SOURCE & RESIDENCE

The concepts of source & residence are basic to most country's tax systems, including Australia.

There has been quite a lot of activity recently in Australia in relation to those topics.

Residence of individuals

The question of residence of individuals has come into questions several times recently in reported decisions, after many years of little activity. The recent cases have not moved past the AAT. More cases would be expected due to the substantive repeal of s23AG, which until 29 March 2009 provided that foreign source employment income was non-assessable non-exempt in relation to foreign continuous service of at least 90 days. Until it was repealed, for many there was not such a great need to argue that the taxpayer had ceased to reside in Australia, although the effect of s23AG was to provide for an "exemption with progression"[1].

The cases have often involved employees going to work in the Middle East and staying in employer provided accommodation. The result has usually been that whatever their status in the Middle Eastern country[2], they would continue to be regarded as ordinarily residing in Australia[3]. As Australia has no double tax treaties with Middle Eastern countries, the potential dual residence was not resolved by a treaty: *Iyengar and FCT* [2011] AATA 856; *Sneddon and FCT* [2012] AATA 516; *Boer and FCT* [2012] AATA 574; *Sully and FCT* [2012] AATA 582.

[1] so that income other than that the subject of s23AG was taxed at a rate which took into account the s23AG income i.e. the s23AG income pushed the other income into a higher tax bracket than would otherwise apply.

[2] Which would often have no or a very low income tax. Section 23AG would usually only be available if some tax was paid in the country of source.

[3] And all were Australian domiciles who generally could not establish a "permanent place of abode" outside Australia.

The only case involving the Middle East in which the taxpayer was successful was one in which there was evidence that the taxpayer intended on living in New Zealand when his employment in Abu Dhabi finished; that he had initially occupied employer provided accommodation but subsequently found more permanent accommodation, and that he did not intend to re-occupy a house in Australia which his son had made his home: *Mayhew and FCT* [2013] AATA 130.

Australia's double tax treaties generally have a "tie breaker" for individuals that provides as its first test, whether the individual has a "permanent home" in one country and not the other. Where an individual has a choice and wishes to be more certain that they will be treated as a non-resident of Australia, they should sell their Australian home, or at least let it out for a number of years so that it is not available to them during that period. At the same time, they should buy or at least take a lease for a number of years of accommodation in a treaty country[4]. Whilst a number of recent cases have involved DTA countries, generally the taxpayer's accommodation in those countries, and a remaining home in Australia, did not trigger the "tie breaker" in favor of the foreign country: *Murray*[5] *and FCT (No 3)* [2012] AATA 557; *AAT Case 2012/4009* [2013] AATA 394. In *Mynott and FCT* [2011] AATA 539, the taxpayer was able to establish that he was a resident of the Philippines and not Australia, and did not rely on the "tie breaker" even though the Philippines is a DTA country.

Residence of companies

There have also recently been a number of cases where the ATO has challenged the tax residence of foreign incorporated companies.

This has mainly happened in relation to companies which have had also had alleged Australia source income, rather than in situations where the company has been trading only internationally, and so would have only foreign source income. The circumstances were also that the foreign incorporated companies had or were likely to have had Australian resident owners[6]. These cases appear to have flowed out of "Project Wickenby" which originally focussed on the activities of the advisory firm known as Strachans, in Jersey & Switzerland, but later expanded to cover activities of a number of Vanuatu advisers (particularly PKF) whose clients used offshore bank accounts and companies incorporated in Vanuatu.

[4] Where they would spend sufficient time to be treated as a resident for the purposes of that country

[5] Murray raised the "tie breaker" argument under the Singapore DTA too late, and so was not allowed to run it. However, his family trust maintained a residence in which he stayed when in Australia. In *Pillay and FC T* [2013] AATA 447 the taxpayer maintained houses in Australia and Bali, but worked in East Timor. He did not argue that he was a resident of Indonesia, but if he did, as he had houses in both countries, the first tie breaker in the Indonesian DTA would not have helped him. In *Re Nordern and FCT* [2013] AATA 271 the taxpayer worked in China, Malaysia and PNG (all treaty countries) for 200 days in the 2011 tax year, but did not become a tax resident of any of them, and so the "tie breaker" was irrelevant.

[6] Which allowed the ATO to argue that not only was the "central management & control" of the company in Australia (the first test of residency), but also that the company was carrying on business "in Australia" and was owed by residents of Australia (the second test of residency).

It seems that the reduced scope of Australian CGT from the introduction of Div 855 in 2006 has had some impact on these issues. It now subjects to CGT only Australian real property, and shares or units representing 10% or more of Australian land-rich entities, and the business asset held by the Australian "permanent establishment" of a non-resident. This has lead to arguments by the ATO that non-resident companies in non-treaty countries, have been dealing with Australian assets such as shares in non-land-rich companies, on revenue account, so as to be taxable in Australia, whereas a capital gain would no longer be taxable: see *Picton Finance* referred to below, at [7].

In *Crown Insurance Services Limited and FCT* [2011] AATA 847, the Commissioner asserted that the Vanuatu incorporated taxpayer was in fact a tax resident of Australia, and that in any event, the source of its funeral benefits insurance premium income was Australia. It is not apparent from the decision, but it appears that it was assumed by all concerned, that such insurance, depending on the death of a nominated party, would have been life assurance (or else Div 15 ITAA 36 would have applied[7]).

The AAT held that the taxpayer company was a tax resident of Vanuatu (principally as that is where it held its directors' meetings, at [74][8]), and that the source of its income was in Vanuatu (as that was where it conducted its insurance business (contracts were entered into and carried out), at [85][9])).

A Mr Pattenden set up Crown Insurance, and was one of its directors. PKF were not used. He was British born and travelled to Vanuatu and New Zealand (where he had a house), but an Australian tax resident at the relevant times. The decision does not expressly say who the other directors were, but it is implied there were a majority of directors resident in Vanuatu. The ATO vigorously pursued Mr Pattenden under Project Wickenby, and has come up short[10]. They gave him Departure Prohibition Orders twice, the first was in due course set aside, as referred to in *Pattenden v FCT* [2008] FCA 1590, and the second given illegally soon after the first was quashed, at which time Logan J remarked in an unreported judgment:

> "That sort of scenario I would usually visit, if proved, with a term of imprisonment for the officer concerned and for those who counseled or procured that course".

Another topical issue relating to company residence was considered in *Resource Capital Fund III LP v FCT* [2013] FCA 363, where the taxpayer was an incorporated limited partnership formed in the Cayman Islands (which doesn't have a DTA with Australia), but its limited partners were tax resident of the US (which does have a DTA with Australia). The taxpayer was assessed on a $58M gain on the sale of Australian shares, and the Commissioner argued that it had no treaty protection. The Federal Court held that as the Caymans LP was "transparent" for Caymans purposes[11], in view of the OECD guidance on the application of DTAs to

[7] To deem a part of the premium income to have been subject to tax in Australia. The other possibility is that the death in question was not an event which could only happen in Australia.
[8] Referring only to *Koitaki Para Rubber Estates v FCT* (1941) 64 CLR 241 at 248, which is only one of many that could have been referred to.
[9] Referring only to *Tariff Resinsurances Ltd v C of T* (1938) 59 CLR 194, which was by far the most relevant case.
[10] Indeed, there are press reports that he may be going to sue them for maladministration.
[11] Whilst it was incorporated, under Caymans law, it is treated as a partnership. There is no income tax inantthe Caymans. The US also treated it as a partnership.

transparent entities, the proper taxpayers to consider for treaty benefits were the limited partners, and they were entitled to the benefit of the Australia/US DTA. The Commissioner has appealed the decision.

Source of income

Having failed to establish in the AAT that Crown Insurance was an Australian tax resident, the Commissioner appealed to the Full Federal Court, on the finding that the source of income was Australia. As the case involved a non-treaty resident, there was no need for the income to be derived above the threshold of a "permanent establishment" in Australia, in order for Australia to have the right to tax.

By a majority, the Court held that there was no issue of law: [2012] FCAFC 153. The dissenting judge (Jessup J) held that there was an issue of law, and that the "indirect" source of the income was Australia. The Commissioner was denied special leave to appeal to the High Court on 6 June 2013, in the light of the High Court decisions in *Nathan, Mitchum* and *Agfa-Gevaert*, "that the case was not a suitable vehicle to explore the distinction between questions of fact and issues of law".

The Commissioner clearly wanted to follow through with comments of Jessup J at [94] in the Full Federal Court, to the effect that the indirect source of insurance premium income of a Vanuatu insurer was Australia, on the basis that the "original source" of the premiums was payments made by members of various funds in Australia. This, with the greatest respect, is clearly wrong. In *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306. Lord Bridge said as to source of income, at 322-323:" The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question." It is not who or where payments are made for the provision of the goods or services. More specifically, in *CIR v HK-TVB International Ltd* [1992] 2 AC 397 the Privy Council said at 402: "If a manufacturer in Hong Kong sells his goods to a merchant in Manila the payment which he receives is no doubt sourced in Manila but his profit on the transaction arises in and is derived from his manufacturing operations in Hong Kong." The reference to "direct or indirect sources" in s6-5(3)(b) and its predecessors has always been there, and was not considered to add anything to the question of source.

In *Re Picton Finance Ltd and FCT* [2013] AATA 116, the taxpayer was a Vanuatu incorporated company (managed by PKF), which conducted share trades in one Australian company listed on the ASX . The Commissioner accepted that the company was not an Australian tax resident, but there are interesting comments in the decision which imply the Commissioner probably should have argued that point, at [86].

The taxpayer's share trades were both "on" and "off" market. The AAT found that all trades were on revenue account and the income there from, was Australian sourced.

In relation to the "off" market share trades, the evidence showed the transferee signed the share transfer forms in Australia, and that being the place where the contract was entered into, the application of established case law pointed to the source of the profit being Australia, at [82].

In relation to the "on" market share trades, no case law was referred to, but it was held that as those trades on the stock exchange occurred "in Australia", the source of the profit was Australia, at [90]. There is long standing Privy Council authority to this effect: e.g. *CIT Bombay v Chunilal Metha* (1938) L.R. 65 India Appeals 332, cited with approval in *Hang Seng Bank* case.

Discrimination against non-residents

The 50% CGT discount for non-resident individuals was removed with effect from the 2012-13 Budget date. It was also announced in that Budget that a 10% non-final CGT withholding by purchasers buying "taxable Australian property" from non-residents, is to become effective 1 July 2016 (along the lines of the FIRPTA in the US).

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