Powerco Limited

CORPORATE OFFICE
84 Liardet Street
Private Bag 2061
New Plymouth
T 0800 769 372
F +64 6 758 6818
www.powerco.co.nz

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

CorporateResidency@taxboard.gov.au

3 October 2019

Re: Corporate tax residence consultation

Thank you for the opportunity to provide input in relation to the application of corporate tax residence in Australia following the recent Australian Tax Office (ATO) publications TR 2018/5 and PCG 2018/9.

Summary

This submission is provided by Powerco Limited (Powerco) on behalf of Powerco New Zealand Holdings Limited (PNZHL) and Powerco. Both of these companies are incorporated and operate in New Zealand, have no business activity in Australia and, under any conventional sense of the test, do not carry on business in Australia. Whilst the current shareholders are Australian residents, they have always been and remain solely tax resident of New Zealand.

However, the broader approach adopted by the ATO in TR 2018/5 to corporate tax residence would now effectively preclude the use of modern communications technology by the boards of Powerco and PNZHL to assist in holding their meetings. Australian resident directors will continue to be required to physically attend all board meetings in New Zealand and as a result incur additional cost, spend more time and undertake more environmentally damaging air travel. This has created an increased cost burden on the Australian shareholders, the Australian economy and the environment; with no benefit to the Australian income tax base.

We consider that the rules set out in TR 2018/5 have resulted in significant commercial uncertainly for PNZHL and Powerco, as well as for many other organisations, to the extent they wish to adopt modern communication techniques. We feel that the rules do not align with modern day governance practices; do not in this case further assist protection or integrity of the Australian income tax base; and do not seem consistent with the modernisation of tax systems in line with technology developments. This uncertainty has been compounded by the recent implementation in Australia and New Zealand of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI) which has effectively removed access to the tie breaker tests contained in the double tax agreement between Australia and New Zealand except in the context of a mutual agreement process. As such we provide input on the application of corporate tax residence in Australia in line with your consultation guide issued September 2019.

Background and issue

For context, Powerco is a business physically located in New Zealand. It owns and operates power infrastructure assets in the mid-lower North Island. It has no business interests outside New Zealand. Powerco is 100% owned by PNZHL.

PNZHL is a company based in New Zealand which holds Powerco. It has no physical assets in New Zealand. However it also has no business interests or assets outside New Zealand. PNZHL is the holding company through which different investors aggregated capital to jointly fund the acquisition of Powerco. PNZHL's seven unrelated shareholders are Australian resident funds and entities, which in turn, consolidate the investments of many (probably more than a million) savers, investors and superannuation fund holders.

The day to day management and operation of both companies is performed from the corporate office in New Plymouth, New Zealand by a New Zealand resident management team. Governance is provided through three New Zealand resident directors (one independent and two shareholder appointed) and three shareholder directors resident in Australia. Figure one below summarises the position.

Guided by information provided by the New Zealand based management team, the directors meet monthly to make governance and strategic decisions for the companies. These meetings are generally physically located in New Zealand. However, to reduce time and costs and to deal with issues like illness or competing work priorities, and to take advantage of new modern communication technology, it may make sense at times for Australian resident directors to attend a board meeting via video conference or telephone conference. On rare occasions, to accommodate the needs of Directors, it would be most practical to hold a Board meeting in Australia. Both of these sensible options are precluded by TR 2018/5 if PNZHL and Powerco wish to avoid any risk of becoming Australian tax resident.

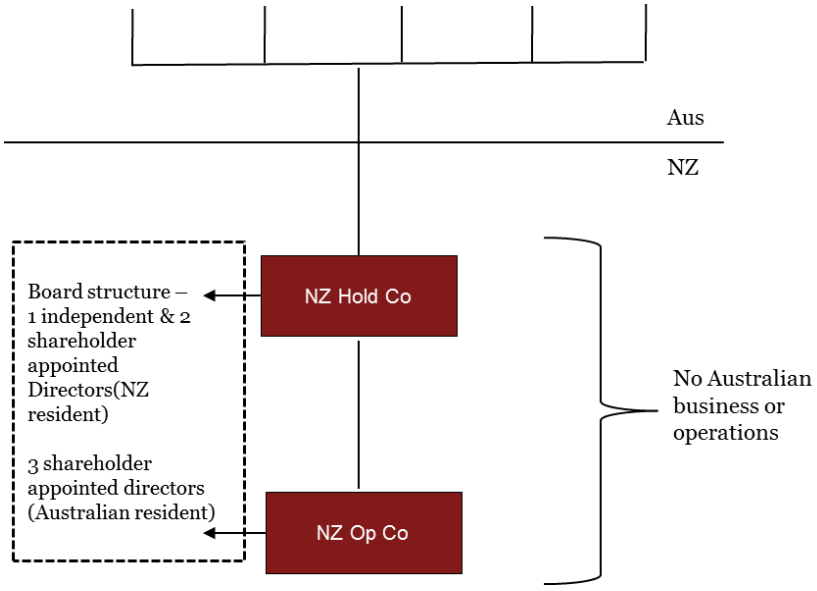

Figure 1: Overview of Director Structure for PNZHL and Powerco

Our submission is that with the issuing of TR 2018/5 and the associated guidance PCG 2018/9 there is a clear risk that the use of video/tele-conference by the Australian directors, or the very occasional meeting held in Australia may result in the ATO asserting Australian tax residence for these companies. As a result, at an increased cost to the company and its Australian shareholders, it is not possible to utilise these communication technologies due to the risk of Australian residence under TR 2018/5. We consider that this is undesirable and produces an economically and environmentally negative outcome. These companies have no business or physical presence in Australia, nor undertake any sales to persons/businesses in Australia, and only operate in New Zealand but are required to mitigate the uncertainty to reduce the risk of substantial compliance costs and impacts to their New Zealand income tax position.

This uncertainty has been compounded by the recent implementation of the MLI by Australia and New Zealand which removes access to the tiebreaker tests in the double tax agreement between Australia and New Zealand. In the event that the ATO asserts Australian residence for a New Zealand incorporated company that is tax resident in New Zealand, that dual residence can only be "tie broken" now by agreement between the two taxing authorities under the mutual agreement process (MAP) contained in the treaty. The MAP process is slow and time consuming. The latest OECD Mutual Agreement Procedure Statistics for 2018 indicates that for a non-transfer pricing MAP matter Australia takes around 8 months on average to reach an outcome.

Discussion

In response to the consultation questions raised in your consultation guidelines we refer the following:

> *Consultation question 3 – replace the central control and management test (C&CM) with a place of effective management (EM) test to align with modern corporate practises; and*
>
> *Consultation question 4 – Alternative criteria for the C&CM and PoEM tests that could increase commercial certainly and align with modern practises*

We agree with the proposition to replace the C&CM test with a place of EM, however the EM test should be supported by other tests and guidance in terms of modern corporate practice to differentiate an EM test from the C&CM test.

Businesses are constantly looking for ways to reduce cost, increase efficiency and meet social responsibility expectations through a reduced impact on the environment. To meet diversity expectations and ensure the Board has an appropriate mix of skills and experience; companies seek leadership from a range of board members which often results in board members from geographically dispersed locations being appointed. Traditionally a board has travelled to board meetings at substantial financial and environment cost. With current and new technologies these meetings can be hosted from the head office/jurisdiction but attended digitally. As currently guided (through the OECD and case law) an EM test alone will not provide directors the ability to attend remotely without jeopardising the deemed location of the meeting.

To better represent the activity associated with EM, we consider that an EM test (or the C&CM test) should include tie breaker provisions and could consider additional criteria such as:

- Where the instructions provided by the board are to be effected or where the day to day management of the company is carried out, akin to a 'carries on business test';
- A head office test;
- Where board meetings are the consideration for C&CM or EM the location of the meeting could be referenced to the Chair and/or where the meeting is being run from. That is, if the meeting is physically held outside Australia and chaired outside Australia then the fact that some or even a majority of directors may be in Australia and dialled in to the meeting is not seen as exercising management and control in Australia.
- A "safe harbour" where by as long as a majority of directors are physically present at the meeting in New Zealand, then the fact that a minority of directors might dial in from Australia is ignored in determining management and control.
- A "safe harbour" whereby as long as the majority of the board meetings are physically held in New Zealand during an income year, then the minority of meetings that might be held virtually or even in Australia are ignored in determining management and control.

Consultation question 6 – is there basis for retaining the 'carries on business' test

As noted above we consider that there is basis for retaining the 'carries on business' test. In the majority of instances, this test better aligns with the taxable activities of a company in that its physical presence and

business activity represent a greater portion of activity of the company than board meetings alone. We acknowledge that this activity is ultimately directed and controlled by the board, however without board decisions being effected by management, the decisions will not result in any profit outcomes.

Should the law be changed, we request that the Board of Taxation recommend the ATO revisit the guidelines provided in TR 2018/5 be revisited. We consider that supplementing the C&CM test with other criteria will give greater clarity and certainly to businesses with geographically diverse boards. These criteria should allow for the operations and presence of the company to influence its tax residence in a way that considers the advancement of technology and its use in business to meet modern day cost, environmental and efficiency expectations.

Please do not hesitate to contact me if you have any questions on either +64 21 489 980 or via email anna.tootill@powerco.co.nz.

Yours faithfully

Anna Tootill
Taxation Manager