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### Tax Practice Update



### Measures (No 5) Bill 2021



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## Conclusion

Taxpayers who released their super under the COVID-19 early release scheme need to be mindful that they will be denied a deduction from 1 July 2021 for personal contributions up to the total amount of their COVID-19 early release amounts (up to a maximum of $20,000).

Even taxpayers who have already re-contributed their COVID-19 early release amounts by 30 June 2021 will not necessarily escape being denied a deduction at some stage (until 30 June 2030) for personal contributions equal to their total COVID-19 early release amounts. Accordingly, super funds should update their disclosure material (especially their *Notice of intent to claim a deduction for personal contributions* form) to alert members to this change.

# [572] Individual residency – what do the recent Full Federal Court cases tell us?

***by Nicole Sammel, Nicole Sammel Tax Lawyers***

The Government announced in its recent 2021-22 Federal Budget that there will be a new regime for determining individual residency (see 2021 WTB 19 [398]). In essence, the Government proposes to replace the existing tests for the tax residency of individuals with a primary "bright line" test under which a person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident. The new regime will have effect from the first income year after the amending legislation receives Royal Assent.

This means that the existing regime for residency will likely remain relevant for the time being and will also likely remain relevant, even after the amending legislation comes into effect, for disputes about residency in prior years.

This article is about the existing regime for residency. It:

- summarises some of the legal principles enunciated in the recent Full Federal Court decisions of *Harding* [2018] FCA 837, *Addy* [2019] FCA 1768 and *Pike* [2019] FCA 2185 (the "Recent Cases"); and
- provides some practical observations/"tips" re those principles.

Although *Addy* is on appeal to the High Court, it seems unlikely that the High Court's decision will affect any of the propositions in this article. (Based on the parties' submissions, the High Court will likely only address the validity of the "backpacker tax": see para [596] of this *Bulletin*.)

## Existing regime for residency

By way of background, under the existing regime for residency, an individual who satisfies any of the following tests will be "resident" in Australia:

- a person who resides, within the ordinary meaning of that word, in Australia (the "Ordinary Concepts Test");
- a person whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia (the "Domicile Test"); and
- a person 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 the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia (the "183 Day Test").

## Overview

Below I discuss principles from the Recent Cases and provide observations/tips on:

1. the Ordinary Concepts Test;
2. the meaning of "permanent place of abode outside Australia" (in the Domicile Test);
3. whether the 183 Day Test deems full year residency; and

 

4. the significance of the expression "the Commissioner is satisfied" (which is used in the Domicile Test and the 183 Day Test).

## 1. Ordinary Concepts Test

### *Principles from the Recent Cases*

To be resident under the Ordinary Concepts Test, a taxpayer must have:

- presence in Australia; and
- the intention to treat Australia as home.

*Presence in Australia*

If the taxpayer is physically in Australia in the relevant period, then the "presence" requirement will generally be satisfied.

However, the "presence" requirement can be satisfied even if the taxpayer is physically absent from Australia during the relevant period. For a taxpayer who has previously established a home in Australia but is then physically absent from Australia, the test will be satisfied if the taxpayer has retained a "continuity of association" with Australia. Determining whether a person has retained a "continuity of association" with Australia requires a consideration of all the relevant circumstances, including whether they have retained in Australia a physical home to which they can return, a family unit, possessions and relationships with people and institutions.

Prior to *Harding*, there had been some doubt as to whether "continuity of association" was the appropriate test. In *Harding*, counsel for the taxpayer argued that the concept of "continuity of association" had been incorrectly incorporated into the notion of "resident" in Australian jurisprudence. He submitted the concept of "continuity of association" was inconsistent with Latham CJ's observation in the High Court decision of *Miller* [1946] HCA 23 that "a man resides where he lives" (being, in that case, where the taxpayer "ate and slept and worked"). The primary judge in Harding rejected the taxpayer's submission. According to the primary judge, the concept of "continuity of association" is not inconsistent with the proposition that a person resides where they live; it is a tool for determining where a person lives. The Full Federal Court agreed with the primary judge.

*Intention to treat Australia as home*

A taxpayer's assertion that they intended, or did not intend, Australia to be their home is admissible evidence, but objective manifestation of the taxpayer's state of mind at the relevant time is usually more reliable evidence.

A taxpayer who maintains their family in a house in Australia will struggle to establish that they did not intend to treat Australia as home. In *Pike*, the Full Court cited what had been said (as *obiter*) in *Harding*:

*"save in the most exceptional circumstances, the existence of a house in Australia maintained by a taxpayer who is working overseas, and the maintenance of a family in that house ...demonstrates ... an intention to treat that place as 'home'"*,

in holding that the primary judge had not erred in finding that Mr Pike was resident under the Ordinary Concepts Test.

### *Observations/tips*

If a taxpayer wishes to establish that they are not resident under the Ordinary Concepts Test, then it may be helpful to make separate, distinct submissions that: (i) the taxpayer did not have "presence" in Australia; and (ii) the taxpayer did not intend to treat Australia as home. If the taxpayer can persuade the decision-maker about either of these propositions, they should be successful.

This is borne out by the decisions in *Harding* and *Addy*. In each case, it was held that the taxpayer did not have an intention to treat Australia as home and accordingly, that the taxpayer was not resident under the Ordinary Concepts Test. This was so, even though each taxpayer seemed to have "presence" in Australia. (In *Addy*, there was physical presence; in *Harding*, there was continuity of association.)

 

## 2. Permanent place of abode outside Australia

### *Principles from the Recent Cases*

As noted above, under the Domicile Test, a person whose domicile is in Australia will be resident unless the Commissioner is satisfied that the person has a permanent place of abode outside Australia.

The Recent Cases do not provide guidance on when a person will have a "domicile in Australia"; but they do provide guidance on the meaning of "permanent place of abode outside Australia". *Harding* clarifies that a taxpayer will have a "permanent place of abode outside Australia" if the taxpayer has been living in a single foreign country (as opposed to having moved between foreign countries) and has definitely abandoned their Australian residence.

### *Observations/tips*

Determining whether a person has a "permanent place of abode outside Australia", seems, intuitively, to require an analysis of the person's living arrangements outside Australia. However, Harding does not support this "intuitive" approach. Instead, Harding clarifies that determining whether a person has a permanent place of abode outside Australia requires, primarily, an analysis of the taxpayer's relationship with Australia – specifically, of whether the taxpayer has "definitely abandoned their Australian residence".

As a result, there is potentially some degree of overlap between:

- the Ordinary Concepts Test (which, quite obviously, is focused on a taxpayer's relationship with Australia); and
- the "permanent place of abode outside Australia" requirement in the Domicile Test (which *Harding* has clarified is also focussed on a taxpayer's relationship with Australia).

In particular, it seems to me that the "intention to treat Australia as home" requirement in the Ordinary Concepts Test may be co-extensive/synonymous with the "definitely abandoned Australian residence" requirement in the Domicile Test. Put simply, I am suggesting that a taxpayer who does not have an "intention to treat Australia as home" (for the purposes of the Ordinary Concepts Test) will necessarily also have "definitely abandoned their Australian residence" (for the purposes of the "permanent place of abode outside Australia" requirement in the Domicile Test).

If I am right, then one impact of the *Harding* decision is that it may reduce the Commissioner's ability to establish that a person who is not resident under the Ordinary Concepts Test is nevertheless resident under the Domicile Test. In other words: if a taxpayer (whose domicile is in Australia) is not resident under the Ordinary Concepts Test, the Commissioner may find it harder to establish that the taxpayer is resident under the Domicile Test than the ATO would have, prior to *Harding*. Specifically, it may be difficult for the Commissioner to establish that a taxpayer is resident under the Domicile Test (if the person is not resident under the Ordinary Concepts Test) where:

- the taxpayer has been living overseas in a single foreign country; and
- the reason the taxpayer is not resident under the Ordinary Concepts Test is because they lack "intention to treat Australia as home".

I say this because, to reiterate: if the taxpayer lacks "intention to treat Australia as home" (for the purposes of the Ordinary Concepts Test), then presumably they would also be regarded as having "definitely abandoned their Australian residence" for the purposes of the Domicile Test. Accordingly, provided the person had been living in a single country overseas, they should be regarded as having a 'permanent place of abode outside Australia" under the *Harding* definition of this phrase.

Of course, the *Harding* definition of "permanent place of abode" does not make the Domicile Test entirely redundant. There would still be situations where a taxpayer that was not resident under the Ordinary

Concepts Test could be resident under the Domicile Test. Specifically:

- a taxpayer who is not resident under the Ordinary Concepts Test but who moves from country to country could be resident under the Domicile Test; and
- it is also conceivable that a taxpayer living in a single foreign country who is not resident under the Ordinary Concepts Test due to lack of "continuity of association" with Australia (rather than due to lack of intention to treat Australia as home) might be resident under the Domicile Test. This is because the taxpayer's lack of continuity of association with Australia will not necessarily equate to the taxpayer having "definitely abandoned" their Australian residence.

## 3. 183 Day Test – does it deem full year residency?

### *Principles from the Recent Cases*

In *Addy*, the taxpayer submitted that a person who is resident under the 183 Day Test (because she/he is physically present in Australia for at least 183 days of an income year and satisfies the other requirements of the test) is deemed to be resident for the whole of that income year.

If the taxpayer's interpretation of the 183 Day Test were correct, then a person who came to live in Australia in say, July 2021 and departed in February 2022, would be treated as resident for the whole period 1 July 2021 - 30 June 2022, notwithstanding that the taxpayer had left Australia in February 2022.

The Full Court did not accept the taxpayer's interpretation of the 183 Day Test.

### *Observations/tips*

Prior to the decision in *Addy*, some practitioners may have advised foreign resident taxpayers who were planning to return to live in Australia that they should not return until the second half of the income year (ie, in January or later), to avoid being in Australia for 183 days of the income year. This was to guard against the possibility of the taxpayer being treated, under the 183 Day Test, as resident for the whole income year (as opposed to only from the date they actually returned to Australia) and consequently being taxed on any foreign income they had earned during the income year prior to arriving in Australia. This approach has less justification in light of Addy.

## 4. The Commissioner is satisfied

### *Principles from the Recent Cases*

The expression "the Commissioner is satisfied" is used in both the Domicile Test and the 183 Day Test. (See above under the heading "Existing regime for residency").

*Addy* confirms that, for the purposes of these 2 tests, a court cannot substitute its own state of satisfaction for that of the Commissioner. It is "the Commissioner's function and not that of the Court to determine on the merits", whether the Commissioner is satisfied. The role of the court is limited to determining whether the Commissioner erred in law in some way in being, or not being, satisfied. If the Court determines that the Commissioner erred in law, the Court still cannot substitute its own state of satisfaction – it can merely remit the issue to the Commissioner for reconsideration.

### *Observations/tips*

Where a taxpayer wishes to challenge the ATO's view about any of the matters (in the existing residency tests) of which "the Commissioner is required to be satisfied", it will be more difficult to do so in a court than in the AAT. This is because a court will be able to intervene only if it can be demonstrated that the Commissioner erred in law in becoming or not becoming satisfied. This will rarely be straightforward to demonstrate. The AAT, on the other hand, can consider the question wholly anew on the basis of all the facts and evidence.

By way of contrast, if the taxpayer wishes to challenge other aspects of the Commissioner's view, ie aspects other than those that the legislation expressly requires the Commissioner to be satisfied about (eg whether the taxpayer is resident under the Ordinary Concepts Test, whether the taxpayer's domicile is in Australia, whether the taxpayer has been in Australia for more than 183 days), then these are matters which a court can consider and make findings about.

### Conclusion

Prior to *Harding*, there had been a long period where the only residency decisions were ones handed down by the AAT. Since AAT decisions have limited precedential value, they provided limited guidance for practitioners about the residency regime.

The recent Full Federal Court cases of *Harding*, *Addy* and *Pike* provide some welcome precedential guidance on various aspects of the residency regime. This article has attempted to: (a) summarise that guidance; and (b) present some ideas about how tax practitioners can helpfully use that guidance in advising clients about their residency and assisting clients with residency disputes.

## [573] Australian ownership in foreign companies: some tax issues

***by Michael Cranston, Partner, Waterhouse Lawyers***

There are many Australian residents who have business interests in overseas companies. These are often with overseas business partners with both as directors. Also, many people migrating to Australia have these overseas business interests when they arrive. For these companies to remain foreign companies and subject to taxation in the country where they reside, there are a number of things to consider.

This brief article discusses some of the tax issues that may be encountered.

### Foreign company: Central Management and Control

First. If the plan is to have the foreign company remain a foreign company, then you do ***NOT*** want to have the attributes that will make it an Australian resident company. The residency test, under tax law, will make the company an Australian resident if it carries on a business in Australia and has its central management and control or 50% of the voting interests in Australia.

Generally, if you have your central management and control in Australia, you are carrying on a business in Australia. There may be disagreements from other countries on this issue and there may be tiebreaker provisions in double taxation agreements to determine residency.

To avoid this scenario, you need to ensure your high-level strategic decisions are made overseas. These can be made in the board meetings. The level of decision-making will be different for small to large businesses.

The ATO's Practical Compliance Guideline PCG 2018/9 provides guidance on this issue. COVID has raised issues but the ATO should understand the practical problems in not being able to travel to overseas board meetings.

### Controlled Foreign companies

Secondly. These foreign companies are more likely be a controlled foreign company ("CFC") and subject to strict rules. The control tests (strict, assumed and *de facto*) would be satisfied because the ownership percentage as shareholder on your own or including your associates would meet one of these tests. A business partner would be an associate of yourself and included in the test.

Once belonging to a CFC, you need to consider whether the foreign company has active business income greater than 95% (active business test). For the great majority of countries (non-listed), if this test is failed, then certain income types such as interest, dividends, sales and service between associates and sale of shares will be attributable to the Australian shareholder each year. This is not so much the case for the 7 listed countries such as the UK and USA. Generally, only a very limited number of income