Tax Residency: A Practical Guide

Mark Chapman

Wednesday 25 October 2023

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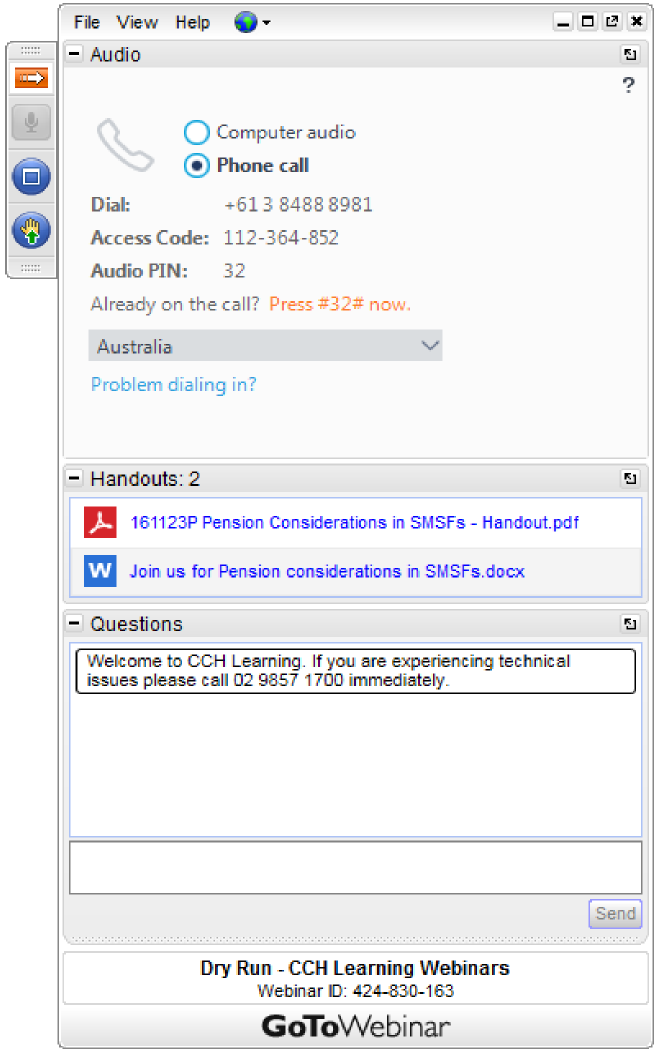

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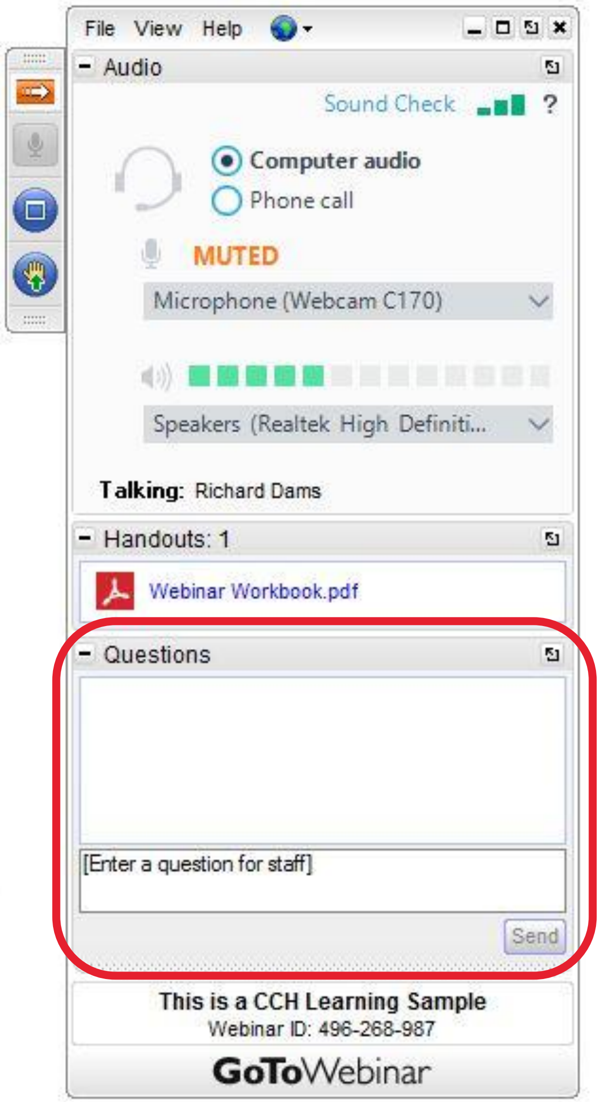

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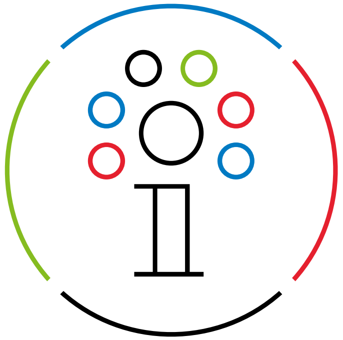
Your Presenter

Mark Chapman
Director of Tax Communications
H&R Block

Today's session will cover



Tax Residency: A Practical Guide

- Arriving in Australia:
  - The residency rules explained: a guide to TR 2023/1
  - How are residents taxed?
  - How are overseas assets taxed when you first come to Australia?
  - How is overseas income taxed in Australia?
- Working holidaymakers:
  - How the rules for working holidaymakers work
  - Impact of the Addy case
- Temporary residents:
  - What is a temporary resident and how are they taxed?
- Going overseas:
  - How are non-residents taxed?
  - How are Australian assets taxed when you leave Australia?
  - The Harding case – is it now easier for individuals leaving Australia, particularly those going on secondment overseas, to claim non-resident status?
  - What is Taxable Australian Property and how does it affect your tax?
  - Leaving Australia and coming back again; what it means for your tax and super
  - How is superannuation affected when you leave?
  - What happens to your student loan when you move overseas?
  - Foreign residents and the main residence exemption

Residency: Why does it matter?

- Law treats residents and non-residents differently
- Residents are taxed on all worldwide income
- Non-residents are taxed only on Australian sourced income
- Tax rates are different for residents compared to non-residents
  - Non-residents do not get the tax-free threshold ($18,200)
  - Non-residents pay tax at 32.5% from the first dollar of income up to $120,000
- Residents pay Medicare levy, non-residents don't (generally) pay Medicare levy (but also can't claim Medicare benefits)
- Non-residents pay withholding tax on bank interest at flat 10%
- Non-residents liable for CGT only on "real property" (e.g Australian land/houses), not shares and other investments

Residency: Primary Test

- 'Resides' test (section 6(1) ITAA 1936)
  - "to dwell permanently, or for a considerable period of time, to have one's settled or usual abode, to live in or at a particular place" *Shorter Oxford Dictionary*
- Take into account (TR 2023/1):
  - Period of physical presence in Australia
  - Intention or purpose of presence
  - Behaviour while in Australia
  - Family, and business or employment ties
  - Maintenance and location of assets
  - Social and living arrangements
- If taxpayer passes the 'resides' test, they are resident and no further tests need be considered
- If taxpayer fails the 'resides' test, consider the other three tests. If any ONE of these tests is passed, the taxpayer is resident.

Residency: Statutory tests

- Domicile test (concept imported from UK law):
  - A person is resident in Australia if his/her domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia considered by law to be your permanent home
    - usually something more than a residence.
    - Domicile of origin, domicile of choice, domicile by law
- 183 day test
  - Physically present in Australia for more than 183 days in a year
  - Need not be continuous
  - Does not apply if your usual place of abode is outside Australia
- Superannuation test
  - Eligible employee under the Superannuation Act 1976 or the spouse or child under 16 of such a person
  - Typically current public servants (but not former ones)

Residency: Common scenarios

If you are:	You are generally
An overseas student enrolled in a course of more than 6 months duration at an Australia institution	Australian resident
Visiting Australia, working and living in one place and have taken steps to make Australia your home	Australian resident
Visiting Australia and travelling and working in various places	Foreign resident (possibly working holidaymaker)
Holidaying in Australia or here for less than 6 months	Foreign resident
Migrating to Australia and intend to live here permanently	Australian resident

Residency: Example

- Adam:
  - Born in Australia, works as an airline pilot
  - Owns a house in Sydney, Australian bank account, private health cover and dividends
  - Works in Dubai from 1 November 2021 to 1 April 2022, lives in leased apartment
  - Salary paid into Australian bank account
  - Spends December in Australia visiting family who remained in Australia
  - Accepts an offer to relocate to Dubai and flies there on 1 July 2022 for an indefinite period
  - Open joint bank account in Dubai, purchase an apartment there
  - Wife joins him in Dubai
  - Kids stay in Australia, retains house (rents it out), retains private health cover and local bank account
  - Takes six weeks leave in Australia over Christmas period to visit children
- Questions:
  - Is Adam resident or non-resident in 2021/22?
  - Is Adam resident or non-resident in 2022/23?

Residency: Example

- 2021/22:
  - Adam is still Australian resident:
    - He passes the "resides in Australia" (common law) test
      - Maintained his family here
      - Home and financial ties are here
      - He visits Australia to stay with family
      - No permanent place of abode outside Australia
    - AND – he is still domiciled in Australia
      - He hasn't established a domicile of choice in Dubai
    - AND – he passes the 183 day test
      - He is physically present in Australia for seven months (away for five months)

Residency: Example

- 2022/23:
  - Adam is no longer Australian resident:
    - He does not pass the “resides in Australia” (common law) test
    - Overseas employment is for an indefinite period
    - Purchased an apartment in Dubai
    - Established a bank account in Dubai
    - His wife has relocated with him
    - Permanent place of abode is in Dubai
  - There are still factors which indicate residency (still owns family home, etc) but they are now outweighed by other factors

New Migrants Tax Action Plan

- Get a Tax File Number (can only apply once in Australia)
- Get a market valuation of any assets that may be subject to CGT – such as property, shares or business interests – which owned on the date of entry to Australia
- Get an ABN if there is an intention to start a business
- Choose and sign up with a superannuation fund
- Lodge first tax return for the period from the date of arrival through to the following 30 June
- Note: If coming to Australia permanently, taxpayer will be tax resident from the date of arrival and will be entitled to a partial tax-free threshold depending on date of arrival. The full tax free threshold consists of two elements:
  - A flat amount of $13,464 which is paid in full
  - An additional $4,736 apportioned for the number of months the taxpayer was in Australia during the income year, including the month of arrival

Coming to Australia

- Once resident, taxpayers must disclose all worldwide income earned from date of arrival:
    - Interest on overseas bank accounts
    - Foreign pensions
    - Rent from investment properties
    - Disposals of foreign assets
    - Shares/proceeds from employee share schemes
    - Wages and salaries
- Foreign tax offset may be available to avoid double taxation
- Money brought into Australia when taxpayer first arrives is not taxable (e.g overseas savings, profits from asset disposals)

Taxable Australian Property

- Foreign residents are only subject to CGT in relation to Taxable Australian Property.
- Five categories of TAP:
  - Taxable Australian Real Property
    - Real property situated in Australia (eg land and buildings)
    - Mining, quarrying, or prospecting rights to minerals, petroleum or quarry materials situated in Australia
  - An indirect interest in Australian real property
  - A business asset of a permanent establishment in Australia
  - An option or right to acquire any of the CGT assets in items 1 to 3, or
  - A CGT asset is deemed to be TAP where a taxpayer, on ceasing to be an Australian resident, makes an election under s 104-165

Taxable Australian Property

- An indirect Australian real property interest exists where a foreign resident has a membership interest in an entity and that interest passes **both** of these tests:
  - the non-portfolio interest test
    - The direct interests held by the foreign resident and its associates in the entity are 10% or more
  - the principal asset test
    - The entity in which the foreign resident holds an interest has, based on market value, more TARP assets than non-TARP assets
- Typical example would be a company or unit trust in which a foreign resident and associates own more than 10% and whose assets consist of at least 50% Australian land and buildings
- Most Australian listed company shares are **not** TAP

CGT for arriving residents

- CGT assets are deemed to have been acquired on the date the taxpayer became resident in Australia (possibly – but not necessarily – the date of arrival)
- Taxpayers will need to get a market valuation of any assets that may be subject to CGT – such as property, shares, business interests, personal items like jewellery – which were owned on the date of entry to Australia
- If the asset is already TAP (such as real estate located in Australia) it is already in the Australian tax system and a valuation is not required
- After that, normal CGT rules apply
- Assets must be held for 12 months from date of becoming resident in order to get the 50% discount

CGT for arriving residents - example

- Clients purchased a family home in England in 2010 for around 500,000 Pounds. They immediately moved into the house and lived there until they left for Australia.
- They left England to live permanently in Australia in 2013 – they were on a temporary resident visa.
- They renovated the house and during the period of renovations the house sat vacant – renovations cost around 100,000 pounds.
- In July 2014 they rented the house out for about 6 months and then their in-laws moved into the house and are still in the house now.
- They became Australian residents for tax purposes in April 2016 (moved onto permanent residency visa). They purchased a main residence here in Australia on 12/03/2014.
- They wish to sell the UK house for around 750,000 pounds. What are the tax implications of the sale of the UK house?

CGT for arriving residents - example

- The UK house would be deemed acquired for Australian tax purposes at the date they became permanent residents in April 2016 for its market value at that date. They will need a market valuation of the property at that date to be prepared. This figure becomes the base cost. Everything prior to that is irrelevant because the asset was not inside the Australian tax net.
- Capital gain will be the difference between sale proceeds and market value at April 2016.
- No main residence exemption because they had already acquired another main residence in Australia (in 2014, before becoming full tax residents).
- But note, both the absence rule and the MRE can theoretically apply to an overseas property sold after becoming resident (see TD 95/7 and ATO ID 2010/101)

Becoming non-resident

- “It is easier to convince the ATO that you have been dead for a year and have miraculously come back to life than to convince them you have ceased to be tax resident for that period”
- Non-residents (foreign residents) are taxed only on Australian sourced income
- Different tax rates
- Leave Australia and do not set up a permanent home in another country
  - Still Australian resident (possibly)
- Leave Australia permanently
  - Foreign resident from date of departure

Becoming non-resident

- Consider:
  - Whether intend to return permanently to Australia
  - The roots put down in new country, such as buying a house or marrying
  - Duration and frequency of visits to Australia
  - Continuing family connections to Australia (e.g spouse, children)
  - Continuing financial, social and emotional ties to Australia (e.g family home, car, salary paid into Australian bank account)

Non-residency: the Harding case

- The recent Harding case dealt with an Australian who moved to Bahrain and then stayed there for several years, albeit that he moved between several different apartments.
- The Commissioner argued that the taxpayer had not established a "permanent place of abode" in Bahrain (because he hadn't settled in one particular apartment) and therefore was still domiciled in Australian and therefore still tax resident.
- The case was ultimately appealed all the way to the Full Federal Court, which held that Mr Harding was not a tax resident as he was no longer domiciled in Australia.
- The reference to "place" in the "permanent place of abode test" was not a reference to a person's specific dwelling but could instead be the town or country in which a person is permanently residing.
- The Full Court found that if a person has abandoned their residence in Australia, there should be no distinction between someone who buys an apartment overseas and someone who lives in a series of temporary flats in the same country (as Mr Harding did).
- Therefore, even though Mr Harding's specific type of accommodation in Bahrain was "temporary" or "transitory", the Full Court concluded that his "place of abode" was Bahrain.

Non-residency: the Harding case

- The key takeaways from the Full Court's decision are as follows:
  - Most Australian expats who move overseas will be deemed as residing in Australia (and hence will remain fully taxable in Australia) unless they can show they have established a permanent 'place of abode' overseas.
  - Temporary accommodation does not preclude a taxpayer from having a permanent place of abode overseas. A "place of abode" can be a town or country, rather than a specific dwelling;
  - if an Australian living or working overseas can establish that a particular town or country outside of Australia is their permanent place of abode, it may now be easier for them to establish that they are not a resident of Australia for tax purposes; and
  - Whether a person is a "resident" of Australia for tax purposes must be based on a holistic assessment of their circumstances, rather than based on "checklists" or facts that were found decisive in other cases. In other words, every taxpayers' circumstances are different, and no shortcuts can be taken.

CGT for departing residents

- CGT event I1 happens
- All CGT assets are deemed to be disposed of at market value, except TAP
- Taxpayer may elect to disregard deemed disposal (s104-165(2))
  - No deemed disposal happens and assets remain with Australian tax net
  - Election is "all or nothing"; all CGT assets must be included
  - The way the tax return for the period of departure is completed is evidence of whether or not the election is made
- There can be advantages in choosing deemed disposal if the value of assets will increase in future but consider also cash flow and the impact of non-residence on the CGT discount

Returning to Australia

- If no election was made to defer disposal:
  - Assets will be deemed to have been acquired at date of becoming resident. Any increase in value whilst overseas will escape Australian tax when ultimately disposed of
- The family home is TAP and therefore not subject to the deemed disposal rules
- If election was made to defer disposal:
  - Assets never ceased to be TAP so returning to Australia has no impact

Special CGT rules for non-residents

- No CGT discount:
  - The 50% CGT discount allowed for gains made by individuals is reduced for any periods in which the taxpayer has been a foreign resident during the period of ownership
- Foreign resident CGT withholding:
  - From 1 July 2017, there is a CGT withholding rate for foreign tax residents of 12.5 percent payable on disposals of Australian property with a market value of $750,000 or more. Relevant in relation to contracts entered into on or after 1 July 2017.

Special CGT rules for non-residents – main residence

- From 9 May 2017, foreign tax residents cannot access the CGT main residence exemption, with exceptions.
- Foreign tax residents who hold property on 9 May 2017 could continue to claim the exemption until 30 June 2020.
- As the legislation applies to foreign residents, the new legislation will also apply to Australian citizens or permanent residents who dispose of their Australian main residence whilst a foreign resident, e.g. whilst working overseas on secondment.
- No partial exemption!
- The determining factor is the residency status of the taxpayer at the time of the CGT event (i.e. when the contract for sale is signed).
- For Australian citizens and permanent residents who may be a foreign resident for a period of time the CGT main residence exemption should still be available if they come back to Australia and dispose of their main residence after re-establishing Australian tax residency.

Special CGT rules for non-residents – main residence

- Exceptions:
  - "life events": the taxpayer satisfies the life events test if they have been a foreign resident for six years or less and meets one of the following:
    - the taxpayer or taxpayer's spouse or child under 18 years has had a terminal medical condition during that period of foreign residency
    - the death of either the taxpayer's spouse or child under 18 years during that period of foreign residency
    - the CGT event happens because of the taxpayer's divorce or separation (s 118-110(5)).
- The effect of these rules is that for Australians going overseas who sell their main residence at the time they are a **foreign resident**, the main residence exemption will not be available **at all**:
  - where a "life event" does **not** occur, or
  - after six continuous years as a non-resident, even where a life event occurs
- Foreign residents will no longer benefit from the "absence rule" rule if the property is sold when they are a foreign resident.

Special CGT rules for non-residents – main residence

- Example:
- *Vicki acquired a dwelling on 10 September 2010 moving into it and establishing it as her main residence. On 1 July 2018 Vicki vacated the dwelling and moved to New York. On 15 October 2020 Vicki signs a contract to sell the dwelling. As Vicki is a foreign resident on 15 October 2020, she is not entitled to the main residence exemption.*
- *This outcome is not affected by Vicki previously using the dwelling as her main residence and the absence rule that could otherwise have applied to treat the dwelling as Vicki's main residence from 1 July 2018 to 15 October 2020.*

Special CGT rules for non-residents – main residence

- In relation to deceased estates, the trustee or beneficiary of a deceased estate will be denied the main residence exemption:
  - for the deceased's ownership period, if the deceased had been a foreign tax resident for a continuous period of six years or more immediately before their death (and therefore an "excluded foreign resident", s 118-195(1)(c)), and
  - for the trustee or beneficiary's ownership period, if the relevant beneficiary had been a foreign tax resident for a continuous period of six years or more immediately before the CGT event (and therefore an "excluded foreign resident", s 118-195(1A)(b)).

Special income rules for non-residents

- HELP/TSL loans
  - From 1 July 2017, Australians living overseas and earning above the minimum repayment threshold must make loan repayments based on **worldwide** income
- Investment income
  - Where received after becoming non-resident, payer must deduct withholding tax:
    - 10% for bank interest
    - Between 15% and 30% for unfranked dividends depending on whether there is a DTA
    - Up to 30% for royalties depending on whether there is a DTA
    - This is a final tax. Income is exempt and doesn't need to be included in tax return
    - If payer does not have overseas address, they must withhold tax at 47%
    - Franked dividends are not assessable and therefore not included in tax return (and imputation credits are not available)

Temporary residents – what is a temporary resident?

- You are a temporary resident if (s995-1 ITAA 1997):
  - You hold a temporary visa under the Migration Act 1958 (for example, a 457 visa) and
  - You (and your spouse) are not an Australian resident within the meaning of the Social Security Act 1991 (SSA), i.e: you reside in Australia and are
    - an Australian citizen
    - the holder of a permanent visa
    - a protected special category visa holder
- TIP: If your spouse is an Australian resident within the SSA, you are not a temporary resident even if you hold a temporary visa

Temporary residents – how are they taxed?

- Temporary residents are only taxed on:
  - Australian source income (e.g employment income, bank interest and dividends)
  - Certain short term foreign employment income
- Temporary residents are not taxed on most foreign income (so overseas bank interest, dividends, rental income and capital gains are not taxed)
- Temporary residents are exempt from Australian CGT (except where the asset is Taxable Australian Property such as an investment property)
- If temporary resident applies for permanent residency, worldwide assets come into Australian tax net at market value at date of application (which defers tax entry point compared to similar permanent migrants)

New Zealand citizens

- When New Zealand citizens enter Australia, they receive a "special category visa (SCV)" allowing them to remain and work in Australia but not re-enter if they leave
- This is a temporary visa (TD 2012/18)
- Where New Zealand citizens entered Australia after 26 February 2001 (on a SCV) and have NOT applied for permanent residency or taken Australian citizenship, they will be treated as temporary residents for tax purposes no matter how long they stay in Australia (even for decades).
- This means that qualifying New Zealanders are not taxed on most foreign (including New Zealand) income and are excluded from Australian CGT except where the asset is TAP.
- This does not apply where the New Zealand citizen is married to (or in a de-facto relationship with) an Australian resident.

Temporary residents: superannuation

- Temporary residents departing Australia permanently are entitled to receive a refund of superannuation contributions paid by their ex-employers on their behalf. This refund is payable after the temporary resident has left the country.
- The tax rates that apply are:
  - 0% for the tax free component
  - 38% for the taxed element of a taxable component
  - 47% for the untaxed element of a taxable component
- Refunds are applied for online and the amount of the refund is not assessable income.

Working holidaymakers

- From 1 January 2017, all working holidaymakers on visa types 417 and 462 are taxed at a rate of 15% on all income from the first dollar up to $45,000. For income from $45,001 onwards, normal tax rates apply (32.5% for income up to $120,000).
- These rates apply regardless of whether the taxpayer satisfies the normal tests for residency/non-residency outlined earlier. In other words, the new rules override the current residency rules.
- If the taxpayer starts a job after 1 January 2017, they must advise their employer if they are on a relevant visa type so that tax can be deducted at the special 15% rate.
- Employers must register with the ATO to deduct tax at the 15% rate. If not registered, employers must deduct tax at foreign resident rates (starting at 32.5%).
- Working holidaymakers cease to be taxed at WHM rates if they transition to a different visa type:
  - Apply the residency tests as normal at that point

Addy case - working holidaymakers

- The Addy case concerned a British working holidaymaker who argued that:
  - although a working holidaymaker, she was resident for tax purposes applying the ordinary 'abode' test, and
  - the 15% WHM rate was discriminatory and should not be applied, per Art 25 of the Australia-UK DTA, which she said should apply pay tax to British nationals at the same rates that apply to Australian citizens who are tax residents.
- Article 25 of the DTA is a "non-discrimination clause" which provides that nationals of, in this case, the UK should not be subject to tax in Australia that is "more burdensome" than the tax to which Australian nationals "in the same circumstances" are or may be subjected.
- The case was ultimately appealed all the way to the High Court, which found for Ms Addy.

Addy case - implications

- Clients affected are as follows:
  - client who has spent time on a working holiday-maker (417 or 462 visa) since 1 January 2017 AND
  - Is also tax-resident under normal tests AND
  - Is from a country with which Australia has a DTA containing a non-discrimination Article like Art 25 (Chile, Finland, Germany, Japan, Norway, Israel, Turkey and the United Kingdom)
- For clients who meet these criteria, the working holidaymaker 15% tax rate is discriminatory and cannot be applied.
- Such clients are to be taxed at normal resident rates, meaning that they are also entitled to the $18,200 tax free threshold.
- The next $26,800 of income (FY 21, FY 22 and FY 23 rates) may be taxed at 19% rather than the 15% WHM rate.
- May also be liable to pay the Medicare levy.
- Affected client must also include their foreign-sourced income in their tax return, to the extent that Australia has taxing rights
- Clients who are not tax residents are not affected by the Addy case.
- Cases are identified because WHM now need to name their home country at box A4 (where working holidaymaker income is declared) and give their residency status at the "resident" label.

Working holidaymakers - superannuation

- Working holiday-makers departing Australia permanently are entitled to receive a refund of superannuation contributions paid by their ex-employers on their behalf.
- This refund is payable after the working holidaymaker has left the country.
- From 1 July 2017, the refund is subject to a tax deduction of 65%.

Medicare

- Prescribed persons are fully or partially exempt from the Medicare levy (ITAA36 s 251T).
- This includes:
  - Foreign residents for Australian tax purposes
  - Those not entitled to Medicare benefits:
    - Temporary residents with a Medicare Entitlements statement from the DHS showing they are not entitled to Medicare benefits
    - Temporary residents from some countries are entitled to Medicare benefits because of reciprocal agreements (eg UK, New Zealand, Ireland, Netherlands, Norway, Sweden, Finland and others)
- There is no exemption for foreign residents and those not entitled to Medicare benefits where the taxpayer has one or more dependents (including spouse) who are not prescribed persons as they do not fall within any of the exemption categories
- Medicare levy surcharge is also not payable by prescribed persons (ie, including foreign and temporary residents).

Questions?

You can type them in the "Questions" box now

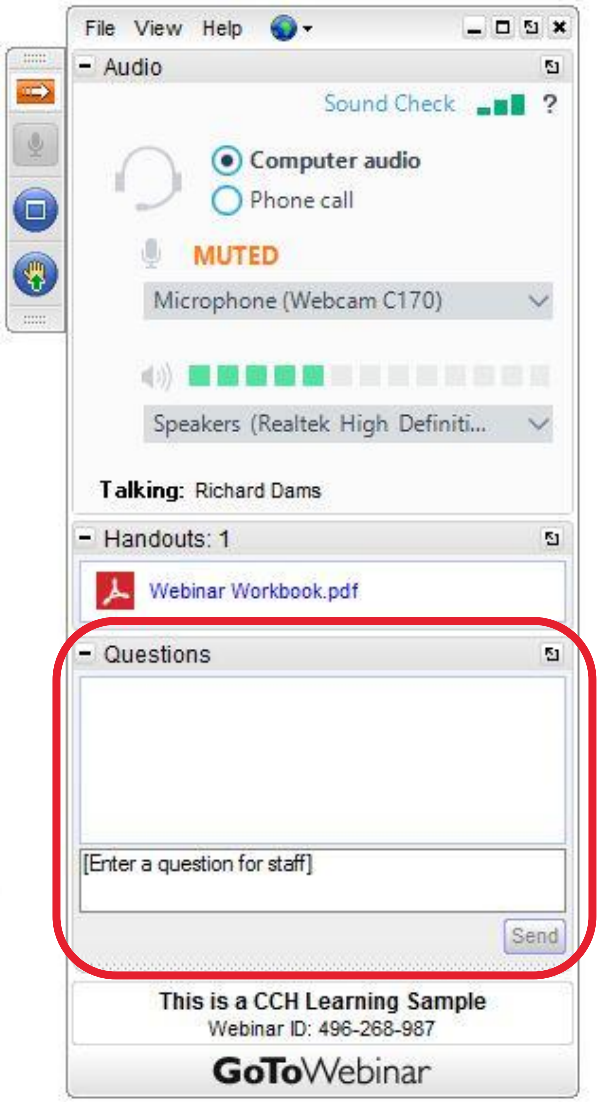
Or contact me via:

- **Mark Chapman**
- Director of Tax Communications
- H&R Block
- 0415 844 388
- mchapman@hrblock.com.au

Questions?

Alison Wood
Moderator

Type your question and hit Send



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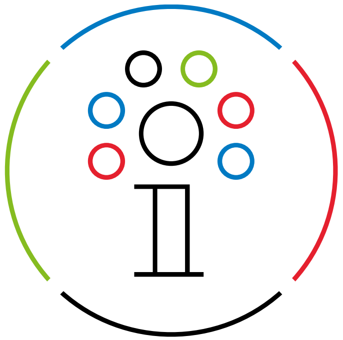

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- 31 October – Tax Technical Update – October 2023
- 1 November – Staff Onboarding – Cyber Security
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Questions?

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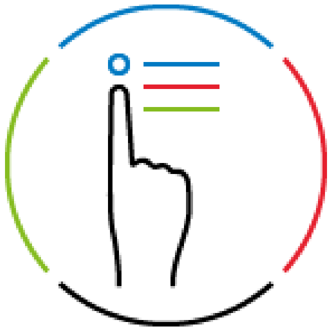

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