The Hon. Jim Chalmers MP
Treasurer
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Australia
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14 October 2022

Dear Treasurer,

Australian Tax Residency Rules

The ATO released draft guidance on the Australian tax residency rules on 6 October 2022, requesting comments on the views and interpretations from the public. The guidance, Draft taxation ruling TR 2022/D2 - Income tax: residency tests for individuals, aims to provide further clarity on the determination of Australian tax residence for individuals.

Interestingly from our perspective, the draft ruling does not make any reference to the announcements made in May 2021 (by the previous Federal Government) regarding the reform of Australia's individual tax residency tests and proposed adoption of the Board of Taxation's recommendations in its report[1].

The Board of Taxation conducted a review of the Australian tax residency rules and in their finalised report, proposed changes to the Australian tax residency rules. These proposals recommended some fundamental changes to the Australian residency rules, with the stated aim of simplifying the rules for when a person would be considered a tax resident of Australia. However, our view and the view of many other professional bodies at that time was that the proposed changes caused a great deal of uncertainty and concern to many Australian businesses and individuals working and living outside of Australia.

Following the issue of the Board of Taxation's report, we along with several other industry bodies, provided the then Treasurer with our comments and concerns on the proposals. The concerns were that the proposed recommendations could adversely impact Australian businesses looking to either expand their operations outside of Australia or to attract much needed talent and expertise to Australia. The changes could also have an adverse effect on Australian nationals living and working overseas, who may return to Australia for short periods, whether such visits are for business, leisure or visiting friends and family. Some aspects of the changes appear to be unduly onerous leading to inequitable results and harsh outcomes for certain individuals. If the government was still considering the Board of Taxation's proposals, we remain concerned that the proposed changes could negatively impact Australian businesses operating in Asia, as well as the ability of Australian organisations to attract foreign talent to Australia.

[1] The previous Federal Government in the 2021/2022 Federal Budget proposed to consider the recommendations of the Board of Taxation in reforming Australia's tax residency rules as contained in its report released in 2019 'Reforming Individual Tax Residency Rules – a model for modernisation'.

Impact on Australian businesses

One of the principal concerns at the time of the release of the report was the impact the changes could have on Australian businesses. The main concern being that the proposals could act as a detriment to Australians wanting to spend time living and working overseas for Australian businesses if they continued to be treated as a tax resident in Australia as well as the country in which they were living and working. This would likely give rise to a significant increase in cost to Australian businesses, as they would likely be required to compensate their employees to work overseas.

We also had several concerns over the ambiguity of the proposals and how they could easily apply to capture Australians living and working permanently overseas as Australian tax residents. The proposed changes would likely make it much harder for Australian businesses to attract foreign talent and expertise to Australia if the foreign nationals were to continue to be treated as Australian tax residents after they departed Australia for a possible period of two years. This would certainly act as a significant disincentive to those persons to come to Australia.

Given how broad the proposals were and the likelihood that many more Australians would be considered to be Australian tax residents if the changes were introduced, perhaps one of the biggest concerns is that it could ultimately dissuade many Australian entrepreneurs from spending time overseas to develop their skills and proprietary technology that they would ultimately look to bring back to Australia.

Impact for Hong Kong

The last few years have been particularly challenging for many Australians and Australian owned businesses, whether they be in Australia or here in Hong Kong. However, our concern is that Australians in Hong Kong would be uniquely affected by the proposed changes if they were to be legislated.

Hong Kong is home to over 100,000 Australian nationals and many thousands of Australian businesses. From a broader business perspective, Hong Kong remains Asia's leading trading and investment hub and a global fincial centre. It also remains the gateway for much of the capital flows to and from China.

Given, Hong Kong's unique role in Asia, there are many thousands of Australians living in Hong Kong and working throughout Asia that often need to travel to Australia on business. It is the frequency of such travel that could easily cause Australians to be caught by the Board of Taxation's recommendations.

Hong Kong does not have a comprehensive tax treaty with Australia and as such, Hong Kong residents could be particularly exposed to the new rules if they were to spend more than 45 days a year in Australia. Australian employees could therefore be reluctant to travel to Australia on business if it impacted their residency status. This would clearly disrupt the commercial and trading relations between the two jurisdictions and upend the mutually beneficial relationship that has developed over the last few decades.

Our suggestions for further consideration

We overwhelmingly support the stated aim of modernising the Australian tax system, particularly where such reform is intended to provide certainty and simplicity for individuals regarding their tax residency status. At the same time, the reforms should seek to accommodate a reasonable level of equity and integrity, to ensure they can be used as a malleable tool by the Australian Government but also adapt to the needs of individuals, families, and businesses.

The above-mentioned draft tax ruling provides some helpful guidance on determining residency status, but it makes no mention of whether the government intends to go ahead and legislate changes to the Australian tax residence rules.

We would therefore urge the government to reconsider the Board of Taxation's proposals recommendations, especially given the current economic environment, cost of living concerns and the challenges faced by many businesses trying to attract talent to Australia.

In our previous submission, we highlighted several commercial and technical concerns regarding the proposals. The new rules could easily result in many Australians being treated as a tax resident simply by being physically present in Australia for more than 45 days in any financial year for whatever reason.

If the government remains committed to reviewing the residency rules, we have the following recommendations on how the proposed rules can be refined to better accommodate Australian businesses in Asia:

- **Increase 45 days to 90 days**: Increasing the 45-day threshold to 90-days to provide greater flexibility and align more closely with international tax agreements. This would provide greater flexibility for individuals and Australian businesses to travel to Australia each year for business or leisure. This is crucial for Hong Kong based Australians and Australian businesses given the absence of a DTA.
- **Increase two factors to three**: Our survey of members found that many Australians would satisfy at least two of the objective factors. As such, we propose that the test threshold is increased from two proposed factors to three, which would lead to less harsh outcomes for taxpayers.
- **Ceasing residency test**: Foreigners should cease to be tax resident upon their decision to permanently depart from Australia regardless of whether they have an employment contract with an overseas employer. At the very least, Australians who depart Australia permanently upon retirement or otherwise, should not be considered an Australian tax resident from the date they leave.
- **Carve-outs**: Without appropriate and reasonable carve-outs, the proposed factors will inevitably deviate from the nexus approach, i.e., that an individual should have sufficient links to a jurisdiction to create a nexus for tax purposes. Examples of reasonable carve-outs include specifying the number of days that must be spent in an Australian property to satisfy the accommodation factor and restricting the economic interests' factor to only include businesses or immovable property actively managed by the individuals themselves.
- **Exclusions**: Consider appropriate exclusions for "special circumstances" that demand unplanned and/or extended trips to Australia, for example, for medical reasons, visiting sick family members, attendance at funerals, etc.

The absence of a DTA between Hong Kong and Australia means that Australians based in Hong Kong are potentially more affected by the proposed changes that in most other countries in Asia. Australians will not have access to any tie-breaker provisions where they are a tax resident of both Australia and Hong Kong. The Hong Kong Government remains committed to executing a DTA with Australia and we would strongly recommend that Australia begins discussions with their counterparts in Hong Kong on entering into such an agreement.

Finally, if changes are to be made, we would recommend the issuance of clear and comprehensive guidance as soon as possible to help individuals and businesses understand the scope and potential practical implications of any new rules and make the necessary arrangements to comply with the rules once they are put into effect.

We trust that you will find our comments useful. We reiterate that we are grateful for the opportunity to comment on the New Residency Rules and would be pleased to discuss our comments in further detail if required.

Yours sincerely,

Robert Quinlivan

Chairman

CC: Elizabeth Ward, Australian Consul-General to Hong Kong and Macau

The Hon. Don Farrell MP, Minister for Trade, Tourism, and Investment

The Hon. Katy Gallagher, Minister for Finance

Enc.: Summary of AustCham Hong Kong Concerns with Proposed New Residency Rules

Summary of AustCham Hong Kong Concerns with Proposed New Residency Rules

"The 45-day rule"

Although the intention of the changes is to simplify the criteria of when an individual will be treated as an Australian tax resident, the effect of the proposals announced is likely to result in Australians living and working in Asia for many years being Australian tax residents going forward. The concerns stem from the construction of the secondary test of the New Residency Rules, which takes into account physical presence in Australia and other factors.

Many Australian nationals living and working in Hong Kong, as well as elsewhere in Asia, could easily spend more than 45 days in Australia in any year, whether such visits are for work or leisure. This is because days in Australia would include periods of vacation, business travel, and even time spent in hotel quarantine.

Under the proposed rules, Australian nationals and permanent residents can be treated as tax resident if they are physically in Australia for more than 45 days in a calendar year, where they also satisfy two out of the four objective substantive ties or nexus factors outlined in the Appendix. We have surveyed our membership and it is apparent from the responses that for many Australians living and working in Hong Kong, they could easily satisfy two of the four factors with many satisfying three or even all four. Simply being an Australian national or permanent resident and either having a dependent living in Australia or a property available for use in Australia would satisfy the conditions. The ease with which many Australians would satisfy these additional factors means that many see the secondary rule as simply a '45 day in Australia' test, i.e., if you exceed more than 45 days in Australia, then you will be treated as a tax resident.

For many Australian citizens living and working in Hong Kong, the introduction of the changes would mean that they may need to limit the number of visits each year to less than 45 days so as not to be considered a tax resident. This would especially be the case for someone that needs to travel to Australia frequently for business, which would "eat into" the number of days they could visit family and friends.

Further, as currently drafted, no consideration is given to individual circumstances that may require unplanned and/or extended trips to Australia. Such visits could include for medical reasons; bereavements or visiting unwell members of family; and even prolonged spells in quarantine.

The potential increased cost and impact on Australian businesses

The proposed changes to the tax residency rules could also have an additional cost to Australian businesses operating in Asia. For many such businesses, employees are required to travel extensively as part of their duties, which often includes business trips to Australia.

This is especially the case for senior executives required to travel to head office in Australia, or for Asian based directors on Australian company boards.

It is quite conceivable that such employees may be reluctant to travel to Australia on business, as such days would count towards the proposed 45-day rule, which would mean less available days for personal travel to visit family and friends in any particular year. This would have an impact on the way in which business could be conducted.

Australian businesses could also find it more difficult to second employees from their Australian operations to postings in Hong Kong and Asia if such employees would still be considered tax resident in Australia. In the survey

that we conducted of our members, the overwhelming majority indicated a reluctance to an overseas posting if they would continue to be a tax resident of Australia. From an employee perspective, the risk of being tax resident and subject to taxation in both jurisdictions would outweigh the perceived benefits of an overseas posting, which would have significant implications for Australian businesses looking to expand into Asia.

The effect of the changes would be that Australian businesses may ultimately need to increase the compensation payable to employees to encourage them to move overseas. Employers would also need to schedule and track their employees' whereabouts to ensure they are not unintentionally caught by the rules. The foreseeable increase in costs and administrative burden would obviously conflict with the objective of the New Residency Rules – i.e., greater simplicity and lower compliance costs.

Education Sector

The education sector could be seriously impacted by the New Residency Rules. Australian teachers are highly sought after by international schools in Asia, particularly by the many Australian international schools operating in the region, including in Hong Kong. Teachers are in a unique position in that they have extended summer holidays during which they would normally return home to spend time with family and friends. The 45-day threshold will make it much more difficult for such teachers to return to Australia for extended vacation periods as they would be at risk of being a tax resident of Australia. This could clearly act as a barrier to recruiting Australian teachers to move to Australian schools in Asia and seriously impact the ability of such schools to attract experienced and suitably qualified teaching staff.

The changes may also have an impact on Australian boarding schools. Australian nationals living overseas often enrol their children in boarding schools in Australia to benefit from the education system in their home country. Parents typically travel to Australia regularly and stay for an extended period during the school holidays to spend time with their children. In their current form, the ease with which Australian nationals could satisfy two of the four factors will undoubtedly discourage parents from sending their children to Australian boarding schools.

We anticipate parents will instead opt for other well-regarded locations to send their children for schooling, such as the United Kingdom, given how easily they could be dragged into the Australian tax residency net.

Attracting Foreign Talent to Australia

Attracting senior executives to Australia under the New Residency Rules could be more difficult if it will be harder for them to cease to be a tax resident upon leaving Australia permanently.

AustCham supports the Albanese Government's continued focus on attracting global talent to Australia. Under the former government's Global Business and Talent Attraction Taskforce, Hong Kong was specifically singled out as a source of talent and global business.[2]

Under the proposed changes, the rules could make it harder to cease being a tax resident of Australia upon departure from Australia. In particular, and what is viewed by our members as excessively sticky, a person that

[2] https://minister.homeaffairs.gov.au/alantudge/Pages/New-taskforce-to-create-jobs-by-attracting-businesses-and-talent-to-Australia-.aspx

leaves Australia permanently after being a tax resident for several years could still find that they remain a tax resident for at least two years after they have left Australia. This would certainly come as a surprise to many people given that in most countries, a person typically ceases being a tax resident at the time they leave the jurisdiction permanently. Senior executives and entrepreneurs are therefore likely to consider this to be a major disincentive to relocating to Australia and taking up permanent residence or Australian citizenship.

There could also be unintended consequences for younger Australians who wish to broaden their experience and pursue overseas work experience opportunities. Such persons could also continue to be a tax resident for a couple of years after leaving Australia, which could act as a disincentive to them when considering going overseas to explore new opportunities and experiences.

The Aviation Sector

The aviation sector is a prime example of an industry that could be significantly affected by the New Residency Rules. Hong Kong based Australian pilots and crew members who routinely travel between Hong Kong and Australia could find themselves being tax resident in both jurisdictions, even if their permanent home is in Hong Kong. In the absence of a tax treaty, an Australian pilot flying to Australia several times a month could be in Australia for more than 45 days. Landing in Australia at any time before midnight would count as one full day for the purposes of counting the number of days physically present in Australia under the New Residency Rules.

The view of Australian members of the airline community in Hong Kong is that they are likely to be severely impacted by the changes given they often fly on the Australian routes. This would be a very unfortunate outcome given the aviation industry is a key enabler of many other economic activities and has already been significantly impacted by the ongoing Covid-19 pandemic.

Absence of a DTA with Hong Kong

Finally, many Australians living offshore, particularly in Hong Kong and Singapore, are concerned about how this rule will impact them. However, unlike Singapore, Hong Kong does not have a double tax agreement ("DTA") with Australia which would otherwise give Australians working in Hong Kong some added protection against becoming an Australian tax resident where they are also tax resident in Hong Kong. As such, Hong Kong based Australians would be uniquely impacted by the proposed residency changes given the absence of comprehensive DTA with Australia.

The benefit of having a DTA in force is that they typically contain tie-breaker provisions to determine the residency of an individual when an individual is considered a tax resident in two jurisdictions. Usually it is the place where they have a permanent home, habitual abode, or strong economic and personal connections that determine which jurisdiction they are resident in. For example, under the DTA signed with Australia, where a person is resident in both Singapore and Australia, they would be considered tax resident in Australia only if they have a permanent home available to them in Australia and no permanent home available to them in Singapore.[3]

The absence of a DTA between Hong Kong and Australia is particularly concerning for the Australian business community in Hong Kong given the important role that Hong Kong plays as a global financial centre in Asia and a regional headquarters for many multi-nationals. An Australian seconded to Hong Kong could therefore be unfairly disadvantaged compared to his counterpart in Singapore.

[3] Article 3 of the Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income.