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Residency and Australians working overseas: can be an expensive lesson in tax law

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Residence is important in determining the Australian income tax liability for individuals that are residents (all income sources) and foreign residents (Australian income sources) of ordinary and statutory income.¹ In recent times the Australian Taxation Office (ATO) appears to be taking a tough stance on the residence of Australian citizens who travel overseas to work for a period of time, especially where that work is undertaken in countries with low income tax rates. This is evident in a number of cases that have recently been decided by the Administrative Appeals Tribunal (AAT) on the issue of residence. These cases highlight significant scrutiny by the ATO and the need for such workers to obtain good tax advice, and provide sufficient documentary evidence for the ATO or the AAT as this may be needed to establish the relevant facts.

Residence defined

The term “resident” of an individual is defined in s 6(1) of the Income Tax Assessment Act 1936 (Cth) (the Act):

- (a) a person, other than a company, who resides in Australia and includes a person:
 - (i) whose domicile is in Australia, unless the Commissioner is satisfied that the person’s 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 the person’s usual place of abode is outside Australia and that the person does not intend to take up residence in Australia; or
 - (iii) who is:
 - (A) ...
 - (B) an eligible employee for the purposes of the *Superannuation Act 1976*; or
 - (C) the spouse, or a child under 16 ...

This provides four tests to establish whether an individual is a resident:

- the resides test according to ordinary concepts;
- the domicile and permanent place of abode test;
- the 183 day test; and

- the Commonwealth superannuation fund test.

An individual will be a resident if any of the four tests are satisfied. The fourth test only applies to relatively few people working overseas who are members of a Commonwealth superannuation fund. The 183 day test generally applies to people coming to Australia, so has little application. Thus, for Australians leaving to work overseas, the questions at issue focus on the first two tests: the “resides test” and the “domicile and permanent place of abode test” (as evident in the recent cases below).

The courts have formulated relevant factors for these two tests that will be taken into account in determining residence. A taxpayer needs to consider all of these factors to determine, on the balance of the facts, whether the test of residency has been satisfied. Generally no single fact will determine the outcome, although some factors are more important than others, and different factors could lead to opposing outcomes. The definition of residence leads to many grey areas, thus it is little wonder that the ATO and the accounting and tax professions are often at loggerheads as to where the residence line should be drawn.

The first test provides that a resident “resides” in Australia; “Resides” is not defined in the Act and the courts have tended to follow the ordinary meaning of “resides” in formulating a list of relevant factors to determine whether a person resides in Australia, as follows:²

- physical presence;
- family, employment or business ties;
- maintenance of a place of abode and other assets;
- frequency, regularity and duration of visits; and
- habits and mode of life.

These factors are similar to those set out by the Commissioner in Taxation Ruling IT 2607³ (residency status of visitors and migrants) and Taxation Ruling IT 2650⁴ (residency status of individuals who temporarily live outside Australia). The weight to be given to each factor will vary with the individual circumstances and no single factor is necessarily decisive.

A person may be held to reside in more than one place.⁵ For taxpayers relocating overseas to work for a significant period with their family, the lack of physical presence, family and work ties, and an Australian abode will ensure that this test will not be satisfied. Thus, the question at issue for such taxpayers usually falls under the second test which has a greater ambit.

The second test generally applies to situations where a resident leaves Australia to work overseas for a lengthy period of time. There are two parts to this test that must be satisfied to find that the taxpayer is a resident:

- a person's domicile must be Australian; and
- the Commissioner is satisfied that his/her permanent place of abode is not overseas.

Domicile refers to the legal relationship between a person and a state by which the person invokes the state's legal system as his or her personal law. Given that domicile does not usually change for taxpayers working overseas for relatively short periods of time, most of the cases turn on the question of where the taxpayer maintains their permanent place of abode.

ATO Taxation Ruling IT 2650 provides relevant factors as to whether a permanent place of abode is overseas as follows:⁶

- intention as to length of stay;
- actual length of stay;
- abandonment of place of abode in Australia;
- acquisition of place of abode outside Australia;
- intention to make place of abode "home";
- nature and quality of use made of place of abode;
- duration and continuity of presence in place;
- durability of association (ties) with place — do you own it, lease it or are you just staying there — and ties — family, children at school, employment, bank accounts and so on.

The leading case is *FC of T v Applegate*,⁷ where the taxpayer had a permanent place of abode overseas even though he was only away 2 years. Permanent does not mean everlasting, but something more than temporary or transitory.⁸ IT 2650 states:

14. The Federal Court rejected the Commissioner's argument that a permanent place of abode outside Australia required an intention to live outside Australia indefinitely without any intention of returning to live in Australia in the foreseeable future, other than at some remote, albeit specific, point of time. The Court said that the term "permanent" must be interpreted in the context in which it appears. The Court said that in its context in the "resident" definition a permanent place of abode does not have to be "everlasting" or "forever". It means something less than a permanent place of abode in which a person intends to live for the rest of his or her life. It should be contrasted with a

temporary or transitory place of abode outside Australia. It connotes a more enduring relationship with the particular place of abode than that of a person who is ordinarily resident there or who has there his or her usual place of abode. An intention to return to Australia in the foreseeable future to live does not prevent the taxpayer in the meantime setting up a "permanent place of abode" elsewhere. The Federal Court also found that the taxpayer's intention regarding the duration of his stay overseas was only one relevant factor to be taken into account. Of more importance is the nature and quality of use which the taxpayer makes of a particular place of abode overseas.

IT 2650 also contains a number of examples of the ATO's view of the application of the residency test. The ATO also has a residency tool, "Determination of residency status — leaving Australia",⁹ to offer guidance for taxpayers on residency who leave Australia to work overseas. However the disclaimer states that:

[The] result is based solely on your answers, the outcome is not binding on the ATO. Whether or not you are an Australian resident for tax purposes will be determined on the actual facts of your situation.

Given this disclaimer and that the determination of residence is a question of fact and degree, the residency tool would appear to be problematic and a poor substitute for professional advice.

Shord v FCT

In *Shord v FCT*¹⁰ the taxpayer worked as a diver and diving supervisor for overseas companies at many places around the world during the 2006–11 income years. The taxpayer considered that he had left Australia in 1999 to pursue a nomadic working life and that he based himself in his country of birth, the United Kingdom. However, the taxpayer maintained strong physical, emotional and financial ties to Australia. Also, he jointly owned a home in Australia which he lived in with his wife in a marriage of over 23 years. He had an Australian passport since 2004. Mr Shord described his background as follows:¹¹

My lifestyle is a nomadic lifestyle. I call the world my home. The barge that I work on is my home. The more established places are bases. These are used to store things that you may not be able to put on your back. My home in the UK is an established base to live and travel from, also my contact place for work as well as a meeting place for friends and family living in the United Kingdom. My life style also relies on trust between my wife, who is reluctant to leave Australia to take up living in some foreign country. I am privileged in my position to be able to get my wife to join me in some countries where I may be, if the circumstances allow it. Even if it is only a few days while they move a barge or vessel to a new location.

...

As advised by the Tax Office in 1999, I removed myself from all Electoral rolls in Australia. These included the Federal, State and Local. I am enrolled in the United Kingdom.

Under the advice of the Tax Office I withdrew all my Superannuation in about 1999 and closed the various accounts. Since then I have only received Superannuation contributions while working for a short time in Australia from July 2011.

As a requirement put to me by the Tax Office in 1999, I sold any assets that I had except for my share of the house I stay at while I am visiting Perth. I don't own a car or any other motorised vehicle in Australia. I have no personal assets here in Australia, those I did have in 1999 have been disposed with.

The only investment that I have within Australia is a part share in a house that my wife and I purchased as her home here in Western Australia. I did own a part share in another house that was rented, but that has since been sold to allow me to pay out various debts that had been accumulating here in Australia and abroad.

I have no Australian shares or any other listed or unlisted investments in Australia.

I do not belong to any club, sporting or otherwise in Australia. I was a past member of the RSL in New South Wales but ceased many years ago.

Due to my occupation, I have medical insurance to cover me world wide. In the United Kingdom I have a national insurance number which covers me throughout the European Community.

My wife lives most of the time in Australia. Cyn is a fully qualified nurse and midwife. She has always worked to keep herself, she is a very independent woman, and has recently retired, being 64 years old.

I have no other family in Australia.

Notwithstanding the advice and that the taxpayer abandoned certain Australian ties, the ATO considered that the taxpayer was a resident of Australia for the 2006–11 income years given the strong physical, emotional and financial ties to Australia. The Commissioner issued amended assessments to the taxpayer increasing the amount of income tax payable by a total of \$149,967.75 plus penalty tax of over \$150,000.

The AAT found that in the 2006–11 income years, the taxpayer resided in Australia under the “resides” tests and also satisfied the domicile test given his domicile of choice was in Australia. The taxpayer had not established a permanent place of abode outside Australia and thus satisfied the permanent place of abode test. The AAT observed that the taxpayer's physical, emotional and financial ties to Australia during 2006–11 were very strong. He jointly owned a home in Australia with his wife of over 23 years. Further, the evidence before the Tribunal supported the finding that Australia was Mr Shord's “domicile of choice” during the period. The taxpayer did not establish that the United Kingdom, or any other place outside Australia, was his “permanent place of abode”. Most of the relevant factors as set out in IT 2650 strongly indicated that the taxpayer resided in Australia.

Engineering Manager v FCT

In *Engineering Manager v FCT*¹² the taxpayer worked as an engineer in Oman for a multinational company in

the oil and gas industry from 4 January 2010 to 29 April 2011. He then returned to live with his family in Perth. Prior to that, he worked overseas on various engineering jobs since 2004.

Despite the lengthy absence of about 6 years, working and living in an overseas abode, the Commissioner argued that the taxpayer was a resident of Australia for the year ended 30 June 2011 as a result of his connection between the taxpayer and his family living in Australia. He often returned to Australia when on leave from his overseas employment. The Commissioner argued the taxpayer was a resident given his continuity of association with Australia. A Notice of Amended Assessment for the 2011 year was issued to include \$274,509 derived from employment in Oman.

The Tribunal held that the taxpayer was a non-resident in 2011. Whether a person resides in Australia is a question of degree and therefore one of fact. The taxpayer was not a resident of Australia under the ordinary resides test, during the whole of the year in question. Further, the taxpayer's permanent place of abode for most of the year ended 30 June 2011 was outside of Australia, thus the alternative test was not satisfied.

Murray v FCT

The taxpayer in *Murray v FCT*¹³ lived and worked in Thailand and Indonesia from June 2006 to February 2010. The taxpayer lived overseas in rental accommodation with his wife and also obtained the right to reside in Indonesia as a retired person. Between 2008 and 2010, the taxpayer had made a number of trips back to Australia.

When visiting Australia in February 2010, the taxpayer was arrested and charged with drug possession. The taxpayer was convicted and sentenced to 18 months imprisonment. After being released from jail in December 2011, he was served a Departure Prohibition Order and was thus prevented from returning to Bali. Again, despite the taxpayer working overseas and living in an overseas abode with his spouse for a lengthy period (5 years) the Commissioner taxed the taxpayer as a resident from 2009–11 and issued default assessments with taxable income of: \$191,699 for the 2009 year, \$765,342 for the 2010 year, and \$37,439 for the 2011 year, all with penalty tax.

The AAT was satisfied that the taxpayer was not a resident of Australia according to the ordinary meaning of resides during the years ended 30 June 2009–11. The taxpayer had not been residing in Australia since June 2006. The taxpayer had set up a home in Bali from early 2008. While the taxpayer's visits to Australia were initially lengthy, they did not destroy the continuity of association he had with Bali.

Conclusion

A review of the three cases shows the extent to which the determination of residence is a question of fact and degree. Further, these cases suggest that the Commissioner's auditors are pushing the boundaries of IT 2650 when determining the residency of Australians working overseas. In particular the case of *Murray v FCT* cannot be easily reconciled to IT 2650 given the lack of connection to Australia. Thus, Australians leaving to work overseas and their tax advisers must take great care in the application of the "resides test" and the "domicile and permanent place of abode test". The ATO's residency tool appears problematic and should not be used to replace professional advice. Tax planning advice and relevant documentary evidence are crucial for Australians choosing to work overseas especially in jurisdictions with low income tax rates.

This paper has been subject to an independent review.



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Footnotes

1. Income Tax Assessment Act 1997 (Cth), ss 6–5(2), 6–10(4).
2. *Levene v Inland Revenue Commissioners* [1928] AC 217; [1928] All ER Rep 746; (1928) 13 TC 486; *IR Commrs v Lyaght* [1928] AC 234; [1928] All ER Rep 575; ATO Taxation Ruling 98/17 Income tax: residency status of individuals entering Australia (25 November 1998).
3. Taxation Ruling IT 2607 Income tax: residency status of visitors and migrants (16 August 1990).
4. Taxation Ruling IT 2650 Income tax: residency — permanent place of abode outside Australia (8 August 1991).
5. *Lloyd v Sulley* (1884) 2 TC 37.
6. *AAT Case 8892* (1993) 27 ATR 1136; (1994) 94 ATC 175 supports this approach taken in IT 2650.
7. *FC of T v Applegate* (1979) 9 ATR 899; 79 ATC 4307.
8. Above n 4.
9. ATO, *Determination of residency status — leaving Australia*, Version 2.3.0, 27 May 2005, www.ato.gov.au.
10. *Shord v FCT* [2015] AATA 355.
11. Above n 10, at [41].
12. *Engineering Manager v FCT* [2014] AATA 969.
13. *Murray v FCT* [2013] AATA 780.