Case study: Tax residency and main residence exemption

Bert Lancaster is an enterprising young mining engineer who has just been offered a new job in New Zealand. He recently bought his first home in Brisbane in January. He starts work in NZ in June on a three year contract and can take a leave of absence from his old Australian employer for up to a year; a policy they have to retain staff. Bert has moved into the home and made best use of the State Government first home owners’ duty concession. He will not rent the property out until February next year. The NZ employer will pay an accommodation allowance and has found and apartment for Bert to live in. He will be paid in NZ currency to a new NZ bank account.

Question: What are the main Australian taxation issues?

Answer: There is a question as to Bert’s residency for Australian taxation purposes. If he remains a resident of Australia for some or all of the time he is in NZ, he will need to return his worldwide income (including the NZ income) in his Australian tax return whereas if he became a non-resident he would only need to return his Australian sourced income.

Also, the main residence exemption for capital gains tax should apply to his new home as he has moved into the house and commenced using it as his home prior to his appointment in NZ. There is an ability to be away from the home for a period of up to six years (if the house is rented out) and still claim the main residence exemption on a subsequent sale of the house.

Question: What will be his tax residency status?

Answer: He will remain an Australian tax resident at least until he rents out his house and terminates his Australian employment. He will then cease to have an Australian residence under its normal and usual meaning. There are four tests under Australian legislation for tax residency being:

1. Residency under its normal and usual meaning;
2. The domicile and permanent place of abode test;
3. The 183 day test; and

Bert is not a member of a Commonwealth Superannuation Fund and the fourth test is irrelevant.

Under the first tax residency test, Bert’s home will still be available to him until the point where he rents it out. After that point, he will have ceased to have an Australian residence under its usual meaning.

Bert was born and raised in Australia and accordingly, he has an Australian domicile. Under the second tax residency test, someone with an Australian domicile becomes a non-resident when they establish a permanent place of abode overseas. In essence, a permanent place of abode is a home and when Bert takes up accommodation in the apartment in NZ he will have this in place. Accordingly, when the first tax residency test ceases to apply in February next year, this second test will have already ceased to apply and Bert will become a non-resident for Australian tax purposes at that time. As Bert’s ties with Australia are closer than those with NZ, at least up to February, the tie-breaker test in the NZ Convention will confirm Australian residency.

That means he will need to return his NZ income in his Australian tax returns up to that point. He
will pay Medicare levy and accordingly, have the benefit of the use of the Australian medical system. Thereafter, Bert will need to ensure that he has comprehensive medical arrangements presumably both in NZ and Australia by way of travel, government or other private health insurance.

Under the third tax residency tests, you are a tax residence of Australia if you are in Australia for at least 183 days out of any tax year. This equates to half the year and the number of days could be spread across a number of trips in and out of the country. Bert will need to keep an eye on this if he has extensive travel back to Australia after February next year.

Question: What steps should be taken regarding tax residency?

Answer: Bert should make sure the rental arrangement for his Australian home is on normal and usual settings with a documented rental agreement, a rental bond, rental collections and a usual term of six, twelve or more months.

Bert should retain his payslips from his NZ based employer to assist in the preparation of his Australian tax return for the upcoming year.

He should retain a dossier of papers illustrating to his intentions in February next year when he is expected to become a non-resident. This would include his NZ employment contract, a copy of his Australian resignation, notification of the Australian electoral roll as to his move to NZ, notifications of banks, investments and other authorities as to his new home address in NZ. Bert should take care in completing immigration departure cards when leaving the Australian airport and make sure his intention to move permanently overseas is set out.

Bert’s taxation calculation will change at that point with the removal of the tax free threshold and Medicare levy, imposition of final withholding taxes on interest and unfranked dividends, the need to consider a CGT election for company shares, unit trusts or other investments and the potential for rental property losses to accumulate that may be utilised if he does eventually come back to Australia.

Question: What will be the main residence status of Bert’s home in Brisbane?

Answer: As Bert moved into the house as his home, it should have gained the status of his main residence. Once a dwelling has become a main residence, you can be away from it and still claim the main residence exemption on a subsequent sale:

- Where the dwelling is rented out, for a period of six years; and
- Otherwise, for an indefinite period.

Question: What steps should be taken regarding the main residence exemption?

Answer: Bert should retain a second dossier of documents and papers with regard to the main residence exemption including:

- The change of electoral roll he underwent in moving into the new house;
- Electricity and gas connection notices in his name;
- Telephone connection notices in his name; and
- His usage of that address for banking, government, other authority and investment purposes during the period from January this year to February next year.

Once the house is rented out, Bert will need to retain records of rental receipts and all expenditure incurred on the property and, most likely, it will be beneficial to obtain a Quantity Surveyor’s report.
to be able to claim depreciation and capital works deductions.

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