



Australian Government

The Board of Taxation

CORPORATE TAX RESIDENCY

Consultation Guide



September 2019

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Chapter 1: Introduction

On 5 August 2019 the Treasurer requested the Board of Taxation ('the Board') to conduct a review ('the review') of the operation of Australia's corporate tax residency rules.

1 Terms of reference

The purpose of the review is to ensure the corporate tax residency rules are operating appropriately in light of modern, international, and commercial board practices and international tax integrity rules.

In particular, the Board is asked to consider whether the existing rules:

1. minimise commercial uncertainty and ambiguity;
2. are consistent with and aligned with modern day corporate board practices;
3. protect the tax system against multinational profit shifting; and
4. otherwise support Australia's tax integrity rules as they apply to multinational corporations.

2 The review team

The Board has appointed a Working Group of its members to oversee the review. The members of the Working Group are Neville Mitchell (Chair of the Working Group), Dr Julianne Jaques and Ann-Maree Wolff.

The Working Group is being assisted by members of the Board's Secretariat and by staff from the Treasury and from the ATO.

The Board is also receiving assistance from a panel of senior tax experts.

The position and affiliations of the Board's members are listed on the Board's website.

3 Consultation process

In conducting this review the Board proposes to consult widely and provide all stakeholders with the opportunity to participate in the review. To facilitate the public consultation process the Board has developed this paper as a basis for further discussions.

The Board will consider the issues raised by stakeholders in their submissions and in consultation meetings. The Board's report and its recommendations will reflect the Board's independent judgement.

4 How to participate

Interested parties may contribute to consultation through online submissions, or by participating in one of the consultation sessions conducted by the Board.

The Board welcomes submissions on the issues raised in this consultation paper. The closing date for submissions is 4 October 2019. Submissions can be made to CorporateResidency@taxboard.gov.au or addressed to the Treasury as follows:

Review of Australia's corporate tax residency rules
Board of Taxation Secretariat
C/-The Treasury
Langton Crescent
Parkes ACT 2600

Stakeholders making submissions should note that Board members, the Review team, and those assisting the Review, will have access to all submissions. All information (including name and contact details) contained in submissions may be made available to the public on the Board's website unless it is indicated that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like only part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request for a submission to be made available under the *Freedom of Information Act 1982* (Commonwealth) that is marked 'confidential' will be determined in accordance with that Act.

Chapter 2: Consultation questions

The Board has posed a number of consultation questions for stakeholder comment throughout the body of this consultation paper. For ease of reference they are reproduced below.

Consultation question 1

The Board seeks stakeholder comment on the difficulties associated with the central management and control test that have been discussed in Chapter 5 so far, and whether there are additional difficulties with the test that the Board's attention should be drawn to (particularly if such difficulties are attributable to matters other than board practices and if they arise in the context of an inward investing corporate structure).

Consultation question 2

The Board seeks stakeholder comment on the primary theme that has informed the discussion under Part 4 of Chapter 5, being whether certain subsequent additions to the income tax legislation have imported at least some degree of redundancy into the central management and control test. The Board also seeks stakeholder assistance in identifying instances in which any other part of the income tax legislation produces different tax outcomes that are dependent on whether a foreign incorporated subsidiary company is, or is not, an Australian resident under the central management and control test.

Consultation question 3

The Board seeks stakeholder comment on whether the central management and control test should be replaced with an alternative test that features place of effective management. The Board is particularly interested in how place of effective management would increase commercial certainty and align with modern corporate practices, whilst maintaining integrity of the rules as they apply to multinational corporations.

Consultation question 4

The Board seeks stakeholder comment on whether there are criteria other than central management and control or place of effective management that could be used to establish corporate residency. The Board is particularly interested in how alternatives would increase commercial certainty and align with modern corporate practices, whilst maintaining integrity of the rules as they apply to multinational corporations.

Consultation question 5

The Board seeks stakeholder comment on whether an incorporation only test should be used as the sole basis for establishing corporate residency.

Consultation question 6

The Board also seeks stakeholder comment on whether there is a compelling basis for retaining the second limb of the test for corporate residence (under which a company is a resident if it carries on business in Australia and has its voting power controlled by shareholders who are residents of Australia) in the event that the central management and control test is replaced with an alternative test.

Chapter 3: Overview of Australia's corporate residency rules

Australia employs a residence based approach to determine the territorial reach of its income tax legislation, being the *Income Tax Assessment Act 1936* ('ITAA1936') and the *Income Tax Assessment Act 1997* ('ITAA1997').

Subsection 6-5(2) of the ITAA1997 provides that the assessable income of an *Australian resident* includes the ordinary income of that resident which has been derived from *all sources*, whether in or out of Australia. Likewise, subsection 6-10(4) of the ITAA1997 provides that the assessable income of an Australian resident includes the statutory income of that resident which has been derived from all sources, whether in or out of Australia.

In the case of *foreign residents*, subsection 6-5(3) of the ITAA1997 provides that the assessable income of a foreign resident includes the ordinary income of that resident which has been derived from all *Australian sources*. Likewise, subsection 6-10(5) of the ITAA1997 provides that the assessable income of a foreign resident includes the statutory income of that resident which has been derived from all Australian sources.

The concept of corporate residency is, therefore, essential in determining the scope of Australia's taxing rights over profits derived by corporate taxpayers.

From an international perspective there are, generally speaking, two methods that are used to determine corporate residency. These have been described in the following terms:

Although different jurisdictions determine corporate location in different ways, the range of options is rather limited. Basically, in locating a corporation, a legal system can adopt either the "place of incorporation" ("POI") rule or some version of the "real seat" ("RS") rule. Under the POI rule, the corporation's location is determined by where it was incorporated, a purely formal criterion. Under the RS rule, a corporation's location depends on some combination of factual elements, such as the location of the administrative headquarters or the location of the firm's center of gravity as determined by the location of the employees and assets. The place of incorporation can also bear on this question, but it is not determinative.¹

Like a number of other jurisdictions, such as Canada and the United Kingdom, Australia uses a combination of both methods in determining corporate residency. The term "resident of Australia" is defined in subsection 6(1) of the ITAA1936 as including:

[A] company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia. [Emphasis added]

This definition incorporates a two-step test. The first step is simply the place of incorporation rule. The second step, which can only be turned to in the event that the company in question has not been incorporated in Australia, is Australia's codification of the real seat rule. In this version, a company must not only carry on business in Australia but must also satisfy one of two alternate limbs, with the first limb requiring the company's central management and control to be located in Australia. It is this particular

¹ MA Kane & EB Rock, 'Corporate Taxation and International Charter Competition' (2008) 106 Michigan Law Review 1229, 1235.

permutation of the real seat rule, under which a company must carry on business in Australia and have its central management and control in Australia ('the central management and control test'), which will represent the primary focus of the current review. The Board understands that the second limb (under which a company's voting power must be controlled by Australian resident shareholders) is seldom resorted to, but the Board is nonetheless interested in any comments or perspectives that stakeholders may have on the second limb.

The Board notes that corporate tax residency also drives other tax outcomes, and is not limited to dictating whether the worldwide income or the Australian sourced income of a company will be subject to Australian taxation. These other tax outcomes include the operation of Australia's double tax agreements,² the application of the controlled foreign company regime, whether a liability to withholding tax exists and eligibility for membership of a tax consolidated group.

² Tax treaties generally defer to a particular jurisdiction's local law for the purposes of assigning residency to a person. By way of example, paragraph 1 of Article 4 of the tax treaty concluded between Australia and the UK provides that a person is a resident of a contracting state for the purposes of the treaty if "...the person is a resident of Australia for the purposes of Australian tax". This can change in certain circumstances, such as where a person is considered to be a resident of both contracting states to a treaty.

Chapter 4: Context for the review

It may be helpful, before turning to the ongoing viability of the central management and control test itself, to consider the series of events that have led to the Treasurer's request to undertake a review of corporate tax residency.

1 Board review of 2003

In 2002 the Treasury released a consultation paper titled "Review of International Taxation Arrangements". In that paper, it was noted that applying residency concepts to companies that are part of a multinational corporate group is difficult, and therefore the test for corporate residency "...needs to be pragmatic, balancing factors such as compliance and administrative costs, integrity of the tax system, and the assertion of Australia's taxing rights against other nations' taxing rights."³

The consultation paper then expanded on the difficulties associated with the Australian test for corporate residency:

...difficulties with the current tests of company residency arise because of uncertainty about applying the test that looks at whether a company's central management and control is in Australia and whether it carries on a business here. The Australian Taxation Office applies the test so that the 'carrying on of a business' is separate to the 'central management and control'. However, the case law is not entirely clear, and arguably, merely exercising central management and control itself may constitute the carrying on of a business. If this interpretation was to prevail, it would significantly broaden the range of the test, and some businesses might arrange their affairs (at some cost) to guard against this.⁴ [Emphasis added]

Consequently, the Treasurer requested the Board to consider options to clarify the test of company residency so that exercising central management and control alone does not constitute the carrying on of a business.

The Board responded to this request in its "Review of International Tax Arrangements" report of 2003. It agreed with the proposition that the test for corporate residency needs to be clear and practical, and noted that the central management and control test created uncertainty in practice.⁵ It could, according to the Board, lead to "...stage-management of board meetings of companies which operate in a number of countries and have top management distributed among those companies."⁶

A significant difficulty with the central management and control test, according to the Board, involved a complication that was:

...introduced by an early High Court case which held that a company which is managed in

³ Commonwealth Treasury, *Review of International Taxation Arrangements: A Consultation Paper Prepared by the Commonwealth Department of the Treasury* (August 2002) 54.

⁴ Commonwealth Treasury, *Review of International Taxation Arrangements: A Consultation Paper Prepared by the Commonwealth Department of the Treasury* (August 2002) 54-55.

⁵ Board of Taxation, *International Taxation: A Report to the Treasurer* (February 2003) vol 1, 107.

⁶ Board of Taxation, *International Taxation: A Report to the Treasurer* (February 2003) vol 1, 107.

Australia is likely to carry on business here. This has the potential to make foreign subsidiaries of Australian companies resident in Australia, even though the subsidiaries are incorporated and operate outside Australia. To prevent this possibility, Australian companies may deliberately seek to appoint a majority of directors resident in the country of incorporation of the subsidiary and hold board meetings there. In practice, however, these directors are likely to closely follow the views of the Australian parent company, thus leaving the place of management unclear.⁷ [Emphasis added]

The difficulties enumerated above led the Board to recommend that the central management and control test should be removed from the residency definition in subsection 6(1) of the ITAA1936, and that a company should be regarded as resident in Australia only if it is incorporated in Australia. It does need to be noted, however, that this recommendation was made before the advent of the OECD's Base Erosion and Profit Shifting (BEPS) agenda to eliminate double non-taxation of income and entities, and consequently this issue needs to be reconsidered within the current and emerging environment.

The "early High Court case" referred to by the Board is *Malayan Shipping Co Ltd v FCT* (1946) 71 CLR 156 ('*Malayan Shipping*').

2 *Malayan Shipping*

In *Malayan Shipping* Williams J was required to determine whether a company incorporated in Singapore was an Australian resident under the central management and control test. In the course of applying the test Williams J made the following observation:

The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business ... must be situated ... in Australia is, in my opinion, to make it clear that the mere trading in Australia by a company not incorporated in Australia will not of itself be sufficient to cause the company to become a resident of Australia. But if the business of the company carried on in Australia consists of or includes its central management and control, then the company is carrying on business in Australia and its central management and control is in Australia.⁸ [Emphasis added]

In *Malayan Shipping* it was conceded that central management and control was located in Australia, but it was argued that the relevant business of the company was not being carried on in Australia. Williams J rejected that submission on the basis that the managing director, an Australian resident, had "...exercised complete management and control over the business operations of the company. It also proves that in these years he exercised an equally complete management and control over the internal administration of the company."⁹

3 Taxation Ruling TR 2004/15

The Board's 2003 report prompted the issuance of *Taxation Ruling TR 2004/15 Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and*

⁷ Board of Taxation, *International Taxation: A Report to the Treasurer* (February 2003) vol 1, 107.

⁸ *Malayan Shipping Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156, 159-160.

⁹ *Malayan Shipping Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156, 160.

control ('TR 2004/15') by the Australian Taxation Office ('the ATO'). In that ruling the ATO formally expressed its view that carrying on business in Australia is a separate requirement of the central management and control test, and one that needs to be established independently of the exercise of central management and control in Australia.¹⁰

In TR 2004/15 the ATO expressed a view that the comments of Williams J in *Malayan Shipping* did not represent a general proposition that the exercise of a company's central management and control in a particular location is sufficient to establish that the company is also carrying on business in that same location. Those comments were, according to the ruling, explicable by reference to the two separate requirements of the central management and control test being met by the same set of facts and activities in that particular case.¹¹ Those facts and activities were described in the following terms in TR 2004/15:

The managing director, who resided in Australia, was empowered to appoint and remove the other directors. He had the power of veto of any resolution of the company and had sole authority to affix the seal of the company. The business of the company was the chartering of a tanker from shipping agents and the sub-chartering of the tanker to the managing director, who provided instructions to the shipping agents, gave instructions for signing the charter party and prepared and executed the relevant documents.¹²

Malayan Shipping, therefore, represents an instance where, in the words of Williams J quoted above, "...the business of the company carried on in Australia ... includes its central management and control", as opposed to an instance where "...the business of the company carried on in Australia consists of ... its central management and control".

It is, however, arguable that Williams J was of the view that the exercise of central management and control in Australia, by itself, is sufficient to constitute the carrying on of a business in Australia. This is perhaps indicated by Williams' J observation that "...even if Mr Phillips is right in contending that the sub-charters were of the essence of the trading observations and were made in Singapore, the company was nevertheless a resident within the meaning of the definition."¹³ Importantly, however, this principle was not decisive in *Malayan shipping* as it was not necessary to apply it given the factual circumstances at hand, and hence it is of limited precedential value.

The ATO adhered to the view in TR 2004/15 until the High Court decision in *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45 (*Bywater*) prompted it to reconsider its stance on this issue.

4 The *Bywater* decision

In *Bywater* the High Court was required to determine whether a number of foreign companies were

¹⁰ Taxation Ruling TR 2004/15 *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*, [5].

¹¹ Taxation Ruling TR 2004/15 *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*, [33]-[34].

¹² Taxation Ruling TR 2004/15 *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*, [32].

¹³ *Malayan Shipping Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156, 160.

Australian residents for the purposes of the paragraph (b) definition of resident in subsection 6(1) of the ITAA1936. The directors of these companies resided in foreign jurisdictions, and board meetings were also conducted in foreign jurisdictions. Despite this, it was established at first instance that managerial control and beneficial ownership of each company was solely attributable to an individual who resided in Australia, and that the arrangements in question had been put in place to obscure the location where managerial control was being exercised.

The majority noted that the central management and control test was “...first legislated in 1930, [and] represents a statutory adoption of the test of residence ... formulated ... in *Cesena Sulphur Company v Nicholson*”.¹⁴ The test has remained unchanged since that time.

The majority then went on to confirm that the test for central management and control has, since its inception, been concerned primarily with identifying the *actual* location of a company’s central management and control, as opposed to mechanically placing central management and control in the jurisdiction in which a company’s board of directors meet. This was expressed by the majority in the following terms:

...there is a long line of authority that makes clear that, for the purposes of s 6 of the 1936 Act, a company has its central management and control where the central management and control of the company actually abides, that being a question of fact and degree to be determined according to the facts and circumstances of each case.¹⁵ [Emphasis added]

The location of a board meeting is not, therefore, necessarily conclusive of the location at which central management and control is exercised. However, it also needs to be recognised that in most cases a company’s central management and control will be located in the jurisdiction in which its board of directors meet. This was also acknowledged by the majority in *Bywater*:

Ordinarily, the board of directors of a company makes the higher-level decisions which set the policy and determine the direction of operations and transactions of the company. Ordinarily, therefore, it will be found that a company is resident where the meetings of its board are conducted.¹⁶ [Emphasis added]

The following caveat was then added:

...it does not follow that the result should be the same where a board of directors abrogates its decision-making power in favour of an outsider and operates as a puppet or cypher, effectively doing no more than noting and implementing decisions made by the outsider as if they were in truth decisions of the board.¹⁷

¹⁴ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [40].

¹⁵ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [40].

¹⁶ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [41].

¹⁷ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [41].

In finding that each company was an Australian resident during the relevant income years the court rejected the presumption that central management and control is located where the directors reside and meet, and furthermore held that:

As a matter of long-established principle, the residence of a company is first and last a question of fact and degree to be answered according to where the central management and control of the company actually abides. As a matter of long-established authority, that is to be determined, not by reference to the constituent documents of the company, but upon a scrutiny of the course of business and trading.¹⁸

This was not a particularly controversial outcome, given the factual circumstances under consideration. It has been noted that the characterisation of the residence test as a question of fact to be answered by reference to a company's *actual* place of management is supported by a long line of authority that extends back to the decision in *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455.¹⁹

5 Taxation Ruling TR 2018/5 and Practical Compliance Guideline PCG 2018/9

The ATO, in response to the decision in *Bywater*, withdrew TR 2004/15 on 15 March 2017 and replaced it with *Taxation Ruling TR 2018/5 Income tax: central management and control test of residency* ('TR 2018/5'). In this ruling, the ATO expressed its revised view that:

If a company carries on business and has its central management and control in Australia, it will carry on business in Australia within the meaning of the central management and control test of residency.

It is not necessary for any part of the actual trading or investment operations of the business of the company to take place in Australia. This is because the central management and control of a business is factually part of carrying on that business. A company carrying on business does so both where its trading and investment activities take place, and where the central management and control of those activities occurs.²⁰ [Emphasis added]

It is possible, therefore, under this view that the central management and control test can be satisfied by a foreign incorporated company that carries out operational activities wholly outside Australia.

Practical Compliance Guideline PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located was subsequently issued by the ATO in order to provide practical guidance to foreign incorporated companies, in order to assist them with applying the principles set out in TR 2018/5.

This change in the ATO's view appears to be based on two factors.

First, although *Malayan Shipping* is not referred to in the body of the ruling itself, it is referenced in

¹⁸ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [77].

¹⁹ K Stern & L Coleman, 'Lessons of the Crooked Pantomime: Corporate Residency Following *Bywater Investments*' (2018) 47 AT Rev 231, 237.

²⁰ Taxation Ruling TR 2018/5 *Income tax: central management and control test of residency*, [7]-[8].

footnote 5 to the ruling as authority for the proposition set out in in paragraph 7 of the ruling.

Secondly, in footnote 5 to the ruling the ATO states that this view of *Malayan Shipping* was endorsed in *Bywater*. The ATO's position in this regard is presumably based on an observation made by the court in *Bywater* in respect of a particular contention that was made in *Malayan Shipping*. That contention was expressed by the court in the following terms:

It was contended that, although the central management and control of the company was located in Melbourne, upon a proper construction of the definition of "resident" in s 6 of the 1936 Act, a company should not be regarded as resident in Australia, notwithstanding that its central management and control was exercised from Australia, unless the company were also carrying on its business operations in Australia.²¹

The court went on to comment that, "unsurprisingly", that contention had been rejected in *Malayan Shipping*.²² It should also, however, be noted that the court considered *Malayan Shipping* to add "little of relevance" to the matters before it.²³

Importantly, as with *Malayan Shipping*, the court in *Bywater* was not required to decide whether the exercise of central management and control in Australia is, by itself, sufficient to establish that a business has been carried on in Australia. That was because each company had conducted trading activity in Australia, being the buying and selling of shares listed on the Australian Stock Exchange. It is perhaps arguable, therefore, whether *Malayan shipping* or *Bywater* can necessarily be taken as clear and indisputable authority for the proposition that the exercise of a company's central management and control in Australia is sufficient, by itself, to establish that a business has been carried on in Australia, even in the event that the operational activity of the company in question takes place exclusively outside Australia.

²¹ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [57].

²² *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [57].

²³ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [57].

Chapter 5: Limitations associated with the central management and control test

In this chapter the Board will examine a number of perceived limitations that have been identified with the central management and control test, with a view to evaluating its ongoing viability and whether sufficient justification exists for replacing it with an alternative test. Some of the apparent limitations that have been brought to the Board's attention include:

- the compatibility of the central management and control test with certain features of modern corporate governance,
- the practicality of establishing the requisite degree of central management and control in Australia when it is being exercised in both Australia and another jurisdiction concurrently,
- the uncertainty associated with the relevant time frame within which central management and control is required to be ascertained, and
- the degree to which, in the context of an outbound corporate structure, the fiscal outcome remains effectively the same regardless of the outcome of the central management and control test.

Each of these issues is discussed below.

1 Modern corporate governance

There is no question that a company's central management and control can be exercised independently, and apart from, its formal mechanisms of corporate governance. This is, as noted by the majority in *Bywater*, evidenced by a long line of English and Australian case law. Given that such instances are exceptions to the ordinary state of affairs it follows that in many cases the practical application of the central management and control test will involve identifying where the meetings of a board of directors have been taking place.

In most instances the meeting of a company's board of directors would, at the time the central management and control test was introduced, have been conducted at a single physical location and attended in person by the participating directors. Identifying the location of central management and control would therefore not be difficult in those instances where it actually subsisted in the meetings of a board. This traditional conception of the manner in which a board meets has now, however, been rendered at least partially obsolete by significant changes in communications technology and the impact of globalisation (which, relevantly, includes significant labour mobility and greater fragmentation of corporate structures across the globe).

The use of modern communications technology, such as the teleconference and the videoconference, has changed the manner in which many board meetings are now conducted. The use of such technology allows board meetings to be conducted when directors are situated in different physical locations. Importantly, this means that central management and control can be exercised from a number of different locations *at the same time*. Since the inception of the central management and control test this has always been a possibility, but it is the widespread and increasing use of modern communications technology in board

meetings that has had the effect of making this outcome a far more prevalent one.²⁴

It should also be noted that the possibility of central management and control being exercised from a number of different locations at the same time is reflected in the definition of “prescribed dual resident” in subsection 6(1) of the ITAA1936 in which, under the “alternative condition”, a company is a prescribed dual resident if (among other things) its central management and control is in Australia and another country.

Similarly, the impact of globalisation has seen corporate structures increasingly spread across multiple jurisdictions as businesses seek to access global labour markets, new product markets and emerging business opportunities. Preliminary feedback provided to the Board suggests that in corporate groups the determination of central management and control at the head board level is less problematic. However, uncertainty and practical challenges amplify further down the corporate structure with subsidiary boards. This can be driven by a number of factors including the nature of the workforce in different countries, challenges accessing talent with the requisite director skill set in every country of operation, (non-tax) regulation, country risk and cross group processes that seek to leverage regional or global capabilities to reduce cost and/or increase efficiencies.

In addition, as modern corporate governance practices have continued to evolve (including through centralisation) a new set of complications have emerged in applying the central management and control test. Whilst a strong focus on board practices is merited because of the significant connection between the activities of a company’s board and its central management and control, it is also important to understand that modern corporate governance extends beyond the activities of a board.

This is illustrated by the presence of business units within the management model of a multi-national corporate group. Business units typically overlay legal entity structures and country/regional management. It is common for the senior management of a particular business unit to be centralised within a single country, with part of that management apparatus usually including group centralised committees such as regional and investment committees. In these circumstances it is possible that a foreign company may be considered to be an Australian resident if it carries on operational activities within a foreign jurisdiction and the senior management of that business unit is exercised from Australia, provided that such management is capable of being characterised as the exercise of central management and control.²⁵ Such an outcome could arise regardless of whether the company is a foreign subsidiary of an Australian company, a foreign holding company of an Australian subsidiary or a foreign subsidiary of the group’s ultimate holding company.

Where the senior management of a business unit (‘BU’) is responsible for all the BU operations globally a foreign subsidiary’s operational activities could, therefore, be substantially controlled by senior management situated in another jurisdiction. For instance, in the diagram below, assume that BU 3 Senior Management is located in Australia and manages the BU operations of the subsidiaries in Countries A, B, and C. These subsidiaries could potentially be considered to be tax residents of Australia on the basis of the central management and control test, regardless of the ultimate legal holding structure.

²⁴ There has been an awareness of this issue for some time. See M Collett, ‘Developing a New Test of Fiscal Residence for Companies’ (2003) 26 UNSWLJ 622, 622.

²⁵ Note that such an outcome can only arise under the view expressed in TR 2018/5.

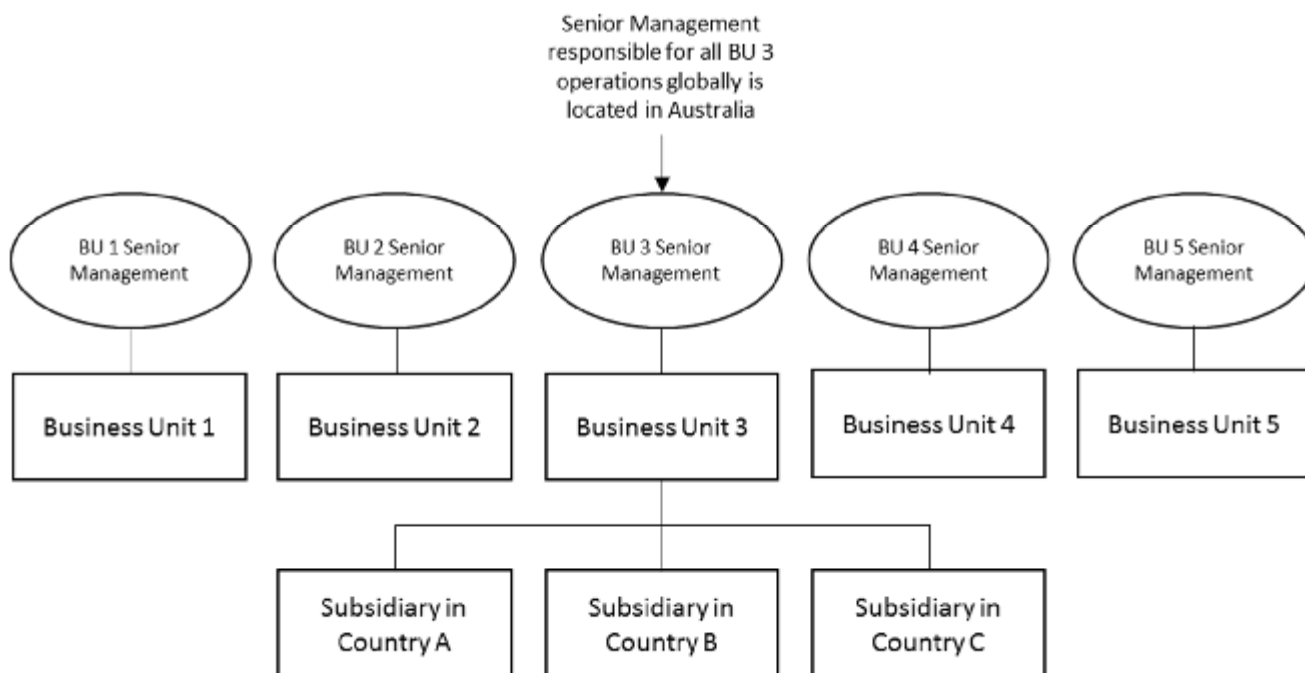


Illustration 1 – Multi-national corporate group organised according to its business units

2 Requisite degree of central management and control

If, as noted above, central management and control can be exercised from more than one location at the same time then two questions arise when it comes to determining whether the requirements of the paragraph (b) definition of resident in subsection 6(1) of the ITAA1936 have been met.

The first question is whether a certain minimum degree of central management and control needs to be present in Australia, or if the mere presence of (any degree of) central management and control in Australia is sufficient. Whether a certain minimum degree of central management and control is required to be exercised in Australia is fundamentally a matter of statutory interpretation, given that the paragraph (b) definition of resident refers to “central management and control in Australia” without further qualification.

The second question is whether the answer to the previous question is conditional on how the central management and control test is itself construed. Different answers to the first question could conceivably be given depending on the position taken on whether the exercise of central management and control in Australia is sufficient, by itself, to constitute the carrying on of a business for the purposes of the central management and control test.²⁶ To elaborate further, if the exercise of central management and control *by itself* is sufficient to constitute the carrying on of a business then one possibility is that a certain minimum degree of it does need to be exercised in Australia, as a corollary of the lack of an additional requirement to demonstrate that a separate business has been carried on in Australia.²⁷ Alternatively, if the exercise of

²⁶ As noted in Chapter 4 the ATO view, as expressed in TR 2018/5, is in the affirmative in this regard.

²⁷ This is reflected in the compliance approach that has been adopted in Practical Compliance Guideline PCG 2018/9 *Central management and control test of residency: identifying where a company's central management and control is located* (at paragraphs [74] and [78]).

central management and control by itself is not sufficient to also constitute the carrying on of a business then another possibility is that the mere presence of (any degree of) it in Australia is all that is required, as a corollary of the additional requirement to demonstrate that a separate business has been carried on in Australia.

In the event that a certain minimum degree of central management and control is required to be exercised in Australia then it follows that an assessment is needed as to how much is required to be exercised in a particular set of circumstances. One approach involves inquiring into where the directors contributing the most to the exercise of central management and control are themselves located at the time that high level strategic decisions are made. This is the approach that is adopted in PCG 2018/9, which (for compliance purposes) advocates identifying the place where central management and control is exercised “to a substantial degree”.²⁸

The Board notes the practical difficulties that attach to determining whether central management and control is located in Australia for the purposes of the paragraph (b) definition of resident in subsection 6(1) of the ITAA1936, particularly in instances where central management and control is exercised concurrently from Australia and a foreign jurisdiction. The use of qualitative criteria, such as identifying where central management and control has been exercised to a substantial degree, is problematic as it requires determinations to be made on a case by case basis as to whether an inexact threshold has been met.²⁹ This could, by way of example, require an assessment of the relative influence that is wielded by individual directors on a meeting by meeting basis, which is clearly an onerous requirement, difficult to substantiate and may be fluid.

The provision of guidance in the form of examples is also of limited utility given that, as noted in the Compendium to PCG 2018/9 itself, identifying the location of central management and control is “dependent on the detailed facts of each case and for this reason it is difficult to provide guidance covering situations where [central management and control] may be in more than one place.”³⁰

Significant consequences will arise if the difficulties associated with central management and control being present in more than one location remain unresolved. In particular, uncertainty will continue to attach to the residency status of foreign incorporated subsidiaries of Australian resident companies. This may promote a number of unpalatable outcomes, including:

- increased compliance cost and decreased productivity, as Australian resident directors travel outside Australia to attend board meetings (rather than use conferencing facilities) in a foreign jurisdiction in order to ensure that central management and control remains outside Australia; and
- an increase in risk through excluding or limiting Australian resident directors from subsidiary board membership. Instead subsidiary boards may be comprised of a majority of foreign resident directors, or even comprised exclusively of foreign resident directors (even though it is likely that such directors

²⁸ PCG 2018/9 *Central management and control test of residency: identifying where a company's central management and control is located*, [74], [78].

²⁹ This is not a criticism of the approach taken in PCG 2018/9. It is, rather, a reflection of a conceptual difficulty that is inherent in central management and control.

³⁰ PCG 2018/9EC *Central management and control test of residency: identifying where a company's central management and control is located*, 4.

will closely follow the views of the Australian parent company's board of directors). Preliminary feedback provided to the Board noted many corporate groups do not have access to staff with the requisite director capabilities in every jurisdiction that they operate. Whilst independent directors may be identified over time, this can create a new set of risks.

3 Relevant time frame

Another aspect of the central management and control test that is generating uncertainty is the question as to whether central management and control is required to be ascertained on a 'day by day' basis, or is determined by reference to the manner in which it is exercised over time.

The ATO has indicated, in paragraph 79 of PCG 2018/9, that the "question of where central management and control is located is determined by reference to how it is exercised over time." It does need to be emphasised, however, that this is a compliance approach and that representations have been made to the Board that the status of this issue as a question of law remains unresolved.

If central management and control is required to be ascertained on a 'day by day' basis then significant difficulties can arise, as is readily apparent by the extensive income tax consequences that are triggered when tax residency changes. This is amply demonstrated by the following listing, which represents *some* of the income tax implications that may arise in the event that a foreign incorporated company ('the company') that is wholly-owned by an Australian company becomes an Australian resident because its central management and control is considered to be in Australia:

- The company will no longer be a controlled foreign company for the purposes of Part X of the ITAA 1936.
- The company will become a prescribed dual resident if its central management and control is present in Australia and the foreign jurisdiction.³¹ If this is the case then the company cannot be a member of a tax consolidated group,³² which means that any dividends paid will be taxable in the hands of the Australian parent company (resulting in double taxation if the dividend is unfranked).³³
- If the Australian parent company is a member of a tax consolidated group and the company is not a prescribed dual resident then the company will automatically become a member of the tax consolidated group, which will trigger the asset cost resetting rules in Subdivision 705-A of the ITAA1997.
- The CGT participation exemption provided for in section 768-505 will not be available in respect of capital gains arising from the disposal of shares in the company, as it only applies to shares in foreign resident companies.
- The cost base of the company's assets for CGT purposes will be required to be recalculated in accordance with section 855-45 of the ITAA1997.

³¹ Refer to the definition of "prescribed dual resident" in s 6(1) of the *Income Tax Assessment Act 1936* (Cth).

³² *Income Tax Assessment Act 1997* (Cth) s 703-15(2).

³³ This is because s 768-5(1) of the *Income Tax Assessment Act 1997* (Cth) only applies to "foreign equity distributions".

This is not a complete listing, and different consequences will arise where an Australian resident becomes a foreign resident for tax purposes (such as the CGT consequences that arise under section 104-160). It does, however, illustrate the unpalatable outcomes that can arise if a company's residency status is readily susceptible to change. On a more fundamental level, there is a greater possibility that consequences of this nature will materialise if uncertainty continues to attach to the central management and control test.

Consultation question 1

The Board seeks stakeholder comment on the difficulties associated with the central management and control test that have been discussed in this chapter so far, and whether there are additional difficulties with the test that the Board's attention should be drawn to (particularly if such difficulties are attributable to matters other than board practices and if they arise in the context of an inward investing corporate structure).

4 Fiscal outcome effectively remaining the same in the context of an outbound structure

When account is taken of how long the central management and control test has been in existence a question arises as to whether some of its intended functions³⁴ have now been effectively superseded by the subsequent introduction of certain rules into the income tax legislation. These include, but are not necessarily limited to, rules on controlled foreign companies, permanent establishments, transfer pricing and capital gains tax.

This contention assumes relevance in instances when a company has been incorporated outside Australia, given that a company incorporated in Australia automatically becomes an Australian resident. What merits exploration in this context, therefore, is whether the Australian income tax consequences remain *effectively* the same regardless as to whether a foreign incorporated company is, or is not, considered to be an Australian resident under the central management and control test.

A discussion of the interrelated outcomes produced by the central management and control test and certain parts of the income tax legislation is given below. It is not intended to be exhaustive and is limited to companies incorporated outside Australia, and has been provided for the purpose of generating stakeholder comment on this issue.

4.1 *Interaction between controlled foreign company rules and section 23AH*

The controlled foreign company rules are found in Part X of the ITAA1936, and apply to a foreign resident subsidiary that is a controlled foreign company ('CFC').³⁵ As a general proposition, the CFC rules operate to

³⁴ Such as, for example, only taxing the Australian source income of a company that is a foreign resident.

³⁵ *Income Tax Assessment Act 1936* (Cth) s 340.

attribute certain categories of a CFC's income to its Australian parent company for taxation purposes.³⁶ The regime also features an "active income test" which, if passed, prevents any attribution of income.³⁷ If the active income test is not passed then the categories of income that are subject to attribution will depend on whether the foreign subsidiary is a resident of either a "listed country" or an "unlisted country".³⁸ Income that is not attributable under the CFC regime can generally be described as 'active' in nature, and includes (untainted) sales and services income.

Section 23AH of the ITAA1936 deems foreign income derived by an Australian resident company in carrying on a business at or through a permanent establishment ('PE') to be non-assessable non-exempt income ('NANE income'), and in this context can perhaps be viewed as being complementary to the CFC regime.

If a foreign incorporated subsidiary is carrying on business operations in a foreign jurisdiction but is deemed to be an Australian resident under the central management and control test then presumably its business operations in the foreign jurisdiction will constitute a PE. In that event the income that it derives from those business operations would not be subject to Australian taxation, as it would be deemed to be NANE income under section 23AH. However, as with the CFC regime, certain categories of income derived at or through the PE may be assessable in Australia depending on whether an active income test has been passed and if the PE is in a listed or unlisted country.³⁹

It can be seen that from a fiscal perspective the overall outcome is likely to be similar, regardless as to whether a foreign incorporated subsidiary is treated as either an Australian resident under the central management and control test or a CFC. This is summarised in the table below:

Type of income	Subject to tax when foreign incorporated subsidiary is a CFC?	Subject to tax when foreign incorporated subsidiary is an Australian resident under the central management and control test?
Attributable income under Part X	Yes	Yes (not NANE income under section 23AH)
All other income that does not have an Australian source	No	No (NANE income under section 23AH)

³⁶ One such category is adjusted tainted income, which is defined in s 386 of the *Income Tax Assessment Act 1936* (Cth) as including passive income, tainted sales income and tainted services income.

³⁷ *Income Tax Assessment Act 1936* (Cth) s 432.

³⁸ *Income Tax Assessment Act 1936* (Cth) ss 384-385.

³⁹ Refer to sub-ss 23AH(5) and 23AH(7) of the *Income Tax Assessment Act 1936* (Cth) and noting relief that may be provided for foreign tax paid under domestic law and tax treaty obligations.

Despite this, it is important to recognise that the tax treatment of a dividend paid from a foreign incorporated subsidiary to an Australian parent company will differ depending on the residency status of the subsidiary. If the subsidiary is a foreign resident then (subject to certain requirements being met) the dividend will not form part of the assessable income of the Australian parent company.⁴⁰ If, however, the subsidiary is also an Australian resident then the dividend will be included in the assessable income of the Australian parent company in the event that either the parent company is not a member of a tax consolidated group or (if it is a member) the subsidiary is not eligible to become a member of that tax consolidated group (because, for example, the subsidiary is not 100 per cent owned or a prescribed dual resident⁴¹).

4.2 Transfer pricing

The domestic Transfer Pricing rules are found in Division 815 of the ITAA1997, and apply to arrangements under which profits are moved out of Australia through either intercompany or intracompany transfer pricing.

If a foreign incorporated subsidiary is not an Australian resident then Subdivision 815-B may apply. This Subdivision applies if a tax advantage arises in Australia from cross-border conditions that are inconsistent with the arm's length principle, which in this context could include dealings between a foreign incorporated subsidiary and its Australian parent.⁴² In such an event the conditions in question will be taken not to operate and will instead be replaced with arm's length conditions.⁴³

Alternatively, if a foreign incorporated subsidiary is considered to be an Australian resident because its central management and control is in Australia then Subdivision 815-B could still apply. This may be the case where there are dealings between the foreign incorporated subsidiary and the Australian parent that are conducted through an overseas PE of the foreign incorporated subsidiary,⁴⁴ and which are inconsistent with the arm's length principle.⁴⁵ Again, in such an event the conditions in question will be taken not to operate and will instead be replaced with arm's length conditions.⁴⁶

In a transfer pricing context there is more ambivalence in terms of whether or not the outcome is effectively the same from a fiscal perspective, regardless as to whether a foreign incorporated subsidiary is (or is not) treated as an Australian resident under the central management and control test. This is particularly so given the differences between how Australia applies the transfer pricing rules in respect of PEs and the authorised OECD approach.

⁴⁰ *Income Tax Assessment Act 1997* (Cth) sub-div 768-A.

⁴¹ *Income Tax Assessment Act 1997* (Cth) s 703-15(2).

⁴² Refer to Item 2 in the table in s 815-120(3) of the *Income Tax Assessment Act 1997* (Cth) – this would apply in the event that the foreign incorporated subsidiary is not dealing with the Australian parent through an Australian PE.

⁴³ *Income Tax Assessment Act 1997* (Cth) s 815-115.

⁴⁴ Refer to Item 1 in s 815-120(3) of the *Income Tax Assessment Act 1997* (Cth).

⁴⁵ As previously noted, if a foreign incorporated subsidiary is carrying on business operations in a foreign jurisdiction but is deemed to be an Australian resident under the central management and control test then presumably its business operations in the foreign jurisdiction will constitute a PE.

⁴⁶ *Income Tax Assessment Act 1997* (Cth) s 815-115.

4.3 Capital gains tax

In many cases (with some exceptions) it is expected that there should be parity of outcome from a CGT perspective, regardless as to whether a foreign incorporated subsidiary is, or is not, an Australian resident under the central management and control test. In this regard the following points may be noted:

1. If a foreign incorporated subsidiary *is not an Australian resident* because its central management and control is not located in Australia then capital gains or losses will only be recognised in respect of CGT events happening to certain classes of assets, such as interests in Australian real property.⁴⁷
2. If, however, a foreign incorporated subsidiary *is an Australian resident* because its central management and control is located in Australia then a capital gain or loss that arises from a CGT event will be disregarded if the relevant CGT asset has been used for the purpose of producing foreign income in carrying on business at or through a PE of the company, provided that the CGT asset is not taxable Australian property.⁴⁸
3. If, however, a foreign incorporated subsidiary is not an Australian resident because its central management and control is not located in Australia then capital gains or losses that arise from certain CGT events happening to interests in the subsidiary will be reduced to the extent that the subsidiary has an underlying active business.⁴⁹

Consultation question 2

The Board seeks stakeholder comment on the primary theme that has informed the preceding discussion under Part 4 of this chapter, being whether certain subsequent additions to the income tax legislation have imported at least some degree of redundancy into the central management and control test. The Board also seeks stakeholder assistance in identifying instances in which any other part of the income tax legislation produces different tax outcomes that are dependent on whether a foreign incorporated subsidiary company is, or is not, an Australian resident under the central management and control test.

⁴⁷ *Income Tax Assessment Act 1997* (Cth) div 855.

⁴⁸ *Income Tax Assessment Act 1936* (Cth) sub s 23AH(3).

⁴⁹ *Income Tax Assessment Act 1997* (Cth) sub-div 768-G.

Chapter 6: Alternatives to the central management and control test

In the previous chapter the Board explored a number of difficulties with the central management and control test, and requested stakeholder input in enhancing its understanding of these difficulties. In this chapter the Board will turn its attention to some alternatives to the use of central management and control as a proxy for determining corporate residency. A viable starting point in this regard is a consideration of the corporate residency rules that have been adopted in a number of other jurisdictions.

1 International comparisons

The table below sets out the test for corporate tax residency in each country that is a member of the Group of Seven (G7):

Country	Corporate residency tests
Canada	Incorporation or central management and control
France	Legal seat ⁵⁰ or <u>place of effective management</u>
Germany	Legal seat or place of management
Italy	Any one of the following criteria: <ul style="list-style-type: none"> - legal seat - administrative office (place of <u>effective management</u> concept) - principal activity
Japan	Incorporation or place of head office Does not use the “central management and control” criteria
United Kingdom	Incorporation or central management and control
United States	Incorporation only

As an additional comparative, the table below sets out the test for corporate tax residency in a number of other relevant jurisdictions:

⁵⁰ This is not the same as incorporation. Rather, it refers to the country in which a company is registered.

Country	Corporate residency tests
China	Incorporation or <u>place of effective management</u>
Hong Kong	Residency is generally not relevant for Hong Kong tax purposes, however, Hong Kong would follow the common law tests of management and control for treaty purposes
India	Incorporation or <u>place of effective management</u>
New Zealand	Any one of the following criteria: <ul style="list-style-type: none"> - Incorporation - Where directors exercise control of the company - <u>Place of management</u> - Place of head office
Singapore	Control and management

It does need to be acknowledged that there are limitations associated with a collation of this nature. Although the language employed by a number of jurisdictions may be the same, it does not necessarily follow that every jurisdiction applies the relevant test in the same manner. Similarly, different jurisdictions may use different terms to denote what is fundamentally the same test.

Despite these limitations, an examination of the above tables does yield some pertinent observations, including:

- First, most countries have (like Australia) adopted a combination of a formal approach and a substantive approach when it comes to establishing corporate tax residency. The United States is unique in this regard in having an incorporation-only test.
- Secondly, a number of countries use place of effective management (or an analogous concept) as their substantive approach for determining corporate tax residency.

2 Place of effective management

Tax treaties typically incorporate a tiebreaker test which may be applied to determine the residency of a particular company for the purposes of the treaty. This test is invoked in the event that the company is considered to be a resident of both jurisdictions to the treaty. Some of Australia's tax treaties feature tiebreaker tests that allocate residency to the jurisdiction in which a company's place of effective

management is located,⁵¹ and others require place of effective management to be taken into account in establishing residency for the purposes of the treaty (the effect of the OECD's Multilateral Instrument is discussed further below). In the context of the Board's review this raises a question as to what is meant by a company's place of effective management, and whether it differs conceptually from a company's central management and control.

The term "place of effective management" is not defined in the OECD's Model Tax Convention, although OECD Commentary accompanying various iterations of the Model Tax Convention does provide some indication as to what it means. In this respect the OECD Commentary to the 2005 version provides:

The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management.⁵²

The OECD Commentary to the 2008 version provides:

The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management.⁵³

In many cases it is expected that a company's central management and control and its place of effective management will be exercised from the same jurisdiction. This is apparent from Gordon's J observation in *Bywater* that "...the place of effective management may "ordinarily" be the place where the board of directors makes its decisions".⁵⁴

In *Bywater* the majority did not examine this issue as it was conceded that in the circumstances of that case the place of central management and control was also the place of effective management.⁵⁵ Despite this, in her separate judgment Gordon J expressed the view that they are different concepts, and that it "...cannot be assumed that if one test is satisfied, then it will automatically follow that the other is satisfied."⁵⁶ One particular feature of place of effective management that distinguishes it conceptually from central

⁵¹ By way of example, Article 4 of the tax treaty concluded between Australia and Austria provides that where "a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the Contracting State in which its place of effective management is situated." [Emphasis added]

⁵² Organisation for Economic Cooperation and Development, *Commentary to Article 4 of the Model Tax Convention on Income and Capital*, (2005), [24].

⁵³ Organisation for Economic Cooperation and Development, *Commentary to Article 4 of the Model Tax Convention on Income and Capital*, (2008), [24].

⁵⁴ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [169].

⁵⁵ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [6].

⁵⁶ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [163].

management and control is that a company's place of effective management can presumably be in only one location, otherwise tiebreaker provisions that rely on place of effective management would be unable to function.⁵⁷

As with central management and control, Gordon J also noted that "...it is clear that the location of the formal organs of a company cannot be determinative of the "place of effective management" of that company".⁵⁸

The substitution of central management and control with place of effective management in the residency definition in subsection 6(1) of the ITAA1936 is a proposition that the Board is interested in exploring, particularly given its use in other jurisdictions as a determinant of corporate residency. The use of the place of effective management concept would ensure alignment with some of Australia's tax treaties, and hence prevent outcomes in which the location of a company's central management and control differs from its place of effective management. It does need to be noted, however, that Article 4 of the OECD's Multilateral Instrument, which has been ratified by Australia, specifies place of effective management as a factor to be taken into account when "Contracting Jurisdictions" are endeavouring to determine the residency of a company by mutual agreement. Place of effective management is not therefore necessarily determinative in the context of those Australian tax treaties, such as those with the United Kingdom and New Zealand, that have been modified by the Multilateral Instrument.

Perhaps more importantly, and as noted above, a company's place of effective management cannot be in two places at once. That being the case, the difficulties that arise from central management and control being in more than one place at the same time (as described in the previous chapter) would no longer apply.

On the other hand, however, there may be circumstances where it can be difficult to identify the singular jurisdiction in which place of effective management is present. Take, by way of illustration, a simple scenario in which half of the directors of a company reside in one country and the other half reside in another country. In such an instance an attempt can be made to apportion central management and control between both jurisdictions by reference to where it has been exercised to a substantial degree, as prescribed in PCG 2018/9. Some of the limitations of that approach were described above in Chapter 5, but it is arguable that the same limitations also arise when attempting to identify the location of a company's place of effective management by reference to factors such as where the "...key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made." It is similarly unclear whether place of effective management would overcome the pressures on determining central management and control increasingly experienced (particularly at the subsidiary board level) due to factors such as globalised talent and value chains, governance practices and the management models of globalised corporate groups as explored in Chapter 5.

⁵⁷ This is confirmed in paragraph 24 to the OECD Commentary to the 2008 Model Tax Convention, which provides that "[a]n entity may have more than one place of management, but it can only have one place of effective management at any one time." This has, however, been questioned in the academic literature. Refer to G Maisto et al, 'Dual Residence of Companies under Tax Treaties' (2018) 1 Intl Tax Stud, 25.

⁵⁸ *Bywater Investments Ltd v Federal Commissioner of Taxation; Hua Wang Bank Berhad v Federal Commissioner of Taxation* [2016] HCA 45, [164].

This was recognised some time ago by the OECD itself, which noted in 2001 that:

... the communications and technological revolution is fundamentally changing the way people run their business. Due to sophisticated telecommunication technology and fast, efficient and relatively cheap transportation, it is no longer necessary for a person or group of persons to be physically located or meet in any one particular place to run a business. This increased mobility and functional decentralisation may have a significant impact on the incidence of dual resident companies, and the application of the place of effective management tie-breaker rules.⁵⁹

Central management and control and place of effective management are nebulous concepts, and by their nature are not amenable to precise definition. The problems this can give rise to are reflected in the changes to the OECD Commentary on Article 4 in various iterations of the Model Tax Convention, particularly the 2005, 2008 and 2017 versions. The Commentary to the 2005 and 2008 versions has been reproduced above, and interestingly the Commentary to the 2017 version reveals an even more substantial change to the role of place of effective management in the Model Tax Convention:

When paragraph 3 was first drafted ... preference was given to a rule based on the place of effective management ... [i]n 2017, however, the Committee on Fiscal Affairs recognised that ... there had been a number of tax-avoidance cases involving dual resident companies. It therefore concluded that a better solution to the issue ... was to deal with such situations on a case-by-case basis.⁶⁰

Consultation question 3

The Board seeks stakeholder comment on whether the central management and control test should be replaced with an alternative test that features place of effective management. The Board is particularly interested in how place of effective management would increase commercial certainty and align with modern corporate practices, whilst maintaining integrity of the rules as they apply to multinational corporations.

3 Other alternatives

The Board is also interested in considering other alternatives to the central management and control test, and notes that attempts to formulate alternative approaches have been made in the academic literature.⁶¹

It was noted above in Chapter 4 that the Board had previously recommended an incorporation only test for corporate residency. Although the chief advantages in such a test include certainty and simplicity it also features significant limitations, as it is possible for a company to be incorporated in one jurisdiction and to have its business operations and management based in another. This is why it has not been used in

⁵⁹ Organisation for Economic Cooperation and Development, *The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie Breaker Rule*, (2001), [34].

⁶⁰ Organisation for Economic Cooperation and Development, *Commentary to Article 4 of the Model Tax Convention on Income and Capital*, (2017), [22]-[23].

⁶¹ By way of example, a proposed tiebreaker test based on a company's "centre of vital interests" is described in M Collett, 'Developing a New Test of Fiscal Residence for Companies' (2003) 26 UNSWLJ 622, 635.

previous iterations of the Model Tax Convention as a tiebreaker test, as “[i]t would not be an adequate solution to attach importance to a purely formal criterion”.⁶² Similarly, it is noted that a prevalence of organisations exploiting differences between countries with incorporation only tests and countries utilising a version of the real seat rule was one impetus behind the OECD’s BEPS agenda. Despite this, the Board is interested to understand any compelling arguments in favour of an incorporation only test.

Consultation question 4

The Board seeks stakeholder comment on whether there are criteria other than central management and control or place of effective management that could be used to establish corporate residency. The Board is particularly interested in how alternatives would increase commercial certainty and align with modern corporate practices, whilst maintaining integrity of the rules as they apply to multinational corporations.

Consultation question 5

The Board seeks stakeholder comment on whether an incorporation only test should be used as the sole basis for establishing corporate residency.

Consultation question 6

The Board also seeks stakeholder comment on whether there is a compelling basis for retaining the second limb of the test for corporate residence (under which a company is a resident if it carries on business in Australia and has its voting power controlled by shareholders who are residents of Australia) in the event that the central management and control test is replaced with an alternative test.

⁶² Organisation for Economic Cooperation and Development, *Commentary to Article 4 of the Model Tax Convention on Income and Capital*, (2008), [22].

