

Aspects of Financial Planning

Taxation implications of overseas residency

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More and more of our clients are being given the opportunity to live and work overseas. Before you make the move, it is worthwhile considering the taxation implications of becoming a non-resident for Australian tax purposes.

Background

If you are moving overseas, for work or study etc, it is very possible that you may be treated as an Australian non-resident for income tax purposes during your overseas stay. It is therefore essential to understand how your residency status will be determined and the tax implications of non-residency.

Determining your residency status

Whether a person is a resident or non-resident for Australian tax purposes is a question of fact and degree – it is not possible to provide conclusive rules for determining residency status. Generally however, an individual is an Australian resident for income tax purposes if he/she satisfies one of the following four exhaustive tests:

- Residence according to the ordinary concepts test; the domicile and permanent place of abode test;
- The 183 day test; or
- The Commonwealth superannuation fund test.





Specifically, in relation to those relocating overseas, an ATO Taxation Ruling (IT 2650) states that the following factors need to be taken into account:

- Intended or actual length of stay overseas
- The duration and continuity of presence in the overseas country
- Any intention either to return to Australia at some definite point in time or to travel to another country Whether a home has been established outside Australia
- The abandonment of any residence or place of abode the individual may have had in Australia; and
- The durability of the person's association with a place outside Australia.

The weight to be given to each factor will vary with individual circumstances and no single factor is conclusive. As a broad rule, and subject to the application of the above factors, if you intend to reside overseas permanently or with the intention of working overseas for more than two years, you will generally be considered a non-resident for tax purposes from the date that you leave Australia. Correspondingly a person who leaves Australia with the intention of returning to Australia within two years will normally remain a resident of Australia for tax purposes, unless the person can demonstrate that his/her permanent place of abode is outside Australia.

Examples of residency

Bob, an Australian resident employee of a mining company, is transferred overseas for a temporary work assignment, so he can gain wider work experience, for a period of two years. He intends to return to Australia at the end of that period. Bob is initially accompanied by his wife and children but the children returned to Australia to continue their schooling. Bob spends his annual holiday in Australia. During his absence from Australia he rents out his home and maintains bank accounts in Australia. He makes no investments in the overseas country and remits all money in excess of living requirements to Australia for investment.

In these circumstances Bob will remain an Australian resident for tax purposes.

Harry, a bank manager is posted overseas for two years. During that time he and his family live in a furnished house provided by the bank. Harry's home in Australia is leased out. On leaving Australia, Harry expects a further overseas posting after his two-year period. He advises Centrelink that the family is leaving Australia permanently and his family payments should cease.

In these circumstances Harry would be considered to have abandoned his place of residence in Australia and to have formed the intention to, and in fact did, reside outside Australia. His place





of abode overseas was not merely temporary or transitory; rather, it was intended to be and was in fact his home for the time being. Consequently he is a non-resident for tax purposes.

Capital gains tax implications of non-residency

Ceasing to be a resident

If you leave Australia and are considered to be a non-resident for tax purposes there may be immediate tax implications. The tax consequences relate to potential capital gains or losses made on certain assets held at the time you become a non-resident.

On the date you become a non-resident, it is deemed that you have disposed of all assets that are not 'taxable Australian property' even if you haven't sold them. The definition of taxable Australian property includes, but is not limited to, real property situated in Australia, some indirect interests in Australian real property and options or rights to acquire an interest in Australian real property.

The effect of this definition for most clients is that their home and any investment properties they own will not be subject to the deemed disposal provisions.

Accordingly this rule would typically catch other commonly held investments such as shares, options and managed fund investments. These assets are deemed to be sold at their market value at the time you become a non-resident and a capital gain or loss realised at this time.

Notwithstanding this, the taxpayer has two options at this time in respect of the deemed disposal provisions, they are:

- 1) Pay the tax when leaving Australia and be free of any Australian tax on any gains made whilst a non-resident; or
- 2) Elect to disregard the deemed disposal at the time you become a non-resident. This election has the effect of treating the affected assets as taxable Australian property. Utilising this option widens the period you are exposed to Australian capital gains tax (CGT).

The way in which you prepare your tax return for the financial year in which you become a non-resident is sufficient evidence of your choice in respect of these provisions.

Option one provides you a possible tax saving opportunity. If you expect your investments to increase in value while you are away from Australia, you may want to pay the tax liability when you leave. This will then mean that the growth in value of your investments during your period of non-residency will not be subject to Australian tax, thus representing tax-free growth. There may however be tax implications in your foreign country of residence, if you sell the asset.





If you choose option two, to disregard the gain or loss, the election must be made in respect of all assets affected, not just selected assets. If you make this election, an asset that would otherwise be deemed to have been disposed of is taken to be taxable Australian property until a CGT event happens in relation to the asset, or until you become a resident again, whichever happens first.

The effect of treating the asset in this way is that the capital gain or capital loss on its eventual disposal takes into account the whole period of ownership, including any period when you were not an Australian resident.

You should be prudent and consider this decision in light of how much tax you pay now against the amount in the future and the potential for growth in the value of your assets.

Investing in Australia – an excellent expatriate strategy

Taking up an overseas posting often brings with it substantial remuneration and the capacity for increased saving. As a result, one of the common questions of expatriates is where is the best place to invest my new found wealth?

Changes to taxation laws from December 2006 make investment in certain Australian sourced assets more attractive to non-resident investors.

As described above, foreign residents are only subject to CGT in relation to capital gains made on assets that are considered taxable Australian property – this excludes assets such as shares, options and managed fund investments. Effectively, a non-resident can potentially avoid paying any Australian CGT on such assets during the period of their non-residency.

Note: The taxation consequences of holding such assets in the country of residency should be considered.

Where such assets are acquired whilst a non-resident, and the individual subsequently becomes an Australian tax resident again, these assets are treated as being acquired at market value for CGT purposes at the date the taxpayer becomes a resident.

Overall this exemption for capital gains on assets that are not taxable Australian property represents an excellent opportunity for expatriates to invest in Australian assets for the duration of their non-residency.





Main residence and temporary absence

As your home will be classed as taxable Australian property you will not be deemed to have disposed of it, if you decide to keep it while you are away.

In fact, continuing to regard your home as your main residence while you are away may be beneficial as no capital gains tax will apply upon eventual sale. You cannot however nominate any other dwelling as your main residence during your period of absence, even if you actually live in that other dwelling.

An election to treat your house as your main residence does not need to be made until the house is sold. You must make the choice by the day you lodge your tax return for the income year in which a CGT event occurs for the disposal of the main residence. The way you prepare your tax return is sufficient evidence of your choice. If you make a choice, it is not affected by you becoming a non-resident during the period of absence.

You can also use your vacated home to produce income and still treat it as your main residence for a period of up to six years. And, you will qualify for another six years each time you move back in.

General taxation matters

Non-resident tax rates

Australian residents are generally taxed on their worldwide income derived from all sources. Non-residents for tax purposes are generally taxed on Australian-sourced income only and are exempt from Australian tax on any foreign income.

Non-resident tax rates are higher than resident tax rates and non-residents are not entitled to the tax-free threshold. The following table represents non-resident tax rates for 2010/11.

Taxable income	Tax on this income
0 – \$37,000	29c for each \$1
\$37,001 – \$80,000	\$10,730 plus 30c for each \$1 over \$37,000
\$80,001 – \$180,000	\$23,630 plus 37c for each \$1 over \$80,000
\$180,001 and over	\$60,630 plus 45c for each \$1 over \$180,000

If you are a non-resident for only part of a financial year, you will be entitled to a pro-rata tax-free threshold and the normal resident tax rates will apply for the number of days/months you are an Australian resident. For the remaining part of the year non-resident tax rates will apply.





Non-residents are not required to pay the Medicare levy, so you can claim the number of days that you are not an Australian resident during a tax year in your return as exempt days.

Note: This also means you are not entitled to claim Medicare benefits during this time.

Non-residents are not able to claim certain personal tax offsets, such as the tax offset for a dependant spouse or the low income offset, so your claim for such will need to be reduced to take account of the period you are a non-resident.

Australian sourced income

Different tax treatment applies to the different types of income you may continue to receive from Australia while being considered a non-resident. Aside from the below exceptions, generally assessable income derived by non-residents is taxed on the same basis as income derived by residents.

If you have a rental property in Australia the rental income will be taxed at non-resident rates. If the property makes a loss (for example if the property is negatively geared), these losses can be carried forward to offset against any future Australian income, including Australian sourced salary income upon returning to Australia.

All Australian sourced interest, unfranked dividends and royalties derived after you cease to be an Australian resident are subject to withholding tax provisions. Withholding tax rates are considered the final tax you will pay on this income and the appropriate tax is deducted from the payment and remitted by the payer directly to the ATO. Specifically:

- 10% of any interest earned from your Australian bank accounts or term deposits is withheld for tax
- 15% withholding tax applies to unfranked dividends where Australia has a double tax treaty
- 30% withholding tax applies to unfranked dividends where Australia does not have a double tax treaty; and
- royalties will be taxed up to 30% depending on the existence of a double tax treaty.

This list is not definitive and certain exceptions do exist. You will need to advise the relevant Australian company of your overseas address so that this tax can be withheld otherwise tax will be withheld at the highest marginal tax rate, currently 46.5%.

As withholding tax is deducted prior to payment, interest, dividend and royalties are considered exempt income and accordingly will be excluded from an Australian income tax return.





Therefore there is no use negative gearing against these types of income because the withholding tax is calculated on your income before deductions. Investment expenses, or deductions, are not claimable in your Australian tax return as the corresponding income is excluded so there would be no link between cost of earning income and losses.

Note: No tax is withheld from franked dividends, as the Australian company has already paid tax on the profit represented by the dividends.

Managed investment funds

From 1 July 2008, a new withholding regime applies to distributions from managed investment funds made to foreign residents. The changes progressively reduce the withholding tax rate from a non-final withholding rate of 30% to:

- 22.5% (non-final) for the year ended 30 June 2009
- 15% (final) for the year ended 30 June 2010; and
- 7.5% (final) for the year ended 30 June 2011 and later income years.

The above rates apply to foreign residents residing in an overseas country in which Australia has an effective exchange of information (EOI) arrangement. Where no EOI arrangement exists, foreign residents will be subject to a 30% final withholding tax.

As distributions of dividends or interest are subject to their own withholding arrangements (refer above) and distributions of capital gains in respect of assets that are not taxable Australian property are tax free, the new withholding regime will only apply in respect of distributions of net trust income (other income), rent and capital gains on taxable Australian property.

It is important to advise any managed funds you are invested in of your non-residence status so that the appropriate withholding tax can be deducted from distributions.

Superannuation

Access to superannuation benefits

Persons relocating overseas must generally leave their superannuation in a complying superannuation fund until they meet a condition of release, for example on permanent retirement after age 55.

Contributions to superannuation

A person who is a member of an Australian superannuation fund is able to continue contributing to that superannuation fund while overseas, as long as the normal contribution





rules are met. The conditions for acceptance of contributions by a superannuation fund do not alter when a person leaves Australia. Generally, if you are under 65 years of age there are no restrictions on making contributions (however see below for tax file number implications).

Over 65 years individuals are required to meet a work test, however the regulations do not confine the activities to those performed in Australia.

Tax deductions for personal contributions while overseas

If a non-resident has assessable Australian sourced income, such as rent, they may be able to claim a tax deduction for personal superannuation contributions in order to offset this income. To claim this deduction, less than 10% of the total of the person's Australian assessable income, reportable fringe benefits and reportable employer superannuation contributions (eg salary sacrificed contributions) must be attributable to employment related activities. (i.e. the 10% rule).

Example

Natalie, 34, is enjoying working in an investment bank in London and is a non-resident of Australia for tax purposes during the 2010/11 financial year. During this financial year she is expecting to receive \$22,000 of rental income from her Bronte apartment. The Australian tax for a non-resident on this income would be \$6,380. If Natalie makes a \$22,000 contribution into a complying superannuation fund in Australia, she would be entitled to a tax deduction for the whole amount. This would offset Natalie's rental income reducing her taxable income to zero and therefore she would not be required to pay any Australian tax. The superannuation contribution will be taxed in the fund at a maximum rate of 15% (i.e. \$3,300).

Note: Non-residents are subject to the same concessional and non-concessional contribution caps as resident taxpayers.

Tax file number implications for non-residents contributing to superannuation

The implications for non-residents not providing their tax file number (TFN) to their superannuation fund are the same as for residents. Where no TFN is provided the fund can not accept non-concessional (personal) contributions (limited exceptions apply).

Where concessional (employer) contributions are received (above certain limits) and the member has not advised their superannuation fund of their TFN, additional tax at the rate of 31.5% will apply to these contributions.





Annuities and superannuation income streams

Non-residents aged over 60 in receipt of Australian superannuation income streams are taxed in the same manner as resident taxpayers. Where such payments are received from a taxed source the income is classified as 'non-assessable, non-exempt income' and is not subject to Australian taxation. Recipients will need to determine whether there is a liability to taxation in their country of residence.

Where the recipient is under age 60 and they live in a country with which Australia has a Double Taxation Treaty then there is generally no Australian tax imposed on superannuation income streams. Income payments may however be subject to taxation in the country of residence.

Self managed superannuation funds

Critical tax issues arise for people who operate their own self managed superannuation fund (SMSF) and relocate overseas. Care needs to be taken to ensure that the fund remains an 'Australian Superannuation Fund' and does not become a non-complying fund. An SMSF qualifies as an Australian Superannuation Fund if the following three conditions are met:

- The fund was established in Australia
- The central management and control is ordinarily in Australia; and
- At least 50% of the benefits in the fund that relate to active members have been derived from active members that are also residents of Australia.

If a fund becomes non-complying, it will be taxed at the highest marginal rate, currently 45% of the market value of the assets in the fund.

In order to prevent this from happening, people with SMSFs intending to reside overseas for an extended period of time, should consider winding up the SMSF and rolling their money into a public offer superannuation fund.

International agreements on superannuation contributions

As a result of our increasingly flexible overseas workplace assignments, Australia has entered into agreements with a number of countries addressing the issue of 'double superannuation coverage' for employees. These agreements remove the potential for super contributions (or equivalent) to be paid in two countries when employees are sent to work temporarily in another country and the employer or employee is required to make super contributions under the legislation of both countries for the same work.

Under these agreements, the employer/employee will be exempt from making super contributions in the country the employee is temporarily working in, if:





- The country has a bilateral agreement with Australia
- The employee remains covered by compulsory super arrangements in Australia
- The employer's application for a 'certificate of coverage' is organised before the employee assumes the overseas assignment and is approved by the Australian Tax Office. The certificate of coverage is the instrumental document that will enforce the exemption from the double superannuation contribution.

Double taxation agreements/treaties

In determining liability to Australian tax on the basis of residence or non-residence in Australia, it is necessary to consider not only domestic tax laws, but also the taxation laws of the foreign country in which you intend to reside. This will include determining any applicable double taxation agreements (DTA). Australia has entered into taxation agreements (conventions or treaties) with more than 40 countries. DTAs prevent double taxation and foster cooperation between Australia and other international tax authorities by enforcing their respective tax laws.

It is possible for a person that is a resident of Australia for Australian income tax purposes to also be a resident of another country for the purposes of that country's taxation laws. A number of double taxation agreements to which Australia is a party recognise the possibility of a person being a resident of two countries, in other words, a person may have dual residency. Those agreements provide rules for determining the country of which the person is deemed to be a sole resident.

Conclusion

This Aspect has provided a brief overview of the Australian taxation implications of relocating overseas and being determined a non-resident for tax purposes. We have not considered the possible taxation imposed by the foreign country. As a non-resident for tax purposes, there are unique investment opportunities available, however as a number of technical issues arise from case to case and also as the Government is continually reviewing domestic and international tax arrangements, specialist tax advice should be sought.





Centric Wealth Advisers Ltd may be able to be of assistance

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