THE TAX INSTITUTE

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Dear Ms Ellershaw and Mr Weiss,

Decision Impact Statement — Addy v Commissioner of Taxation

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to the Decision Impact Statement – *Addy v Commissioner of Taxation* (the **DIS**).

In the preparation of this submission, we have consulted with our national Large Business and International and Taxation of Individuals Technical Committees to prepare a considered response that represents the views of the broader membership of The Tax Institute.

The High Court's decision in *Addy v Commissioner of Taxation*[1] (***Addy***) is of interest to taxpayers because it explains the operation and application of the anti-discrimination clauses of certain double tax agreements in the context of a working holiday maker (**WHM**). The operation and application of Australia's double tax agreements is a complex area for taxpayers and usually requires advice from an experienced and specialised tax adviser. This is compounded by the complexity of Australia's individual tax residency rules that require both an understanding of the legal principles and a comprehensive review of a broad factual matrix to apply the law correctly.

The Tax Institute's view is that the *Addy* case provides an opportunity for the ATO to provide greater clarity on these matters in the DIS. We consider that ATO advice or guidance that focuses solely on the issues addressed by the High Court's judgment will assist taxpayers in understanding how the decision affects their circumstances. Advice or guidance set out in the DIS should not go beyond those issues specifically considered by the court.

[1] *Addy v Commissioner of Taxation* [2021] HCA 34.

We are concerned about statements made by the ATO in the DIS for three reasons.

1. Whether the ATO's position is technically correct, based on the operation of the tax treaty with the United Kingdom and having proper regard to the decision of the High Court.
2. Whether the statements made by the ATO in the guidance materials are properly explained such that taxpayers can fully understand the different outcomes, based on the ATO's interpretation of the High Court's decision.
3. Whether the interpretive statements made in the DIS should be published in the form of legally binding guidance, such as a Taxation Ruling or Determination, rather than by way of a DIS.

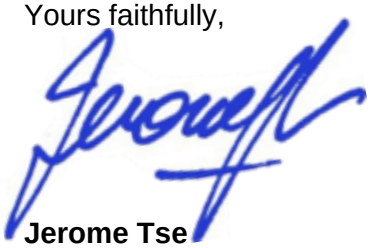
Our detailed response is set out in **Appendix A**.

We would be pleased to continue to work with the ATO on any amendments to the DIS.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more about The Tax Institute.

If you would like to discuss any of the above, please contact our Senior Advocate, Robyn Jacobson, on (03) 9603 2008.

Yours faithfully,



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President

APPENDIX A

Scope and effect of Article 25

The Tax Institute disagrees with the ATO's views expressed in the DIS on the scope and effect of Article 25(1) of the United Kingdom Convention (the **Convention**) with respect to the tax treatment of WHMs following the *Addy* decision. The references to WHMs below refers to individuals holding a WHM visa, from a country with a tax treaty with Australia containing a non-discrimination article (**NDA**) similar to Article 25(1) of the Convention and who earn working holiday taxable income (**WHTI**).

ATO view of scope and effect of Article 25(1)

We note that under the section titled 'Issues decided by the Court – Application of non-discrimination article', the DIS states:

> *'Their Honours found that the ordinary taxation laws as they applied to this taxpayer and to an Australian national in the same circumstances were the same but for the rate. An Australian national 'doing the same work, earning the same income, under the same ordinary laws' would pay less tax than the taxpayer… Therefore, the effect of the NDA being contravened for this taxpayer was that the taxpayer* ***should pay tax at the rates applying to resident nationals****…*'
>
> *(Emphasis added by The Tax Institute)*

Further, we note that under the section titled 'ATO view of decision – Application of the non-discrimination article', the DIS states:

> *The Commissioner considers that the effect of the decision is to tax the resident working holiday maker visa holder on the same basis* ***as if they were an Australian national*** *deriving the same income from the same sources in the same circumstances.*
>
> *Where the resident working holiday visa holder derives working holiday maker taxable income as well as other income, they are taxed* ***as an Australian resident national*** *deriving that same income.[23] This may mean that they include in their assessable income any foreign income that an Australian resident national in the same circumstances would include.*
>
> *(Emphasis added by The Tax Institute)*

Footnote 23 in the DIS states as follows:

> Noting that an Australian resident national will not have the benefit of Subdivision 768-R of the ITAA 1997.

Based upon our discussions with the ATO, we understand that the Commissioner's view requires WHMs to assess a threshold question of whether they have been subjected to any taxation in Australia (or any requirement connected therewith) which is more burdensome than the taxation and 'connected' requirements to which Australian tax residents in the same circumstances are or may be subject.

We understand that the Commissioner's view requires WHMs to compare their actual tax liability on their WHTI based on the WHM tax rates[2] against a hypothetical tax liability. The hypothetical tax liability is of a comparable Australian national who is also a resident for Australian tax purposes[3] (**Australian National**) deriving the same income and in the same circumstances to determine whether the NDA has been enlivened (i.e. breached). In comparing the hypothetical scenario, the WHM is required to have regard to all income derived from all sources.

In effect, the Commissioner's view results in the NDA being enlivened in the following two circumstances:

- If the WHM derives only WHTI and no foreign passive income; or
- If the WHM derives mostly WHTI and a relatively smaller amount of foreign passive income.

Conversely, the NDA will not be enlivened in instances where the WHM derives WHTI and has a comparatively higher level of foreign passive income which benefits from the concessions for temporary residents set out in Subdivision 768-R of the *Income Tax Assessment Act 1997* (**ITAA 1997**).

Our understanding of the Commissioner's view is illustrated in the two examples set out below.

Facts

Assume that the taxpayer is a WHM, has WHTI of $20,000 and has varying amounts of foreign dividend income. If the taxpayer is subjected to taxation that is more burdensome than a tax resident would be subject to, the NDA is activated. The examples below do not factor in the Medicare levy or the Low Income tax offset.

Example 1 — $15,000 of foreign dividend income

A tax resident would be liable to total tax of $3,192[4] on $35,000 of taxable income. Under the WHM rates in Part III of Schedule 7 (**Part III**) to the *Income Tax Rates Act 1986* (**Rates Act**), the taxpayer is subject to tax of 15% × $20,000 = $3,000. In totality, the tax burden imposed on the taxpayer under Part III of $3,000 (with the exemption available on their foreign dividend income under Subdivision 768-R of the ITAA 1997 is **less** than the taxation a tax resident would be subject to ($3,192).

The Commissioner's view is that the taxpayer is not subject to taxation that is more burdensome, so the NDA is not activated. The result is they would be taxed under Part III as a WHM, and the total tax payable would be $3,000. They will not be taxed on their foreign dividend income because of the operation of Subdivision 768-R.

Example 2 — $1,000 of foreign dividend income

A tax resident would be liable to total tax of $532 on $21,000 of taxable income. Under the Part III rates, the taxpayer is subject to tax of 15% × $20,000 = $3,000.

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2 Set out in Part III of Schedule 7 to the *Income Tax Rates Act 1986*.

3 Referred to in the DIS as 'Australian resident nationals'. There is no reference to 'Australian resident national' in the domestic tax laws of Australia.

4 All examples in this submission have calculated the tax using the 2020–21 income tax rates.

> In totality, the tax burden imposed on the taxpayer under Part III of $3,000 (with the exemption available on their foreign dividend income under Subdivision 768-R) is **more** than the taxation a tax resident would be subject to ($532). The taxpayer is subject to taxation that is more burdensome, so the NDA is activated. The result is they would be taxed under the rates in Part I of Schedule 7 to the Rates Act (**Part I**) on the same basis as a tax resident, and the total tax payable would be $532.
>
> In this example, note that the foreign dividend income of $1,000 is no longer subject to the exemption in Subdivision 768-R and is therefore subject to tax in Australia. The Commissioner's view is that where an NDA is activated, the result is that the taxpayer is treated for *all* taxation purposes as an Australian tax resident.

The Tax Institute does not consider this to be a correct interpretation of the High Court's decision in *Addy*. If the High Court (or the Federal Court) had preferred such a simplistic, qualitative gateway to determine whether a person had been subject to more burdensome taxation (and therefore the NDA was engaged), they would have made this clear. The extensive submissions by both parties concerning the nature of the particular visa, and whether residents could obtain a visa, would have been unnecessary.

Implications for temporary resident concessions

As demonstrated by Examples 1 and 2 above, there is an inappropriate and inconsistent outcome on the liability of WHMs to taxation on categories of income that were otherwise intended to be exempt under Subdivision 768-R. The ATO's view expressed in the DIS means that the purported re-characterisation of a WHM as an Australian National pursuant to NDAs has the effect of also removing any tax benefits for which affected WHMs should be eligible, such as those under Subdivision 768-R. However, other taxpayers with similar visas who are not from countries with NDAs can still access these concessions.

Further, the ATO's view in the DIS suggests that the loss of the tax concessions provided by Subdivision 768-R depends on whether the NDA is activated, which in turn depends on whether the total tax payable is more or less burdensome than would be imposed on a tax resident. While the burden of the total tax liability may be less under the ATO's view, the Commissioner's approach means that activating an NDA clause results in certain individuals being taxed on amounts that were previously not subject to tax in Australia. In practice, the Commissioner's approach appears to more greatly impact WHMs with lower amounts of foreign sourced passive income than those with higher amounts (where the benefit of Subdivision 768-R outweighs the punitive nature of the tax rates applied to the WHTI).

As noted in our analysis below, we do not consider that the High Court's decision supports the conclusion that an affected WHM may be re-characterised or deemed to be an Australian National for all purposes under Australian domestic tax legislation pursuant to the activation of an NDA. Similarly, we do not consider that it is reasonable to draw a conclusion that, where the NDA is activated, a WHM could lose their status as a temporary resident and access to the tax concessions on their foreign passive income those rules provide. We consider, at law, that WHMs in similar circumstances to Ms Addy will still be able to access the temporary resident concessions if they meet the requirements of those rules, irrespective of the amount of foreign passive income.

We note that subsection 768-910(1) of the ITAA 1997 provides that the foreign income of a temporary resident is non-assessable non-exempt (**NANE**) income and should therefore not be included in their assessable income.[5]

A temporary resident is defined under section 995-1 of the ITAA 1997 as follows:

> *"temporary resident" you are a temporary resident if:*
>
> *(a) you hold a temporary visa granted under the Migration Act 1958; and*
>
> *(b) you are not an Australian resident within the meaning of the Social Security Act 1991; and*
>
> *(c) your *spouse is not an Australian resident within the meaning of the Social Security Act 1991.*
>
> *However, you are not a temporary resident if you have been an Australian resident (within the meaning of this Act), and any of paragraphs (a), (b) and (c) are not satisfied, at any time after the commencement of this definition.*

As a result, we note that an individual can be both an Australian resident for tax purposes under subsection 6(1) of the *Income Tax Assessment Act 1936* (**ITAA 1936**) and a temporary resident under subsection 995-1 of the ITAA 1997, as these two concepts are not mutually exclusive. Where an individual is found to be a temporary resident, they may use the benefits available under Subdivision 768-R, including the treatment of their foreign passive income as NANE income.

In *Federal Commissioner of Taxation v Addy* [2020] FCAFC 135, the taxpayer was found to be a tax resident by the Full Federal Court. This issue was not contested in the High Court. Although not considered by the courts, Ms Addy would also meet the definition of a temporary resident under subsection 995-1 of the ITAA 1997. She would not be disqualified by the knock-out clause in the definition of a temporary resident, as she would still hold the relevant visa under the *Migration Act 1958* and would also meet the other conditions in limbs (b) and (c) of the definition. She would therefore have been treated as a temporary resident. As a result, her foreign passive income would be treated as NANE income pursuant to subsection 768-910(1).

The Tax Institute strongly disagrees with the Commissioner's position — that a WHM deriving foreign passive income where an NDA has been enlivened cannot access the temporary resident tax concessions in Subdivision 768-R. The Tax Institute considers such a view is not supported by analysis or commentary. Accordingly, we recommend that the DIS be amended to accurately reflect that the foreign passive income of a temporary resident is treated as NANE income, pursuant to subsection 768-910(1), regardless of whether an NDA is activated, or the amount of the taxpayer's foreign passive income.

The Tax Institute view on the scope and effect of Article 25(1)

The Tax Institute considers that the ATO's view incorrectly applies subsection 4(2) of the *International Tax Agreements Act 1953* (**Agreements Act**), which provides that a double tax agreement will prevail where it conflicts with a provision in Australia's domestic tax laws.

[5] We note that subsection 768-910(3) of the ITAA 1997 excludes certain amounts from this exemption. As a result, section 768-910 of the ITAA 1997 has the result of making passive income from foreign sources (such as interest in an overseas bank account or foreign dividends) NANE income.

In its decision, the High Court determined that:[6]

> *In contravention of Art 25(1) of the United Kingdom convention, the more burdensome taxation was imposed on Ms Addy owing to her nationality and, for that reason, the tax rates in Pt III of Sch 7 [of the Rates Act] did not apply to Ms Addy in the 2017 income year.*

In instances where the domestic law is more burdensome than that prescribed in a double-taxation convention, we consider that the correct approach is to modify only the provision or provisions necessary to remove the extent of the inconsistent and burdensome treatment. Under this approach, WHMs would still be subject to tax under Part III. However, the relevant tax rates would be wound back to match those of tax residents under Part I, so the taxation is not more burdensome. In all other respects the taxation of the WHM would remain the same.

As highlighted by the extract below, The Tax Institute considers that this view is supported by contemporary commentary on non-discrimination articles:[7]

> *… it should also be noted that it is the "treatment" itself (i.e. the tax measure under scrutiny) which must not be "other or more burdensome". The possibility that the taxpayer who is discriminated against in a contracting state ultimately bears a lower tax burden than a national of that state (because he is entitled to a special regime in his home state or in the source state) is irrelevant. If the domestic measure at issue is discriminatory, then that discrimination is not removed by establishing that a different, beneficial measure counterbalances the disadvantage.*

We also note the High Court's decision states the following commentary regarding the operation of non-discrimination articles in its decision:[8]

> *… the words '... shall not be subjected ... to any taxation or any requirement connected therewith which is other or more burdensome ...' mean that* ***when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form as regards both the basis of charge and the method of assessment, its rate must be the same*** *and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.*
>
> *(Emphasis added by the High Court)*

The High Court further goes on to state that:[9]

> *In the present case, the application of the ordinary taxation laws – the basis of the charge and the method of assessment in relation to the taxable income of Australian nationals and nationals of the United Kingdom in the same circumstances – was the same,* ***but the tax rate was not. The tax rate was more onerous*** *for Ms Addy, a national of the United Kingdom, than it was for an Australian national in the same circumstances.*
>
> *(Emphasis added by The Tax Institute)*

The Tax Institute considers that the High Court's decision supports our view of the operation of Article 25(1) of the Convention. The High Court explicitly stated that only the rate of taxation is more onerous or burdensome. As a result, we consider that the correct approach is to continue to impose tax on qualifying WHMs at the rates under Part III but at a less burdensome tax rate. We do not consider that affected WHMs should be re-characterised or deemed to be an Australian National.

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6 Ibid. at [8].

7 from Neil Bammens and Frans Vanistandael, 'Article 24: Non-Discrimination' in Pasquale Pistone (ed), Global Tax Treaty Commentaries (IBFD online, 2021).

8 Ibid. at [31], quoting OECD, *Model Tax Convention on Income and on Capital (Condensed Version)* (2003) at 258-260.

9 Ibid. at [34].

The Tax Institute's preferred approach is outlined in Example 3 below. Consistent with the facts in Examples 1 and 2 above, the example below assumes that the taxpayer is a WHM, has WHTI of $20,000 and has foreign dividend income. If the taxpayer is subjected to taxation that is more burdensome than that to which a tax resident would be subject, the NDA is activated. The example below does not factor in the Medicare levy or the Low Income tax offset.

> **Example 3 — Take only WHTI into account in determining whether NDA is activated**
>
> A tax resident would be liable to total tax of $342 on $20,000 on their Australian employment income. Under Part III, the taxpayer is subject to tax of 15% × $20,000 = $3,000. Taking only the WHTI into account, $3,000 is more than the taxation a tax resident would be subject to on that same category of income ($342).
>
> Accordingly, the taxpayer is subject to taxation that is **more** burdensome, so the NDA is activated. The taxpayer is taxed 'on the same basis as if they were an Australian National deriving the same income from the same sources in the same circumstances' — but with regard only to the tax on their WHTI. They continue to be a temporary resident, so the exemption in Subdivision 768-R continues to apply to their foreign dividend income, and the total tax payable would be $342.
>
> This approach illustrates that the tax outcome is not affected by the amount of the foreign dividend income.

We therefore consider that the ATO should remove any statements that a WHM will be taxed as an Australian National from the DIS, as this view is not supported by *Addy*. We also note the long-standing ATO position to adopt an approach that is favourable to the taxpayer in instances where there is more than one interpretation that achieves the policy intent[10] and consider that a consistent approach should be undertaken in relation to this issue.

Greater explanation of ATO view

Notwithstanding our comments above regarding the accuracy of the Commissioner's approach, The Tax Institute considers that the ATO's view is not adequately explained in either the DIS or website guidance.[11] This is likely to result in confusion and uncertainty for WHMs regarding the ATO's position.

As illustrated in Examples 1 and 2 above, the ATO's view requires WHMs to undertake several steps and calculations to determine whether the NDA is enlivened in their circumstances. These calculations would be undertaken seemingly by reference only to the total amount of tax they would pay on all of their income if they were an Australian tax resident. However, the DIS and website guidance do not highlight these steps in any detail. The analysis in the DIS is limited to the extracts mentioned in our submission above. Further, the website guidance is limited to one example[12] which explicitly states that: 'As a WHM from an NDA country, Richelle is assessed on the same basis as a resident Australian national'. This guidance is likely to result in WHMs assuming that their foreign sourced passive income is always subject to tax in Australia, without undertaking the comparative analysis that is required by the ATO's approach.

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[10] For example, see www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/What-you-should-know/The-right-services/how-we-interpret-and-apply-the-law/.

[11] See www.ato.gov.au/Individuals/coming-to-australia-or-going-overseas/coming-to-australia/working-holiday-makers/.

[12] Ibid, see Richelle's example.

We consider that the Commissioner's view should be properly articulated in the appropriate guidance product. We do not consider it sufficient for the website guidance material to merely request that WHMs contact the ATO for advice regarding their foreign income, particularly when it is our view that the basis for this approach is unfounded and is likely to cause confusion.

Form of guidance issued

The Tax Institute considers that a DIS is not an appropriate guidance document for expressing the kinds of technical views and interpretive positions set out in the DIS. Due to the technical nature of the issues in the *Addy* case, and the extent to which the Commissioner seeks to rely on these views, we consider that a legally binding public taxation ruling or determination is more appropriate for discussing these issues and setting out the Commissioner's position.

Further, we note that the DIS makes only a cursory mention of the implication of the temporary resident rules in footnote 23. The DIS does not provide any technical reasoning or explanation as to why the Commissioner considers that the rules in Subdivision 768-R would not (or may not) have applied to Ms Addy had she derived, or had it been established that she derived, foreign passive income (depending on the amount of that income). We consider that this issue should be expanded and discussed in greater detail, in the appropriate guidance product, to enable taxpayers and practitioners to better understand how the Commissioner has arrived at this conclusion. In its current form, we have received feedback from our members that many practitioners have overlooked the footnote and not been able to properly understand the reasoning behind the Commissioner's views expressed in the DIS.

Web guidance

The Tax Institute considers that it was not appropriate for the ATO to have updated the web guidance (QC 50742) on the taxation of WHMs. In particular, we have observed that the section titled 'Example: tax for resident working holiday maker from an NDA country' was last modified on 17 December 2021, the day on which the DIS was published on the ATO's Legal Database.

The DIS is currently a draft document for public consultation and covers significant unconsulted technical issues. We consider that the ATO should revert the content on the web guidance to the previous version until the appropriate final guidance product is released that outlines the ATO's rationale and support for their view.

Other concerns

Inconsistency with TR 98/17

The Tax Institute considers that the position taken by the ATO in the DIS is inconsistent with previous guidance provided in TR 98/17 *Income tax: residency status of individuals entering Australia* (**TR 98/17**).

In the DIS, the Commissioner expresses the following views about working holiday makers:

> *Most [working holiday makers] will not answer the description of a person who 'dwell[s] permanently or for a considerable time' in Australia or who has their 'settled or usual abode' in Australia. While they may 'live', in the sense of 'stay' at a particular place even for extended durations, this is insufficient. The association most working holiday visa holders have with Australia will be temporary and casual. Most are visitors.*

In TR 98/17, the Commissioner stated that, ‘When an individual arrives in Australia not intending to reside here permanently, all the facts about his or her presence must be considered in determining residency status.’ TR 98/17 also provides an example of where an individual with no family in Australia is determined to be an Australian tax resident. In Example 3 of TR 98/17, the individual stayed in Australia only for 5 to 7 months, but leased an apartment for six months, purchased a car, opened a bank account and formed social connections in Australia. Such an individual was found to be a tax resident.

That an individual may renew their working holiday visa for up to three years suggests that it would not be unusual or rare for a large number of these individuals to have a fact pattern resembling the facts in Example 3 in TR 98/17.

We are concerned that the remarks excerpted from the DIS above overemphasise the fact that a working holiday visa provides visa holders only with the right to remain in Australia temporarily. This gives WHMs the impression that they should be non-residents for tax purposes. In our view, it is preferable to emphasise that a taxpayer’s residency status is heavily dependent on the entirety of their facts and circumstances and is not dictated solely by their visa status.

Use of terms

The Tax Institute considers that use of the term ‘Australian resident national’ in the DIS should be avoided, as it is not defined in Australia’s domestic tax law. The term ‘national’ has a very specific definition and meaning for migration law purposes and for the purpose of the Convention, so it will likely confuse taxpayers and advisers reading the DIS. We therefore recommend that the ATO uses consistent terminology used in the DIS to minimise any confusion for taxpayers and practitioners.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.