taxation v Applegate* (1979) 27 ALR 114; *Gregory v Deputy Federal Commissioner of Taxation (W.A.)* [1937] HCA 57; (1937) 57 CLR 774; *Koitaki Para Rubber Estates Limited* v *The Federal Commissioner of Taxation* [1941] HCA 13; (1941) 64 CLR 241; *Levene* v *Commissioners of Inland Revenue* [1928] UKHL 1; [1928] AC 217.

He only referred to two AAT cases: *The Engineering Manager and Commissioner of Taxation* [2014] AATA 969; *Dempsey and Commissioner of Taxation* [2014] AATA 335

The basic facts in *Landy* where that: *o*n 29 December 2007 the applicant signed an employment agreement requiring him to provide services at a worksite in Oman. On 4 January 2008 the applicant left Australia to take up the new employment role which ended in September 2009, when he returned to Australia. During the 2009 year the applicant: spent the majority of his time outside Australia; had food and accommodation facilities provided to him by his employer at both the worksite and in Muscat; arranged some rest period accommodation with six other work colleagues in Thailand; used the Thai accommodation for two short periods; had family in Australia; visited family in Australia; supported his wife in Australia; had two motor vehicles in Australia; and had a home available to him in Australia.

Senior Member O'Loughlin found: the applicant was a resident within the meaning of s 6(1) of the ITAA 1936 for the 2009 year, "either by reason of being a resident in accordance with the ordinary meaning of the word or by reason of having an Australian domicile and no permanent place of abode outside Australia…. The lack of severance of connections with Australia, and the lack of establishment of enduring and lasting living ties with Oman require a conclusion that the applicant had not ceased to be a resident of Australia as ordinarily understood… Whether the applicant established a permanent place of abode in Oman requires the same or substantially the same analysis as required to determine whether he resided in Oman under ordinary principles."

Tan

Other than *Harding*, the only relevant new case was the *Tan and Commissioner of Taxation* [2016] AATA 1062. If it was correctly decided, it stands for the proposition, amongst others, that the availability of accommodation in Australia for the purposes of the question of whether he has a "permanent home" in Australia is easily met as in Mr Tan's case, his habitual staying with his parents when he was in Australia under no formal arrangement but which situation was long standing and continuing, satisfied that test.

In *Tan*, the parties were in agreement that Mr Tan was a dual resident of Australia and Malaysia in the 2015 tax year. The dispute concerned whether the tie-breaker under the Australia/Malaysia DTA resolved dual residence in favour of Malaysia or Australia. During that year of income he was in Australia for a total of 182 days and in Malaysia for a total of 187 days. In the preceding year of income he was in Australia for more than 183 days (in fact 279 days), and in Malaysia for a total of 88 days. While it was not in dispute that Mr Tan was a dual resident, the facts set out by the Tribunal demonstrated that there would have been little doubt that his concession that he was an Australian resident, was well made.

What is interesting about the case is that while in Australia he lived with his parents since 2008 including with his wife since 2011. There was no formal rental agreement but his parents' house was found to be a "permanent home" in Australia for the purpose of the tie-breaker. When in Malaysia, he stayed with his wife's parents and indeed, entered into a 12 months lease agreement with his wife's mother to rent a room, with an option to renew. Whilst the rent per month was a modest Malaysian equivalent of approximately A$100, there was no evidence that he in fact paid those amounts. As he had a permanent home available to him in each country, analysis moved to the second tier of the tie-breaker which is resolved in favour of the place of his habitual abode. However, as he was found to have a habitual abode in both Australian and Malaysia, analysis moved to the third tier of the tie-breaker which is with which country did he have personal and economic relations that are closer. The Tribunal's conclusion is that such relations were closer with Australia, and that he was therefore resolved to be solely an Australian resident under the tie-breaker.

Set out below is a Table which sets out several the cases between 2011 and 2016, including all which were successfully claiming non-residence. Clearly most of them involved the taxpayer having a residence available to them while in Australia. All of them spent some time in Australia during the years in dispute. Most of them were employees working in the Middle East. Of the cases, the most interesting are those where the taxpayer was found to be a non-resident.

In three of the cases where the taxpayer was found to be a non-resident, *Dempsey* (2014), *Agius* (2014) and *Engineering Manager* (2014), the taxpayer had accommodation available to them in Australia in which they stayed at least sometimes when they came to Australia.

Overall

If the more robust approach of the President of the AAT in *Dempsey*, and the Deputy President in *Murray* (2013), was followed by others, could be expressed in layman's language as saying that if the taxpayer under consideration was viewed by an objective bystander as a mere visitor to Australia because he had established their home in another country, then they should be regarded as a non-resident.

Table with yellow highlight showing those where taxpayer was found to be non-resident

Case	Accommodation in Aust	Days in Aust	Resided overseas in	No of visits to Aust	Spouse in Aust	Children in Aust	Resident
Mynott (2011)	N Vacant lot (drop in value meant it was not worthwhile selling)	**1999 2000 2001 2002** 48 142 43 58	Philippines	9 over 4 years	N	N	N
Iyengar (2011)	Y	**2008 2009** 14 19	Qatar	2	Y	Y	Y
Sneddon (2012)	Y	52	Qatar	3	N	Unknown	Y
Boer (2012)	Y	Many	Fly-in fly-out; Oman	Many	N	Y	Y
Sully (2012)	Y	17	On ship - USA Dubai	1	Y (girlfriend, the status of their relationship was in doubt)	N	Y (based on domicile test)
Murray (2013)	N	**2009** - 191 **2010** - 194 (partly due to	Bali	8	N	N	N

		imprisonment) **2011** - 365 (wholly due to imprisonment)					
Mayhew (2013)	N (the family home was rented by the taxpayer's son, the taxpayer stayed in hotels when in Australia)	Once the taxpayer had left Australia (in Dec 2007 of the 2008 income year) he spent little time here	UAE	2 (work-related)	Y (she joined the taxpayer abroad after the income year in question)	Y	N
Nordern (2013)	Y	131	Oil rigs – China Papua New Guinea Malaysia	7	Y	Y	Y
Taxpayer (2013)	Y	35	Singapore India	Several	Y	Y	Y
Pillay (2013)	Y	42-56 days	East Timor Bali	Unclear	N	Y	Y
ZKBN (2013)	Y, although home was sold in June 2007	**2007 2008** 47 117	UAE France Korea UK		Y until June 2007, when he was joined by his spouse overseas	N	Y
Mulheirn (2013)	Y	155	Singapore	5	With taxpayer	Y	Y
Dempsey (2014)	Y	**2008 2009 2010** 6 29 6	Saudi Arabia	Several	N	Y	N
Agius (2014)	Y	**1997-2006** between 48 & 84 days a year, or 70 on average	Vanuatu	Many	Y but estranged	Y	N

Engineering (2014)	Y	62 between **23 July 2010 – 29 April 2011**	Oman	4	Y but estranged	Y	N
Hughes (2015)	Y	**2010 2011 2012** 136 158 156	Fly-in fly-out; S. Korea	At least 10	Y	Y	Y
Tan (2016)	Y (parents' home)	**2015 2016** 279 182	India Singapore	Several	N	Y	Y

Resident nowhere?

From press reports, it appears that the actor Paul Hogan, had an argument with the ATO, where he has asserted that in the relevant years, he was not a tax resident of any country[29]. Clearly the ATO prefer the argument that he was an Australian tax resident[30].

The BOT Consultation has also focused on this issue. However, the subsequent full Federal Court in *Harding* seems to have made in clear that to be a non-resident of Australia, it is likely to be necessary to become a resident of a particular foreign country. If this is correct, the BOT concern is misplaced (second last sentence of [40]).

It has been suggested that the cruise liner, "The World" reputedly promotes the possibility of ceasing to be a tax resident anywhere, by selling up in the home jurisdiction, and buying a suite on the liner, which will then cruise the world endlessly[31]!

[29] e.g. "Crime body suspects Hogan of travel sham", The Age, 22 Aug, 2008

1. [30] Due to largely ineffective suppression orders, the first reported decision that refers to Hogan by name is *Hogan v ACC (No.4)* [2008] FCA 1971 (22 Dec 2008). Whilst the ACC abandoned their claim that certain documents were not subject to legal professional privilege based on the crime/fraud exception, there is still a dispute about the suppression of a document prepared by the applicant referring to inferences that could be drawn from the privileged documents: see *Hogan v ACC* [2009] FCAFC 71, appeal heard by the High Court on 4 Feb 2010. In the light that the legal professional privilege claim was abandoned by the ACC, it is difficult to see why the press reports that the outcome of the High Court appeal is relevant to whether the ACC will seek to charge Hogan e.g. "Crime body close to charging Hogan and Cornell", The Age 3 Feb, 2010.

2. [31] From Wikipedia entry: "The World" (cruise ship)

"The World" is a floating residential community owned by its residents. The residents, currently from 40 different countries, live on board as the ship slowly circumnavigates the globe — staying in most ports from 2 to 5 days. Some residents live onboard full time while others visit their floating home periodically throughout the year.

From "The World" website (www.aboardtheworld.com):

…*The World* opens a vast amount of opportunity to travel the world in an exclusive community as either a Resident or vacationing Guest. With 165 private residences located aboard, many Residents call *The World* home on a consistent basis while others open their doors temporarily for short term rentals that allows others a unique vacation experience unlike any other.

This idea might not be farfetched. On remission to the AAT in *FC of T v Executors of The Estate of Subrahmanyam*, the AAT referred (at p445) to the Commonwealth Taxation Board of Review in *Case No. 56*, (1946) 15 CTBR 443:

> The taxpayer took up an appointment on board a ship and placed all of his personal belongings on board with the intention of living on it and without any definite intention of ever returning to Australia to live. The ship was in Australia for short periods during each of the tax years under consideration. The taxpayer had not abandoned his domicile in Australia.
>
> Therefore, in view of paragraph (a)(i) of the definition, he was a resident and so subject to taxation unless his permanent place of abode was outside Australia.

28. Mr Gibson considered the dictionary meanings given to ``abode'' and ``place'' and formed the view that, in one of its senses, a ``place of abode'' was a place of habitation or home. The ship was the taxpayer's place of abode because it was the place where he slept, ate, worked and had his recreation. It was immaterial where the ship was moored. It was his permanent place of abode because he was residing on it for an indefinite time and his presence was not merely fleeting. Mr Gibson also considered that the expression ``place of abode'' might be given a broader interpretation and that:

> ``... meaning may be a `person's home or dwelling-house or other habitation or the village, town, city, district, county, country, or other part of the world in which a person has his home or dwelling-house or other habitation or in which he habitually resides'. In the broader of these senses the taxpayer's `abode' at the material times was his ship or on his ship, and his place of abode was the particular part of the world where the ship happened to be at any given time. Even applying that sense it could, I think, be held that the tax-payer's permanent place of abode was outside Australia.''

Indeed, Williams J in High Court said in *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* [1941] HCA 13; (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 situate, 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: See *Halsbury's Laws of England*, 2nd ed., vol. 17, pp. 376, 377." (Underlining added)

4. COMPANIES

1. Residence of companies

Section 6 of the ITAA defines an Australian resident company as one "which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia" (underlining added).

Until the recent *Bywater* case, the law in Australia hadn't expressly referred to all the jurisprudential developments in the UK on the central management and control of companies.

The test of residence for companies often depends upon the place of management of the company and/or the place of incorporation of the company.

The United Kingdom and Australia are examples (there are many), of countries which now determine corporate tax residence on the alternative bases of:

(a) place of incorporation; or
(b) place of "central management and control".

Malaysia determines corporate residence solely on the basis of "central management and control". In contrast, the United States simply looks to the place of incorporation.

The classic general law "central management and control" test, which until 1988 was the sole test of company residence in the United Kingdom[32], was set out in the speech of Lord Loreburn in *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455. Also see *Unit Construction Co Ltd v. Bullock* [1959] 3 All ER 831.

As can be seen from *Swedish Central Railway Co v. Thompson* [1925] AC 495, the central management and control of a company can be shared between two countries, such that the company can under the test, be a dual resident.

The High Court of Australia in *Esquire Nominees (1972)* held that a company incorporated on Norfolk Island (part of Australia but then only taxable on income sourced from the mainland), and all of whose board resided on Norfolk Island, indeed had its central management and control on Norfolk Island, notwithstanding the resolutions for board meetings were prepared in Melbourne by the ultimate shareholders' accountants. This was on the basis that the board met to consider such resolutions, and it would not have passed them, had they been illegal, or not in the best interests of the company.

It is contended that the most relevant principles to be gleaned from the earlier authorities were:-

(a) Effective management should be where the board of directors regularly meets to decide the policy, conduct and manage the strategic ("high level") decisions necessary for the business, and that each of them have sufficient information for that purpose; and

[32] see SP 1/90

(b) A majority of the board should be residents of the jurisdiction the company is to be resident of.

The Australian Taxation Office had issued a tax ruling TR2004/15 which confirmed those principles, and in addition, confirmed (at [50]) that if an Australian resident director participates by telephone or electronically, in a majority foreign board meeting overseas, the fact that the Australian resident is in Australia at the time does not upset the outcome[33].

TR 2004/15 two requirements

"5. For a company to be a resident under the second statutory test two separate requirements must be met. The first is that the company must carry on business in Australia, and the second is that the company's central management and control (CM&C) must be located in Australia. ..

"50. Where board meetings are conducted via electronic facilities (rather than physical attendance) the focus is on where the participants contributing to the high level decisions are located rather than where the electronic facilities are based.[12] The fact that a majority of these high level decision makers regularly participate from a jurisdiction other than Australia would support a conclusion that the CM&C is not located in Australia, particularly where the majority of decision makers usually undertake their company duties and participate in the company's high level decision making processes in that other jurisdiction. Where the range of locations using electronic means makes this judgement difficult, regard may need to be had to other factors, for example, where the key functions of the board are undertaken, where the decision makers usually undertake their company duties and participate in the company's high level decision making processes, where the high level decision makers are resident and where the secretariat is located."

There had been a number of cases between 2011-2013 where the ATO has challenged the tax residence of foreign incorporated companies.

This has mainly happened in relation to companies which have had also had alleged Australia source income, rather than in situations where the company has been trading only internationally, and so would have only foreign source income. The circumstances were also that the foreign incorporated companies had or were likely to have had Australian resident owners[34]. These cases appear to have flowed out of "Project Wickenby" which originally focused on the activities of the advisory firm known as Strachans, in Jersey & Switzerland, but later expanded to cover activities of a number of Vanuatu advisers (particularly Robert Agius who was with PKF, but was sentenced to a non-parole 6 years & 8 month in Australia) whose clients used offshore bank accounts and companies incorporated in Vanuatu.

It seems that the reduced scope of Australian CGT from the introduction of Div 855 in 2006 has had some impact on these issues. It now subjects to CGT only Australian real property, and shares or units representing 10% or more of entities which are Australian land-rich, and the business asset held by

[33] This is in contrast to the commentators on the UK position, who now all caution against a UK resident director participating other than physically.

[34] Which allowed the ATO to argue that not only was the "central management & control" of the company in Australia (the first test of residency), but also that the company was carrying on business "in Australia and was owed by residents of Australia (the second test of residency).

the Australian "permanent establishment" of a non-resident. This has led to arguments by the ATO that non-resident companies in non-treaty countries, have been dealing with Australian assets such as shares in non-land-rich companies, on revenue account, so as to be taxable in Australia, whereas a capital gain would no longer be taxable.

In *Crown Insurance Services Limited and FCT* [2011] AATA 847, the Commissioner asserted that the Vanuatu incorporated taxpayer was in fact a tax resident of Australia, and that in any event, the source of its funeral benefits insurance premium income was Australia[35].

The AAT held that the taxpayer company was a tax resident of Vanuatu (principally as that is where it held its directors' meetings, at [74][36]), and that the source of its income was in Vanuatu (as that was where it conducted its insurance business (contracts were entered into and carried out), at [85][37])).

A Mr Pattenden set up Crown Insurance, and was one of its directors. PKF were not used. He was British born and travelled to Vanuatu and New Zealand (where he had a house), but was an Australian tax resident at the relevant times. The decision does not expressly say who the other directors were, but it is implied there were a majority of director's resident in Vanuatu. The ATO vigorously pursued Mr Pattenden under Project Wickenby, and has come up short[38]. They gave him Departure Prohibition Orders twice, the first was in due course set aside, as referred to in *Pattenden v FCT* [2008] FCA 1590, and the second given illegally soon after the first was quashed, at which time Logan J remarked in an unreported judgment:

> "That sort of scenario I would usually visit, if proved, with a term of imprisonment for the officer concerned and for those who counseled or procured that course".

2. Source of income

Source of income in Crown

Having failed to establish in the AAT that Crown Insurance was an Australian tax resident, the Commissioner appealed to the Full Federal Court, on the finding that the source of income was not Australia. As the case involved a non-treaty resident, there was no need for the income to be derived above the threshold of a "permanent establishment" in Australia, in order for Australia to have the right to tax.

[35] It is not apparent from the decision, but it appears that it was assumed by all concerned, that such insurance, depending on the death of a nominated party, would have been life assurance (or else Div 15 ITAA 36 would have applied. to deem a part of the premium income to have been subject to tax in Australia. The other possibility is that the death in question was not an event which could only happen in Australia.

[36] Referring only to *Koitaki Para Rubber Estates v FCT* (1941) 64 CLR 241 at 248, which is only one of many that could have been referred to.

[37] Referring only to *Tariff Resinsurances Ltd v C of T* (1938) 59 CLR 194, which was by far the most relevant case.

[38] Indeed, there are press reports that he may be going to sue them for maladministration.

By a majority, the Court held that there was no issue of law and therefore the Court had no power to deal with the appeal: [2012] FCAFC 153. The dissenting judge (Jessup J) held that there was an issue of law, and that the "indirect" source of the income was Australia. The Commissioner was denied special leave to appeal to the High Court on 6 June 2013[39].

The Commissioner clearly wanted to follow through with comments of Jessup J at [94] in the Full Federal Court, to the effect that the indirect source of insurance premium income of a Vanuatu insurer was Australia, on the basis that the "original source" of the premiums was payments made by members of various funds in Australia. This, with the greatest respect, is clearly wrong[40].

Source of income in Picton Finance

In *Re Picton Finance Ltd and FCT* [2013] AATA 116, the taxpayer was a Vanuatu incorporated company (managed by PKF), which conducted share trades in one Australian company listed on the ASX. The Commissioner ultimately accepted that the company was not an Australian tax resident, but there are interesting comments in the decision which imply the Commissioner probably should have argued that point, at [86].The taxpayer's share trades were both "on" and "off" market. The AAT found that all trades were on revenue account and the income there from, was Australian sourced. In relation to the "off" market share trades, the evidence showed the transferee signed the share transfer forms in Australia, and that being the place where the contract was entered into, the application of established case law pointed to the source of the profit being Australia, at [82]. In relation to the "on" market share trades, no case law was referred to, but it was held that as those trades on the stock exchange occurred "in Australia", the source of the profit was Australia, at [90]. There is long standing Privy Council authority to this effect: e.g. *CIT Bombay v Chunilal Metha* (1938) L.R. 65 India Appeals 332, cited with approval in *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306.

3. Bywater at first instance

Soon after it came out, I wrote:

> "The decision of Perram J in *Hua Wang Bank Berhad v FC of T* [2014] FCA 1392) in the writer's view, unnecessarily distinguished the long standing decision of Gibbs J in *Esquire Nominees*, in finding that a number of foreign incorporated companies were tax residents of Australia . The result was affirmed by the full Federal Court reported as *Bywater Investments Ltd v FC of T* [2015] FCAFC 176 (11 December 2015) but the authority of *Esquire Nominees* was not distinguished on appeal to the full Federal Court.

[39] In the light of the High Court decisions in *Nathan, Mitchum* and *Agfa-Gevaert*, "that the case was not a suitable vehicle to explore the distinction between questions of fact and issues of law". The Commissioner issued a Decision Impact Statement saying that the original decision of the AAT did not create a precedent. This is in contrast to his reliance on AAT decisions that suit him, on which he expressly relies in his rulings, ATOIDs, published guidance & instructions to counsel in conducting litigation.

[40] In *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306. Lord Bridge said as to source of profits, at 322-323:" The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question." It is not who or where payments are made for the provision of the goods or services. More specifically, in *CIR v HK-TVB International Ltd* [1992] 2 AC 397 the Privy Council said at 402: "If a manufacturer in Hong Kong sells his goods to a merchant in Manila the payment which he receives is no doubt sourced in Manila but his profit on the transaction arises in and is derived from his manufacturing operations in Hong Kong." It is of course, to be remembered, that the UK legislation focuses on the source of profits, whereas the Australian legislation looks to the source of income, but bearing that distinction in mind, the reference to profit and income in the Privy Council cases is directly relevant. The reference to "direct or indirect sources" in s6-5(3)(b) and its predecessors has always been there, and was not previously considered to add anything to the question of source.

On the facts as found by Perram J, that Mr Vanda Gould (an Australian tax resident) was the beneficial owner of the companies, and had "usurped" the boards of the companies, there was no need to distinguish *Esquire Nominees*. His doing so potentially risked the *status quo*. However, on appeal, the full Federal Court glossed over Perram J's distinction.

It has long been considered that the decision of Gibbs J in *Esquire Nominees* stands for the proposition that the "central management and control" of a foreign incorporated company, which is relevant to its residence, will be determined by the place of residence of the board of directors properly carrying out their duties, notwithstanding the directors receive suggestions from the company's shareholders or their advisers, as long as they act in the best interests of the company and would not do anything illegal or improper suggested to them. This position was accepted by the Commissioner in TR 2004/15 at [63]. What the Commissioner said in TR 2004/15 was not confined to companies acting as trustees.

Perram J in *Hua Wang Bank* said that *Esquire Nominees* effectively decided only that suggestions of shareholders or their advisers in relation to a particular trust, are not relevant to the place of residence of the trustee company (at [400]):

> *"Whilst the accountants could tell the trustee what to do qua trustee they could not tell the directors of the trustee company what to do qua company."*

Accordingly, he concluded that it was not surprising that Gibbs J found that the trustee company in *Esquire Nominees* was resident on Norfolk Island (as he concluded the influence was *only* in relation to the assessed trust). Put another way, Perram J appears to have been of the view that the outcome may have been different if the accountants had sought to influence the decisions of the board generally, and not just in relation to particular trusts.

One reason why it was unnecessary to distinguish *Esquire Nominees* was that Perram J found in relation to Mr Borgas' activities as a director, at [98]:

> *"Mr Borgas' evidence about this persuaded me that he was a witness who was willing to lie on oath in a most discreditable way."*

And at [405] – [406]:

> *"The role of Mr Borgas was fake. He made no decision of any kind but simply implemented Mr Gould's instructions after which he generated a false document trail to make it appear otherwise….I reject entirely the idea that Mr Borgas might have declined a transaction which he believed or suspected to be improper. Such an approach would have put him out of business."*

In relation to the words underlined above, and based on his Honour's assessment of the evidence, with respect, the conclusion with respect to Mr Borgas may be correct, but as a general proposition as to directors and boards of subsidiaries relationship with their foreign parents, DTAs are premised on the basis that merely because of the parent / subsidiary relationship, the subsidiary does not represent a permanent establishment of the parent in the country of the subsidiary, let alone make the subsidiary's place of central management and control the same as that of the parent. Invariably the parent's expectations in relation to the subsidiaries' activities will be made known. This will be so

whether the local board is constituted by employees of the subsidiary or by independent directors (usually provided by service providers in the country of the subsidiary). The idea that generally an independent director provided by a service provider (that has many clients) is more likely to implement a plan which he believes or suspected to be improper, than would an employee of the subsidiary who may owe his whole living to the subsidiary, is not terribly logical.

4. Bywater in the full Federal Court

The Full Federal Court appeal disregarded Perram J's distinction of *Esquire Nominees* and said at [8]-[10]:

> "The test of residence has been applied in circumstances where the decisions of those in control of the company have been heavily influenced by others [referring explicitly to Esquire Nominees]
>
> "Critical to the outcome in that case, however, was that those exerting influence, albeit strong influence, were not those making the decisions of the company. As observed by Gibbs J at first instance, the compliance of the directors with the wishes of others was because the directors accepted those wishes to be in the interest of the beneficiaries to give effect to the scheme.
>
> "A similar result can be seen in Wood v Holden [2006] 1 WLR 1393; [2006] EWCA Civ 26 and Commissioners for Her Majesty's Revenue and Customs v Smallwood [2010] EWCA Civ 778. In Unit Construction Co Ltd v Bullock [1960] AC 351 distinctions were drawn between those with an ability to influence others who make the decisions of the company and those who may be usurping that function or who are directing those appearing to act for the company: see Unit Construction at 364–6; Wood v Holden [2006] EWCA Civ 26; [2006] 1 WLR 1393 at [24]–[27]; Smallwood [2010] EWCA Civ 778 at [61]. In Wood v Holden the critical finding of the trial judge was that the effective decisions had been made by the directors and the trial judge specifically rejected the suggestion that their participation was "merely going through the motions of passing and signing documents": see [36], [40]–[43].
>
> "His Honour below applied these principles."

5. Bywater in the High Court

The High Court had not reconsidered the issue of "central management and control" of foreign incorporated companies for 43 years until: Bywater Investments Limited v FC of T; Hwa Wang Bank Ltd v FC of T [2016] HCA 45. Soon after the decision came out I wrote:

> "As the appellant companies had conceded before the High Court, that they were carrying on business in Australia, the companies would be Australian tax residents if their "central management and control" was in Australia.

The last time the High Court dealt with that issue was the decision of Gibbs J in Esquire Nominees Limited v FC of T [1972] 129 CLR 177 affirmed as to the central management and control point by the full High Court in that case. There the Norfolk Island board of the Norfolk Island company actually considered recommendations of the Australian accountants to the Australian parent company, considered and implemented them. However, because their decisions were found have been in the best interests of the company and they would not have done anything which would be unlawful, the central management and control was found to be in Norfolk Island.

For present purposes it should be noted that the plurality in Bywater said at [82], the appellants contended that, since Esquire Nominees was decided, that "there has been a general accepted understanding in Courts and within the academy that the central management control of a company is taken to be an exercise where the company's board meets to exercise its constitutional functions, and therefore that the company will be taken to be resident abroad even if the board does no more than mechanically implement instructions given by residents of Australia". (The writer understands the unusual expression "academy" in this context was intended to refer to academics as a group).

The High Court in Bywater found that all decisions of the foreign incorporated companies in that case were in fact made by Mr Vanda Gould in Sydney, on the basis that the offshore directors where simply "rubber stamping" his instructions, or that no board meetings were held at all.

Whilst based on the authority of Esquire Nominees, the decision in Bywater is not surprising given the original findings of facts about Mr Gould, the applicants' submission as to the threat of uncertainty and litigation if its understanding of Esquire Nominees was not accepted, which the High Court said at [80] were "exaggerated", the case still sends a clear message that the question of "central management control" is always a question of fact not answered by simply holding board meetings outside Australia.

UK Wake Up Calls

Indeed it may have been assumed that the status quo following Esquire Nominees was as the applicants submitted in Bywater, at least until the UK Inland Revenue started to test the tax residency status of foreign companies that claim to be tax residents outside the UK in the mid-1990s. Perhaps this first became apparent with the decision of the Special Commissioner in Untelrab Limited v McGregor (Inspector of Taxes) [1996] STC (SCD) 1. Whilst the Special Commissioners held that the company in that case was resident in Bermuda and applied Esquire Nominees, what was noteworthy was the depth of analysis of the evidence of the activities of the company over a six year period, including cross-examination of the offshore directors. It is noted that the decision in Untelrab was footnoted by the High Court in Bywater at footnote [132].

The next "wakeup call" coming from the UK was the criminal prosecutions in R v Dimsey; R v Allen, [2000] QB 744 where the defendants were jailed for "conspiracy to cheat the Public Revenue" in circumstances where Mr Dimsey (a solicitor in Jersey as a director of Jersey and other haven companies) acting on the instructions of his client Mr Allen in the UK, who was not an actual director, but rather a "shadow" director. R v Dimsey; R v Allen were not referred to by the High Court in Bywater as those cases were criminal cases.

Subsequently, in Wood v Holden (HMIT) [2006] EWCA Civ 26, the Esquire Nominees principle was confirmed, that the place where a board of directors exercises its duties (properly), will be the place of its "central management and control" (in that case, The Netherlands), even where the controlling shareholders, or advisers recommend or even expect the board to reach certain decisions, and those persons are elsewhere (UK). In that case, the directors carried out their duties responsibly.

Another UK case which if sufficient attention had been paid to it, might have sent a further warning about complacency in the corporate governance of offshore subsidiaries of Australian resident parties, was the UK First Tier Tribunal decision in Laerstate BV v Revenue & Customs [2009] UKFTT 209 (TC), where a Dutch company was found to be tax resident of the UK again, demonstrating the detailed enquiry into the decision making process of the directors (and for a period, a "shadow" director), and again referring to Esquire Nominees with approval, but with a somewhat more detailed emphasis on whether the director who did not own the company, had sufficient information before him to be able to make an informed decision. Note, Laerstate was not footnoted in Bywater.

The High Court also distinguished trading and finance companies from special purpose companies, in relation to the impact of the authority of Esquire Nominees, which company only had to implement one transaction. What that probably means is that trading and finance companies' boards will have to meet far more often to make the high level decisions of the company. However, the High Court couldn't be taken to be suggesting that the delegation of day to day decisions to management (or indeed to one director) would invariably mean that the board's authority had been usurped. However, having a board protocol and a clear rule as to delineation of day to day management from high level board type decisions, should make it clear to management that they need the board's authority to carry out other than day to day operations. So in essence, an offshore company needs to be governed in the same fashion as a listed company (with a clear delineation between the functions of the board compared to managers), rather than the fusion that takes place in an owner run small private Australian company.

The reality is that as the ATO had not apparently challenged the tax residence of foreign subsidiaries of Australian companies (at least as is apparent from reported Court and Tribunal decisions after 1972 and before 2011 (in Crown Insurance)), the UK warnings after the UK Inland Revenue became active in the area, sounded by Untelrab, R v Dimsey; R v Allen, Wood v Holden, and Larestate, may not have been sufficiently heard in Australia, and so a sense of complacency may have developed.

Some Suggestions

Whilst pure formalistic responses will not be enough, it is certainly the case that ensuring that directors do met to consider proposals put forward by the parent company or individual owners (rather than have an Australian resident director or "shadow" director bind or act on the company's behalf and only inform the board after the fact), and the directors have sufficient information in front of them to make an informed decision (as well as the Esquire Nominees baseline- only acting in the best interests of the company and not doing anything which would be unlawful), will go a long way to solving the problems that may flow from more vigorous ATO enquiry as to the "central management & control" of foreign companies doing business in Australia or which are majority owned by Australian residents.

As the onus of proof will always be on the company that claims it is a non-resident, ensuring that the persons chosen to be directors of such companies have the knowledge, skill and diligence to carry out their duties, and have sufficient credibility that they can give evidence in an Australian Court or Tribunal (which may not be permitted to be by video-link, but by travelling to Australia), of how they have fulfilled that role, will be extremely important if the foreign company is challenged. At a practical level, this will invariably increase the cost of having that function performed by a non-resident director."

6. TR 2018/5

Above I noted paras 5 and 50 of TR 2004/15, of which para 5 is reversed in TR 2018/5 following *Bywater*, may have profound[41] and unnecessary results[42]. The most recent paper of interest on this topic is by the winner of the 2019 Forsyth/Pose Prize of the Law Council, Heydon Wardell-Burns, whose paper "Corporate Tax Residency: Clarity and Consequences", forcefully argues that *Bywater* did not require the Commissioner to change his views in TR 2004/15. Further, TR 2018/5 says nothing of electronic communications, and leaves that to PCG 2018/9, again, with a substantial reversal from para 50 of TR 2004/15 and again may have profound and unnecessary results.

In a joint submission by the Tax Institute and other Professional Bodies concerning draft TR 2017/D2 the following comments fell on deaf ears in the final TR 2018/5:

[41] Or "far reaching": see Hickey & Wood, "Are all your overseas subsidiaries really non-residents?", TTI NSW Div 21 Sept 2017, at p41. Also see Dunn & Madden, "International Tax – SME Update", TTI Qld Div 24-25 Aug 2017 at p11.

[42] Julanne Jaques, one of the barrister's appearing for the Commissioner in Bywater, has written in "Residency for Companies and Trusts Post-Bywater",TTI Vic 5th Annual Tax Forum 12-13 Oct 2017, at p37, that the one tier test set out in draft TR 2017/D2, would not as a matter of statutory interpretation "give meaning to every word in the text", contrary to the High Court authority in *Project Blue Sky* [1998] HCA 28 at [71]. Also at p37 she says a close reading of *Bywater m*any confine the scope of the decision to similar facts as in *Bywater*. However, her paper was written before TR 2018/5 and PCG 2018/9 issued.

> "Former Taxation Ruling TR 2004/15 contained the Australian Taxation Office's (ATO) long-held views on the statutory corporate residency test contained in section 6(1)(b). The Professional Bodies'

understanding is the handing down of the decision [by the High Court in Bywater] has prompted the ATO to revisit its views on section 6(1)(b).

In the Professional Bodies' view, the section 6(1)(b) test that applies to corporate residency is a two limb test.

The Commissioner's preliminary view in paragraph 5 of the Draft Ruling is not consistent with the interpretation of paragraph 57 of the *Bywater* High Court decision. Paragraph 57 refers to the High Court decision *Malayan Shipping Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156 (Malayan Shipping). Importantly, *Malayan Shipping* did not address the interpretation of CMC. The contention in *Malayan Shipping* was solely in respect of the CoB test. Accordingly, paragraph 57 in the *Bywater* decision does not require the Commissioner to revisit the principles of CMC, i.e. there is no inference to be drawn from the CoB test with respect to the CMC test or vice versa.

The High Court in *Bywater* found at paragraph 57:

> "(vi) Malayan Shipping

On its facts, Malayan Shipping Co Ltd v Federal Commissioner of Taxation comes closer to the present appeals but adds little of relevance. In that case, it was conceded that central management and control of a company incorporated in Singapore was exercised inMelbourne, where a Mr Sleigh resided. That was because, inter alia, the articles appointed Sleigh managing director; empowered him to appoint and remove other directors; provided that a resolution of directors was of no force unless first approved by Sleigh; and required that the seal of the company not be affixed without the authority of Sleigh. The only business done by the company during the relevant period was to charter a ship and to sub-charter it on a number of occasions, that charter being effected in London on instructions cabled from Sleigh in Melbourne, and the sub-charters being organised by Sleigh in Melbourne, where he prepared all the documents before sending them to Singapore for execution. It was contended that, although the central management and control of the company was located in Melbourne, upon a proper construction of the definition of "resident" in s 6 of the 1936 Act, a company should not be regarded as resident in Australia, notwithstanding that its central management and control was exercised from Australia, unless the company were also carrying on its business operations in Australia. Unsurprisingly, Williams J rejected that contention" (emphasis added).

... *Bywater* can only ever be authority for what had to be decided by the High Court, that is, whether Bywater's CMC was in Australia. The decision doesn't say anything by way of *ratio decidendi*, about whether CMC itself represents carrying on business. *Bywater's* comments in relation to *Malayan Shipping*, were thus *obiter* and whilst perhaps persuasive, would not be binding on a later court.

The ATO provides no further detailed analysis in its Decision Impact Statement on the High Court decision in *Bywater*:

> "The approach the Commissioner took in TR 2004/15 in relation to the earlier High Court decision in Malayan Shipping can no longer be sustained. At [57] the majority of the court clearly agreed with Williams J's rejection of the contention that where a company has its central management and control in Australia it must, to be a resident of Australia, in addition also carry on its business operations in Australia. Therefore if a company carrying on business has its central management and control in Australia it will necessarily carry on business in Australia. That is so even when the only business carried on in Australia consists of that central management and control, and trading operations are conducted outside this country".[underlining added]

a) Purpose of the CoB test - limits the scope of the second statutory test

Australia intentionally adopted a definition of residency in 1930 that differed to that adopted in the United Kingdom (the UK). The UK test was a Common Law test based on CMC. Australia expressly adopted three alternative tests of residency, and in respect of the second test, that test was both CMC in Australia and carry on business in Australia.

We respectfully disagree with the following comments of Williams J. that:

"The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business or the controlling shareholders must be situate or resident in Australia is, in my opinion, to make it clear that the mere trading in Australia by accompany not incorporated in Australia will not of itself be sufficient to cause the company to become a resident of Australia".

If Australia had instead simply adopted the UK model (CMC in Australia) it would have been equally clear that (to use the words of Williams J.) "the mere trading in Australia by a company not incorporated in Australia will not of itself be sufficient to cause the company to become a resident of Australia".

In our view, the inference to be drawn from the express statutory language adopted by Australia in the second statutory test, is that in respect of a company not incorporated in Australia, the COB test is a limitation or a narrowing of the scope of residency, as compared to a test which simply asked whether the CMC was in Australia. Australia expressly adopted a different formulation of the test of residency as compared to the UK.

General comments

In many ways, the Australian tax system in respect of corporates operates on the basis that Australian-based profits and activities should be taxed in Australia and that foreign-based profits and activities should not be taxed in Australia, e.g. Subdivisions 768-A 768-G of the *Income Tax Assessment Act 1997*, and section 23AH of the *Income Tax Assessment Act 1936*. These principles are supported by effective integrity measures in Part IVA, Division 815 and the CFC provisions, in cases where an Australian group has a foreign subsidiary.

An overly complicated application of the tests of residency or an expanded scope of residency having regard to the roles and functions of an Australian parent at the centre of a global organisation could lead to a hollowing out of Australian based skills, functions and operations.

TR 2017/D2 impact on Australian outbounds

Malayan Shipping and *Bywater* both involve extreme set of facts, far removed from the reality of multinational business in 2017 and both essentially involved passive / investment type-activities. The lack of analysis of the distinction between substantial foreign operating companies, and the companies considered in the *Bywater* case, mean that a literal reading of the conclusions in the draft ruling could result in any and all Australian owned and supervised foreign companies to be Australian residents regardless of their business purpose (i.e. investment/holding versus operational).

The 1975 Commonwealth Taxation Review Committee (the Asprey Committee) identified these issues and rejected this type of interpretation because:

> *"This wide meaning would, however, increase the likelihood of a company being resident both in Australia and in a foreign country to a degree that might be regarded as unacceptable: many wholly-owned subsidiaries of Australian resident companies, though incorporated in foreign countries and resident there, could become Australian resident companies"*

And the 2002 Treasury Consultation Paper on the Review of International Taxation Arrangements commented on the uncertainty if the second statutory test was taken too far:

> "*However, the case law is not entirely clear, and arguably, merely exercising central management and control itself may constitute the carrying on of a business. If this interpretation was to prevail, it would significantly broaden the range of the test, and some businesses might arrange their affairs (at some cost) to guard against this*"

The above two authorities support our view that the interpretation proposed in the Draft Ruling would do significant damage to Australian taxpayers and the Australian tax system.

As currently drafted, the Draft Ruling may significantly expand the scope of the corporate residency test. This expansion of the scope of the corporate residency test would likely affect foreign incorporated companies that carry out operational activities offshore.

The Commissioner's preliminary interpretation of the second statutory test may result in adverse tax consequences for foreign incorporated companies that are taken to be Australian residents under the second statutory test…""

The joint Professional Bodies submission also outline the consequences that follow, including s23AH, Div 768-G, franking credits and s25-90.

7. PCG 2018/9

The Tax Institute, other Professional and Industry Bodies made a submission on the draft of PCG 2018/9 (i.e. PCG 2018/D3) which strongly repeated the view expressed on the draft of TR 2018/5 (i.e. TR 2017/D2), that the test is a two tier test.

The PCG set out many examples of the application of the ATO views to various fact situations.

> "The Joint Bodies believe that the interpretation of the corporate residency test adopted by the ATO in both TR 2018/5 and the Draft PCG are incongruous with the policy objectives of the corporate residency test and create uncertainty…
>
> "The Joint Bodies submit that the compliance approach should not be limited to "public groups". If the Commissioner has a particular concern with private companies and groups then surely under the compliance approach such concerns are adequately dealt with by the requirements set out in (iii) that the company has not undertaken or entered:
>
> - any artificial or contrived arrangement affecting the location of its central management;
> - a tax avoidance scheme whose outcome depends, in whole or part, on the location of its residence;
> - arrangements to conceal ultimate beneficial or economic ownership; or
> - arrangements involving abuse of board processes including backdating of documents or the board not truly executing its functions.

There is no reason why the vast majority of private companies and groups should not be able to rely on the compliance approach because the Commissioner's concerns around the actions of a small minority of taxpayers."

Again, these particular submissions fell on deaf ears.

The Joint Bodies also had something to say about electronic communications:

a) Decisions made in more than one place

Example 13 in the Draft PCG provides perhaps one of the most critical safe harbours in terms of practical guidance. However, the conclusion in paragraph 87 that the central management and control of the company is exercised to a "substantial degree in Australia" relies on, in part, that two of the four directors are located in Australia. The Joint Bodies suggest that a more useful example (or additional example) may be where only one of the four directors, all participating equally, are located in Australia. Having a minority of Australian directors on the board of a foreign company is common and so it would be useful to have clear guidance that such an arrangement will not result in central management and control being exercised to a substantial degree in Australia. Such an example would also provide clear guidance that it is not necessary that the single Australian director is required to physically attend board meetings overseas.

Such an approach is consistent with the position outlined in the "Ongoing Compliance Approach" section of the Draft PCG at paragraph 104, which refers to "the majority of directors attend board meetings while present in that jurisdiction".

Our concern is that the Commissioner's approach to the different forms of communication as articulated in the Draft PCG will engender more awkward Australian participation in relation to foreign subsidiaries of Australian companies. Distinguishing between video conference, circular resolutions, teleconference and physical presence will tend to create inefficiency and artificiality. It may promote situations where an Australian resident director is required to physically travel to the foreign board meeting to avoid central management and control being at least partly in Australia. This raises questions as to whether the Australian resident director might travel to the nearest country outside Australia (for example, Singapore or New Zealand) and participate in the directors' meeting by video conference or teleconference from that jurisdiction. It might also lead to boards being constituted only with foreign resident directors, therefore making the corporate governance of offshore subsidiaries of Australian companies far more cumbersome. Requiring a minority Australian resident director, or indeed, a number of Australian resident directors to travel overseas to attend board meetings to avoid having a substantial degree of central management and control in Australia is not consistent with a desire to limit "red tape" and to promote business efficiency."

The final PCG essentially rejected this submission, by not dealing with a single Australian resident director (rather than an equal number of Australian resident directors) in example 14, which provides:

Example 14 - decision making equally split between more than one place

87. *OS Package Co, a company incorporated in Ostasia carrying on a delivery business, has a board of four directors. Two of the four directors are located in Ostasia and two are located in Australia.*

Possibility A

88. *Board meetings are always conducted by video conference with directors participating equally from where they are based. No single director controls the decision making to the exclusion of the others.*

89. *High-level decisions are also made outside board meetings by resolution, which are passed via email circulars with all four directors participating equally in the company's high-level decision making from their respective locations.*

90. *The central management and control of OS Package Co is exercised to a substantial degree in Australia. It is therefore a resident of Australia under the central management and control test of residency because:*

- *all four directors participate equally in making all OS Package Co's high-level decisions, and*
- *two of the directors are located in Australia when they do so.*

The Joint Bodies usefully set out an Appendix for their reasons for recommending a further review.

"Appendix

"In 2003, the Board of Taxation (Board) issued its report following its *Review of International Tax Arrangements*. The Board considered the corporate residency rules (refer to pp106 – 111 in Volume 1) and made two recommendations:

- Recommendation 3.12 re residence of companies; and
- Recommendation 3.13 re dual resident companies.

The Board made numerous pertinent comments in relation to the issue of company residency which are still highly relevant today. Firstly, it noted the policy objective at paragraph 3.122 being "To assist in establishing Australia as a centre for internationally-focused companies, it is necessary to have clear, practical and internationally-acceptable rules for company residence".

In paragraphs 3.125 to 3.127, the problems with the 'central management and control' test were identified and in particular referred to (at para 3.126) 'an early High Court case which held that a company which is managed in Australia is likely to carry on business here." The Board went on to note that "This has the potential to make foreign subsidiaries of Australian companies resident in Australia, even though the subsidiaries are incorporated and operate outside Australia."

At paragraph 3.129, in considering the policy issues arising from the problems identified, the Board noted "The main objective of the company residence test should be to produce certainty and ease of operation." With this in mind, the Board considered Option 3.12 which was expressed as:

> Option 3.12: To consider options to clarify the test of company residency so that exercising central management and control alone does not constitute the carrying on of a business.

The Board recommended that "a company should be regarded as resident in Australia only if it is incorporated in Australia" (Recommendation 3.12). The effect of adopting this recommendation would be to provide a clear and certain corporate residency test.

Subsequent to this review, the ATO issued the now withdrawn TR 2004/15. This ruling addressed some of the concerns raised by the Board and provided sufficient certainty to taxpayers on how the central management and control residency test would apply.

In light of the withdrawal of TR 2004/15 which contained the ATO's long-held views in relation to the central management and control test, and the change in the ATO's views which are now contained in TR 2018/5 and the Draft PCG in response to *Bywater*, the Joint Bodies consider that the Board of Taxation should review the corporate residency test again.

In the Joint Bodies' view, the issues identified by the Board are more relevant today given the change in the ATO's view of this corporate residency test. Based on the above, in the Joint Bodies' view, a current review by the Board of the corporate residency rules is warranted."

In relation to the expose draft PCG 2017/D## which was the precursor to PCG 2018/D3, there was some improvement in the PCG in relation to electronic communication, where I said to the Law Council for the purpose of its submission, at the time:

"Virtual Decision Making

The conclusions in the examples concerning "virtual decision making" are possibly the most disturbing feature of the PCG. The examples lumped together at paragraph 51 are teleconferencing, videoconferencing, and circular resolutions. To describe them all as "virtual decision making" is unhelpful, as circular resolutions may involve no interaction with the other directors at all.

In fact, where the majority of the board reside and meet in a particular foreign country and an Australian resident director teleconferences or videoconferences with the majority, it is the directors meeting in the foreign country where the decisions are made. It may be that to pass a resolution, a majority of directors present in person or by video conference or teleconference, and voting, need to make a decision. If the majority are in a particular foreign country and the Australian resident director is in a minority, and whose vote is not necessary to carry a decision, the position might be different from where the decision must be unanimous.

Another possibility is that the Australian resident director may hold a particular view concerning how he or she will vote at the directors meeting, but following debate held by teleconference or videoconference, decides to vote a different way than they had originally proposed. In such circumstances the decision making by the Australian resident director is even more clearly made as a result of participation in the foreign board meeting.

The warning given in the joint bodies' submission on TR2017/D2 was that the ATO changed approach to *Malayan Shipping* will be economically harmful (Sub 4 on p2). This is certainly borne out in the PCG's approach to "virtual decision making" as it will force more awkward Australian participation in relation to foreign subsidiaries of Australian companies. It will tend to create inefficiency and artificiality in that an Australian resident director will have to travel to the foreign board meeting to avoid the CM&C being at least partly in Australia. This raises questions as to whether the Australian resident director might travel to Singapore and participate in the third country directors' meeting by videoconference or teleconference from Singapore? It might also lead to boards being constituted only with foreign resident directors, therefore making the corporate governance of offshore subsidiaries of Australian companies far more cumbersome.

TR2004/5 dealt with the CM&C issue where a board split between countries based on whether there was a "substantial degree" of high level decision making in Australia or the foreign country. It now appears (¶63) the Commissioner's view is that one Australian resident director participating electronically from Australia must therefore represent a "substantial degree" of high level decision making? In contrast, the Commissioner accepts at ¶50 that a board could actually meet in in Australia as long as it only decides "minor administrative matters" i.e. the ATO must be thinking of a "junket" trip.

The Commissioner's position on circular resolutions might be more understandable, but likewise, he does not distinguish between board resolutions which can be passed by a majority as against, being unanimous."

The final PCG didn't deal with the DTA concept of "effective management", as it said it was "out of scope". I had the following to say about "effective management" that in relation to the exposure draft:

"Tie-breaker in DTAs

At various places in the PCG it is stated that the CM&C is exercised both in Australia and the foreign country and that it is necessary therefore, to consider the application the "place for effective management" tie-breaker test in the relevant DTA (e.g. ¶ 49, 59, 64). However there is no guidance given to the interpretation of such tie-breaker provisions and the meaning of the words "effective management". Only Gordon J. in *Bywater* had anything to say about the topic, and otherwise the common law jurisprudence on it as far as I know, is limited to the *Smallwood* case in the UK. It may be that referring to the tie-breaker is just a "fob-off" where the two DTA parties are common law countries, where effective management is likely to equate to CM&C. Where one party to the DTA is a common law country and the other is a civil law country, which necessarily has some other test of residence, might effective management be meaningful. To make the guidance given by the PCG of any use in the case of dual residents, it is necessary for the PCG to express a view as to the Commissioner's approach to the tie-breaker provisions in the DTAs."

An interesting issue comes up out of the decision of *Wood v Holden*, as to the evidentiary burden of proof shifting to the Revenue, in cases where the taxpayer has done all that it can to show where the CM&C of a company resides. It is submitted that whilst the overall burden of proof is undoubtedly on the taxpayer, it should be possible that the evidentiary burden shift where the assertion of the Commissioner is improbable, but the Commissioner adduces no evidence[43].

5. TRUSTS

1. A trust is a resident of Australia if it has a resident trustee, or its central management and control (CM&C) is in Australia, in either case, at any time during an Australian year of income.[44] A non-resident trust is one that is not a resident trust.[45]

2. The concept of CM&C is usually relevant to corporate tax residence, for example to determine the residence of a corporate trustee. When the current definition of resident trust was inserted, it seemed unnatural to use CM&C, as to that date it had not been considered to be relevant to trusts, and there has not been a decision directly on it by an Australian court in relation to trusts.

3. However, a recent Supreme Court of Canada case, *Fundy Settlement v Canada*[46] (commonly referred to as the *Garron* case), applied the concept. In that case, a Barbados trustee did not save the *inter vivos* trust formed in Barbados from being a resident of Canada, as the court held the CM&C was in Canada with the trust's settlor. *Garron* was mentioned in passing by the High Court

[43] See Carol Grey, "Corporate tax residency after Bywater Investments", Taxation in Australia Vol 51(10) May 2017 at p548 & 552.

[44] s95(2) of Div 6, ITAA 1936.

[45] s95(3) of Div 6, ITAA 1936

[46] [2012] 1 SCR 520

in *Bywater* at [84]. After explaining why the residence of the trust should be considered in the same way as a corporation (at [14]), the Supreme Court of Canada said:

> "As with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where "its real business is carried on" (*De Beers*, at p. 458), which is where the central management and control of the trust actually takes place. As indicated, the Tax Court judge found as a fact that the main beneficiaries exercised the central management and control of the trusts in Canada. She found that St. Michael had only a limited role — to provide administrative services — and little or no responsibility beyond that (paras. 189-90). Therefore, on this test, the trusts must be found to be resident in Canada. This is not to say that the residence of a trust can never be the residence of the trustee. The residence of the trustee will also be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident. These, however, were not the facts in this case."

4. In relation to a trust with all non-resident trustee(s)[47], it should only be if the trustee "rubber stamps" instructions from e,g, an Australian resident appointor/protector, rather than to properly exercise its duties as trustee, that there might be a question of CM&C being in Australia, along the lines of *Bywater*.

6. CIVIL LAW ENTITIES

Whenever advising Australians about suitable structures offshore, or dealing with offshore structures already in place when foreigners come to Australia, it is necessary to be aware of some of the civil law entities that may be encountered[48].

Disclaimer: The material and opinions in the paper should not be used or treated as professional advice and readers should rely on their own enquiries in making any decisions concerning their own interests.

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[47] It goes beyond the scope of this paper, but for more discussion of the use of offshore trusts, see my paper "Overseas Assets in a Succession Context", LIV 14 April 2016 pp19-20.

[48] As this goes beyond the scope of the paper, again refer to my paper *ibid* pp26-37, but now also see undated PBR 1051209890341, where the ATO came down in favour of a Liechtenstein foundation being a trust, although this was not turned into a public ruling.

