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Australia's Taxing Rights over Individuals under the *Income Tax Assessment Acts*: Examining the Utility of the General Jurisdictional Rules

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CORE JURISDICTIONAL RULES

How useful are the general jurisdictional rules in Division 6 ITAA97?

- ***The 'residency rule'***: the assessable income of Australian residents comprises their ordinary and statutory income from all sources (s6-5(2), s6-10(4));
- ***The 'source rule'***: the assessable income of foreign residents comprises their ordinary and statutory income from Australian sources (s6-5(3)(a), s6-10(5)(a)).

CORE JURISDICTIONAL RULES

HOWEVER

- These core jurisdictional rules are subject to some significant exceptions;
- The residency rule in particular is probably not a very useful description of Australia's taxing rights over individuals.

THE RESIDENCY RULE

proposition: "**residents** are taxed on their worldwide income"

The concept of residency for tax purposes (as per s6(1) ITAA36) is far wider than the migration concept of residency

- The primary test is the 'ordinary concepts' or 'resides' test (not necessary to consider the other three tests if this is met) > focuses on physical presence in the jurisdiction; 6 months is a sufficient time period if there is 'continuity, routine and habit' consistent with residency (TR 98/17);

➢ A foreign national who comes to Australia for a stable purpose (employment; education) would usually be ***a resident for tax purposes***.

THE RESIDENCY RULE

BUT

- If we were to apply the residency rule to such a foreign national (who is a resident in the tax law sense)
- Is it true that they would be taxed on their worldwide income?

NO

- A person who comes to live in Australia without a permanent residency visa is a 'temporary resident' under migration law > and as a general rule, is not assessed on their foreign-sourced ordinary and statutory income: Subd 768-R ITAA97 (introduced 2006).

TEMPORARY RESIDENTS

Who is a temporary resident?

- A person who holds a temporary visa under the *Migration Act* 1958 (provided that they or their spouse are not a resident under the *Social Security Act* 1991);

- Under section 30 of the *Migration Act* 1958 all visas other than permanent visas are regarded as temporary.

TEMPORARY RESIDENTS

2006 EM introducing Subdivision 768-R ITAA97:

Sought to: “to attract internationally mobile skilled labour to Australia”

- Intends to treat temporary residents in a similar way to non-residents

- The measure may have a sound rationale… but it substantially undermines the utility of the proposition that ‘residents are taxed on their worldwide income’.

Jurisdictional reach of the ITAA

WHO is taxed in Australia on their foreign-sourced ordinary and statutory income?

Essentially two groups:

1. Those who satisfy the 'resides' test but are *not* temporary residents – necessarily Australian permanent residents and Australian citizens;
2. Those who are deemed to be an Australian resident based on Australian domicile (provided they do not have a permanent place of abode overseas)

Jurisdictional reach of the ITAA

- National identity is not traditionally associated with the tax concept of residency because the 'resides' test is strongly tied to physical presence in the jurisdiction;
- However, the effective exemption given to temporary residents on foreign-sourced income means:

Australian permanent residency or citizenship ('Australian National Identity')

is a minimum condition for assessing foreign-sourced ordinary and statutory income under the ITAA.

Jurisdictional reach of the ITAA

- The main practical consequence of the tax concept of residency does not relate to jurisdictional reach but to being able to access more favourable tax rates

- Back to the residency rule: 'residents are taxed on their worldwide income'

The consequence stated in the residency rule (taxability of worldwide income) does not attach to 'residents' (i.e. tax residents) as Division 6 ITAA97 indicates, but to Australian permanent residency and Australian citizenship

The Source Rule

Proposition: foreign residents are liable to tax on their Australian-sourced income

- Division 855 ITAA97 is an important qualification (also introduced in 2006, but in separate legislation to the 'temporary resident' measures).
- ➢ Narrows asset base on which foreign residents are liable to CGT to:
  - "Australian taxable property" (land); and
  - the business assets of a foreign resident's PE.
- Rationale from EM (2006): to "reduce disincentives for foreign residents to invest in Australia."
- For foreign residents, Australian source not sufficient to trigger CGT liability on many assets including the sale of shares in Australian resident companies.
- NB. 'Temporary residents' are also assessed in the same way as foreign residents in Division 855: s768-915 ITAA97.

Double Tax Agreements (DTAs)

- *Potentially* Double Tax Agreements can significantly qualify the core jurisdictional rules …

- Australia's DTAs are incorporated as part of domestic law under the *International Tax Agreements Act* 1953

- The DTAs (e.g., as per Australia-UK Treaty) have a tie-breaker for determining residency: based on the location of a person's permanent home (sub tie-breakers based on habitual abode and closeness of personal, economic relations).

Double Tax Agreements (DTAs)

More often than not (e.g., as per Australia-UK Treaty) the treaty provisions take the approach that particular classes of income may be taxed in both the country of residence and the country of source

[domestic foreign tax offsets avoid double taxation]

DTAs and Jurisdictional Reach

e.g., the Australia-UK Tax Treaty

"*may* be taxed" in the country of residence and source	**"*shall be taxable only*" in one contracting State – qualify domestic jurisdictional rules**
Examples: Income from property; alienation of property (subject to a qualification); employment income exceeding 183 days; Dividends, royalties, interest	**Employment income** not exceeding 183 days (Art 14) – only country of residence if employer is a non-resident (and remuneration not deductible for any PE in source country) **Changing residency**: re deemed disposal rules (in Australia CGT event I1), which apply to all assets except for taxable Australian property (TAP) upon a person ceasing to be a resident (e.g. Australian leaves to live in UK): in scenario where individual elects to disregard the gain at time of exit and treat as TAP - if the individual becomes a resident of the other State (e.g., UK), gain only taxable in country of residence (UK) – qualifies capital gain rules under ITAA.

Concluding comments and further issues …

- The consequence stated in the residency rule (taxability of worldwide income) is not true for persons who are residents *only* in the tax law sense … Australian PR or citizenship a minimum condition for capturing foreign-sourced ordinary income and capital gains;
- Source rule appears to have continued utility – but subject to some qualifications in ITAA and DTAs;
- Is there, or should there be, a cohesive policy for determining what should be the reach of Australia's taxing rights?
- Before any policy could be developed or articulated, we need an accurate sense of current jurisdictional reach.