Corporate Taxpayers Group

9 October 2019

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

CORPORATE TAX RESIDENCY: CONSULTATION GUIDE

The Corporate Taxpayers Group ("**the Group**") is an organisation of major New Zealand companies. We are writing to submit on the Australian Board of Taxation's Corporate Tax Residency consultation guide ("**Consultation Guide**") as members of the Group have been adversely impacted by the uncertainty regarding Australia's corporate tax residency rules. The Group appreciates the opportunity to comment on this issue, which is of particular interest to our members.

New Zealand and Australia have long had a strong economic relationship, with a significant amount of investment and trade between the countries, particularly since the Closer Economic Relations ("**CER**") free trade agreement came into force in 1983. Foreign Direct Investment between New Zealand and Australia is estimated at NZ$66billion.[1]

SUMMARY

The Group submits that:

- Any changes to Australia's corporate tax residency rules **must** provide companies with **certainty** as to whether they are Australian resident for tax purposes.

- The primary submission made by the Corporate Tax Association and the Business Council of Australia should be accepted (i.e., that the purpose and effect of withdrawn Taxation Ruling TR2004/15 (*Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*) should be reinstated with appropriate adjustments to reflect modern business practices).

- The current application of the central management and control test ("**CMAC**") under Taxation Ruling TR2018/5 and Practical Compliance Guideline PCG2018/9 is too uncertain because:
    - businesses are more mobile and it is not uncommon for directors to be spread across the world;
    - establishing the requisite degree of CMAC in Australia can be challenging when the CMAC is being exercised in Australia and another country; and
    - the timeframe over which the CMAC is to be assessed is unclear.

[1] https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/nz-australia-closer-economic-relations-cer/

Contact the CTG:
c/o Robyn Walker, Deloitte
PO Box 1990
Wellington 6140, New Zealand
DDI: 04 470 3615
Email: robwalker@deloitte.co.nz

- Under the current application of the CMAC test a New Zealand company can too easily be (inadvertently) resident in New Zealand and Australia resulting in increased compliance costs and adverse tax consequences. New Zealand businesses with Australian operations are incurring significant costs (both time and money) managing operations to avoid dual residency.

- The breadth and uncertainty of the current interpretation of the CMAC test is resulting in New Zealand headquartered companies, that should clearly be resident only in New Zealand, avoiding the use of Australia as a venue for one-off board meetings in circumstances where there may be good commercial reasons for doing so (e.g., the New Zealand headquartered group has interests in Australia for which a board meeting should not on its own result in the relevant company being tax resident in Australia). In addition, Australian resident members of a New Zealand resident company's board of directors are finding themselves having to travel to New Zealand to attend board meetings in person. It is undesirable for uncertainty in the tax laws to unduly influence practical administrative matters, and also result in otherwise unnecessary travel (particularly when many companies are trying to reduce their carbon footprint).

- There should be a requirement for a non-Australian incorporated company to be separately carrying on business in Australia by virtue of activities other than the simple exercise of CMAC before it is considered to be resident in Australia, consistent with the generally accepted position prior to the decision in *Bywater Investments Limited & Ors v Commissioner of Taxation* [2016] HCA 45.

- The New Zealand-Australia Double Tax Agreement should be amended so that the place of effective management (PoEM) test is reinstated as the tie-breaker for dual resident non-individuals (i.e., the effect of article 4 of the Multilateral Instrument should be reversed).

ABOUT THE GROUP – INFORMED, PRINCIPLED, PRACTICAL

About the Group

The Corporate Taxpayers Group is an organisation of major New Zealand companies whose objective is to pursue the principled interests of its members in the tax policy sphere. A list of our members is included at the end of this submission.

The Group's Principles for a Good Tax System

The Group believes that a good tax system for New Zealand should be built around a number of principles, including:

- *High certainty and low business risk:* For the corporate sector, tax is not just a cost of doing business but is also a very significant risk. Funds are raised, staff hired, and investments made on the basis of expected returns to corporate shareholders / owners. If tax rules increase business risk by creating uncertain or unexpected tax outcomes then the rate of return on investment has to be higher to compensate for this. Higher required rates of return mean less investment and fewer jobs, to the detriment of the economy. To lower business risks caused by the tax system, tax rules need to be as certain as possible and they need to be administered and interpreted consistently and speedily. Having a high level of certainty over the medium to long term is of high importance to the Group.

- *Low compliance costs*: Compliance costs imposed by the tax system are an economic cost. Those resources would be better employed creating jobs and raising the wealth of New Zealand.

- *Positive contribution*: The tax system plays a significant role in society and has the ability to contribute to the overall welfare and wellbeing of New Zealand and New Zealanders. Any changes to the tax system should focus on building and utilising the collective human, social, natural and financial capital of New Zealand, and should also make a positive contribution to New Zealand.

The above principles are central to the way the Group judges tax policy issues.

ISSUES WITH THE CURRENT CMAC TEST / INTERPRETATION

1. Certainty and modern business practices

1.1 The Group submits that any changes to Australia's corporate tax residency rules must provide companies with certainty as to whether they are Australian resident for tax purposes. The current CMAC test, including its interpretation through Taxation Ruling TR 2018/5 *(Income tax: central management and control test of residency)* and the subsequent Practical Compliance Guideline PCG 2018/9 *(Central management and control test of residency: identifying where a company's central management and control is located)* means that companies can be left uncertain as to whether they are Australian tax resident.

The compatibility of the CMAC test with aspects of modern corporate governance

1.2 Board meetings are more often being held via videoconference / phone dial in. This is in part due to improvements in technology, but also reflects the fact that businesses are more mobile, and it is therefore not uncommon for directors to be spread across the world. This means that the CMAC for a company can be in multiple places, and companies have to consider how and where board meetings are held.

1.3 Some of the Group's members have found this to be a challenge to navigate, as many directors do not wish to travel (particularly where the travel time far exceeds the meeting time), putting their participation on the board at issue. However, these may be the very directors a company wants to have on its board, as they have the necessary skills and capabilities. Many directors do not understand why it should be necessary for them to meet in a single physical location, nor why it should make any difference where they meet as the service they are offering is the same regardless of location.

Environmental impact

1.4 Directors travelling for board meetings just to avoid the risk of dual residence is inefficient and results in environmental externalities at a time when businesses are seeking to reduce their environmental impact.

Determining whether CMAC is exercised in Australia to a substantial degree sufficient to conclude that a company is carrying on business in Australia can be difficult

1.5 As management and control can be exercised from more than one location at the same time, this has added to the uncertainty in determining corporate residency. To mitigate this risk, companies can take action to make it clearer where their CMAC lies, however this merely increases compliance costs and decreases productivity, with directors having to travel to different jurisdictions to ensure that the CMAC remains outside Australia.

The uncertainty as to the relevant timeframe within which CMAC is to be ascertained

1.6 There is a question as to at what point in time, or points in time, the CMAC is to be ascertained. Is this day-to-day, or is it a more holistic view over time? This is another factor adding to the uncertainty in the CMAC test.

Impact of dual residency

1.7 Further compounding this issue is that under the CMAC test a New Zealand incorporated company can too easily be (inadvertently) resident in both New Zealand and Australia. This has an adverse effect on a company given it will (for example):

- have to file an income tax return in both Australia and New Zealand;
- not be able to maintain a New Zealand imputation credit account unless a trans-Tasman election is made;
- not be able to join a consolidated group with other New Zealand companies;
- not be able to undertake a residents restricted amalgamation with other New Zealand companies;
- not be able to share losses with other New Zealand companies.

2. Submission: Certainty is paramount

2.1 The Group submits the current interpretations under Taxation Ruling TR2018/5 and Practical Compliance Guideline PCG2018/9 create considerable uncertainty and risk of a split CMAC such that a change is required. Any change should:

(a) provide certainty as to whether a company is resident in Australia;
(b) not result in companies being inadvertently dual resident in New Zealand and Australia; and
(c) not result in foreign companies being resident in Australia if they are not carrying on substantial business **in** Australia where the majority of the CMAC is exercised outside of Australia.

3. Submission: Revise the interpretation of the CMAC test

3.1 The Group has had the opportunity to review the submission jointly prepared by the Corporate Tax Association ("**CTA**") and the Business Council of Australia ("**BCA**"). The Group supports the points made in that submission, and in particular the recommendation:

> The working group should consider as a first option a recommendation to reinstate the purpose and effect of the withdrawn Taxation Ruling TR2004/15 appropriately adjusted to reflect changes in modern business structures and communication technologies that have occurred in the 15 years since the withdrawn Ruling was first issued.

3.2 While there are alternative residency tests which could be considered (such as place of effective management (PoEM)), the preference for reinstating Taxation Ruling TR2004/15 (with appropriate adjustments) reflects the fact that there was broad understanding of how residency should be determined prior to the withdrawal of that ruling.

3.3 The Group suggests, consistent with the CTA and BCA, that consideration should be given to making changes to the residency test which ensure that merely exercising CMAC in Australia does not on its own constitute the carrying on of a business in Australia.

4. Submission: Reverse the modification to the New Zealand-Australia/Double Tax Agreement made by article 4 of the MLI

4.1 Australia has ratified the Multilateral Instrument, under which Article 4 has modified some of Australia's treaties (including the treaty with New Zealand) to make PoEM just one factor for determining residency of a company by mutual agreement.

4.2 In practice, article 4 of the Multilateral Instrument has caused significant compliance issues for companies dealing with dual resident entities, as it has replaced the PoEM tiebreaker test with a requirement to seek competent authority determination. Without such a determination, dual resident companies will be denied relief under the DTA, which will increase the incidence of double tax. As New Zealand and Australia have relatively broad corporate residency tests, it is easy for dual residency of the two jurisdictions to occur, after which they will have to undergo a time consuming and uncertain process to apply for competent authority approval. The administrative approach agreed in May 2019[2] goes someway to addressing these difficulties, but only in the case of certain small and medium sized groups.

4.3 Therefore, the Group submits that when Australia and New Zealand renegotiate their double tax agreement with each other (we understand this may be in contemplation), both countries should unwind the Multilateral Instrument ("MLI") tiebreaker changes introduced under the MLI. This means that the PoEM tiebreaker test is reinstated, and the MLI competent authority approval requirement is removed.

4.4 The MLI tiebreaker test has introduced significant uncertainty and compliance costs into New Zealand and Australia's consideration of dual residency, and the requirement to seek competent authority approval is unduly burdensome, when considering the number of New Zealand and Australian companies that operate across borders. The close economic relations between New Zealand and Australia, the close co-operation between revenue authorities, and the fact that New Zealand is not a low tax jurisdiction (but rather has a comprehensive corporate income tax imposed at a similar rate to Australia) all suggest that reinstatement of the tie-breaker is appropriate and would not lead to the base erosion concerns that gave rise to article 4 of the MLI.

[2] http://taxpolicy.ird.govt.nz/publications/2019-other-australia-nz-admin-approach-mli-article-4-1/text

For your information, the members of the Corporate Taxpayers Group are:

1. AIA Sovereign
2. Air New Zealand Limited
3. Airways Corporation of New Zealand
4. AMP Life Limited
5. ANZ Bank New Zealand Limited
6. ASB Bank Limited
7. Auckland International Airport Limited
8. Bank of New Zealand
9. Chorus Limited
10. Contact Energy Limited
11. Downer New Zealand Limited
12. First Gas Limited
13. Fisher & Paykel Appliances Limited
14. Fisher & Paykel Healthcare Limited
15. Fletcher Building Limited
16. Fonterra Cooperative Group Limited
17. Genesis Energy Limited
18. IAG New Zealand Limited
19. Infratil Limited
20. Kiwibank Limited
21. Lion Pty Limited
22. Meridian Energy Limited
23. Methanex New Zealand Limited
24. New Zealand Racing Board
25. New Zealand Steel Limited
26. New Zealand Superannuation Fund
27. NZME Limited
28. Oji Fibre Solutions (NZ) Limited
29. OMV New Zealand Limited
30. Pacific Aluminium (New Zealand) Limited
31. Powerco Limited
32. SKYCITY Entertainment Group Limited
33. Sky Network Television Limited
34. Spark New Zealand Limited
35. Summerset Group Holdings Limited
36. Suncorp New Zealand
37. T & G Global Limited
38. The Todd Corporation Limited
39. Vodafone New Zealand Limited
40. Watercare Services Limited
41. Westpac New Zealand Limited
42. WSP Opus
43. Xero Limited
44. Z Energy Limited
45. ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

John Payne
For the Corporate Taxpayers Group

cc
Emma Grigg, Deputy Commissioner Policy and Strategy (Acting), New Zealand Inland Revenue
Carmel Peters, Strategic Policy Advisor, New Zealand Inland Revenue, Paul Kilford, Policy Manager, New Zealand Inland Revenue