Australia: Residency case a win for the taxpayer

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In brief

On 22 February 2019, the Full Federal Court of Australia ("the Full Court") allowed the taxpayer's appeal in *Harding v Commissioner of Taxation [2019] FCAFC 29* and held that the taxpayer was not an Australian tax resident.

In the earlier decision, the Federal Court ("the Court") had held that the taxpayer, who was an Australian citizen living outside of Australia for some years, and who had established a home overseas, remained a tax resident of Australia because his accommodation overseas (i.e. temporary and furnished apartment) was not permanent enough. See our previous TaxTalk Alert for a summary of the matter considered by the Court at first instance.

In allowing the taxpayer's appeal, the Australian Full Court has determined that, when assessing residency of an individual, the phrase "permanent place of abode" should not be interpreted by reference to the permanence of a person's specific house or dwelling, but rather should be interpreted more widely to consider whether a person is living permanently in a particular "country or state".

In detail

Mr Harding had, prior to 2006, worked for approximately 15 to 16 years in the Middle East. Mr Harding then returned to Australia with his wife and children and stayed until 2009 at which time he took up a position in Saudi Arabia. Upon moving to the Middle East, Mr Harding occupied a fully furnished two bedroom apartment in Bahrain. The plan was that his wife and children would temporarily remain in the family home in Australia, and move to Bahrain in 2011 once the middle child finished schooling. It was Mr Harding's intention to purchase a larger property once his family relocated. However, despite Mr Harding's best efforts, in 2011 his wife chose to remain in Australia and they separated shortly after. Mr Harding moved to a smaller furnished apartment in the same building.

The question of Mr Harding's tax residency was at first instance addressed by a single judge from the Court who found, in the judgment handed down in June 2018, that Mr Harding was a tax resident of Australia because he did not have a permanent place of abode outside of Australia, i.e. his accommodation in Bahrain was only temporary and transitory.

Mr Harding appealed against the Court's decision where the question of Mr Harding's tax residency was subsequently addressed by the Full Court (three judges).

The appeal was allowed and Mr Harding was found not to be a tax resident of Australia for the relevant year.

Question of law

The issue was whether Mr Harding was a non-resident of Australia for tax purposes for the 2011 tax year, i.e. whether he did not reside in Australia in 2011 (the “resides test”) and whether he had established a permanent place of abode outside Australia in 2011 (the “permanent place of abode test”).

Permanent place of abode test - A temporary accommodation does not prevent a person having a permanent place of abode overseas

In the earlier decision, the Court held that the maintenance of Mr Harding’s fully furnished apartment overseas was not sufficient to satisfy the permanent place of abode test.

Under the definition in section 6 of the *Income Tax Assessment Act 1936*, a resident of Australia means a person “*who resides in Australia and includes a person whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia*”. Therefore, the question before the Full Court was not whether Mr Harding had a permanent place of abode outside Australia, but rather whether the Commissioner should have been satisfied, based on the facts provided by Mr Harding, that he had a permanent place of abode outside of Australia.

In 2011, it was found that Mr and Mrs Harding made enquiries about a suitable school for their youngest son and enrolled the son in the British School for the education year commencing 2011, Mr Harding purchased a second car for his wife to use when she would join him in Bahrain, Mr Harding made various attempts to convince his wife to continue with their plans to relocate to the Middle East and Mr Harding was not prepared to alter his plans and the pursuit of his employment opportunities in the Middle East by returning to Australia. All these findings provided strong evidence that Mr Harding lived in Bahrain in 2011.

Although the Court at first instance focused on Mr Harding’s specific accommodation in Bahrain, and whether it was considered to be sufficiently permanent, the Full Court stated that this was a too narrow conception of what may constitute a “permanent place of abode”. Indeed, for the purposes of the permanent place of abode test, this should not be determined by reference to whether a person is permanently located at a specific house, flat or dwelling, but rather “permanent place” requires the identification of a country or state in which the person is living permanently:

> *The question is whether the taxpayer in a given case has satisfied the Commissioner that he has a permanent place of abode outside Australia… “place of abode” may mean the house in which a person lives or the country, city or town in which he is for the time being to be found…Thus a person might be correctly said to have a permanent place of abode…notwithstanding that during a given period he lived in a number of different establishments occupying each for only a relatively short period.*

While Mr Harding’s accommodation in Bahrain may have been considered temporary or transitory, as he was looking to purchase a larger property once his family relocated, this was entirely consistent with the settled purpose and conclusion that his permanent place of abode was in Bahrain.

Resides test - A place of residing or living needs to be regarded as own home

The Court at first instance held that the taxpayer did not reside in Australia. In a reassuring development for taxpayers, the Full Court has confirmed this conclusion.

The Commissioner of Taxation again relied on all the connections Mr Harding had with Australia such as Mr Harding was an Australian citizen, Mr Harding’s family remained in Australia during the 2011 year and lived in the family home, Mr Harding visited his family and stayed in the family home in Australia for 91 days in 2011, Mr Harding maintained his Australian bank accounts, etc.

The Full Court confirmed the holistic approach taken by the Court at first instance in considering the full situation of the taxpayer, and especially considering Mr Harding’s intention not to return to Australia following his departure in 2009. In this context, while he had a place to live in Australia, the Full Court found that he did not treat that place as his home.

The Full Court also rejected the Commissioner's argument that the taxpayer resided in Australia, having regard to the objective connections that he retained in Australia. Some of the objective connections were supportive of a conclusion that he did not reside in Australia. In the end, the Full Court decided that the quality and nature of those connections either supported a finding that Mr Harding was not a resident of Australia, or were not sufficient to outweigh Mr Harding's intention to leave Australia indefinitely.

It is also worth noting that the Court at first instance was supportive of the use of checklists to assist in answering a question of residency. Indeed, while factors set out in a checklist may be useful to determine the tax residency status of a person, the Full Court's decision is a reminder that they cannot substitute the text of the law and that the law should be applied to the facts according to its ordinary meaning.

The takeaway

The decision at first instance was concerning for many expatriates seeking to work overseas, or currently working overseas. By taking a too narrow conception of what may constitute a "permanent place of abode", the decision had made it harder for them to break Australian tax residency, even if they have the intention to live overseas for an indefinite period.

The latest Full Court decision is a win for Australians going on assignment overseas. The Full Court has arguably struck a better balance, by focusing on whether a taxpayer has demonstrated that they are living in a foreign country permanently. While the type of accommodation in the overseas country may be relevant to that inquiry, it is still necessary to consider the totality of facts and circumstances when determining Australian tax residency.

This latest decision is also very timely as the Government will shortly consider the Board of Taxation's review of Australia's residency rules for individuals. It provides yet another example of the difficulty of applying the current law to Australians expatriates, and the need for change in order to provide greater clarity when it comes to determining the Australian tax residency status of expatriates.

Let’s talk

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