Corporate Tax Residency

16 October 2019

CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

16 October 2019

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

Dear Board

Review of Corporate Tax Residency rules

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to respond to the Board of Taxation's consultation paper, Corporate Tax Residency.

The objective of the Board's review is to consider whether the existing corporate tax residency rules are operating appropriately in light of modern, international and commercial board practices and international tax integrity rules.

We acknowledge that the Board has established a Working Group for the review and that CA ANZ Australian Tax Leader, Michael Croker, has been appointed to this group. Accordingly, the focus of this submission is to provide input from a New Zealand perspective.

Background

The term resident of Australia is defined in subsection 6(1) of the Income Tax Assessment Act 1936 (ITAA1936) as including:

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

*[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).*

Until 14 March 2017 the Australian Taxation Office (ATO) accepted, that a foreign incorporated company trading outside Australia was not carrying on business in Australia therefore was not an Australian tax resident even if the company's central management and control (CMAC) was in Australia.

However, the ATO has changed its view following the High Court of Australia decision, Bywater Investments Limited and Ors v Commissioner of Taxation,1 and released Taxation Ruling TR 2018/5 Income tax: central management and control test of residency. In TR 2018/5, the ATO considers that if the CMAC of the business is in Australia, then for Australian tax purposes, the foreign company will also be considered to be undertaking business in Australia.

The change arising from TR 2018/5 is significant. CA ANZ is not convinced the ATO's interpretation of subsection 6(1) and the Bywater decision is correct, and we previously lodged a joint submission with other professional bodies on the draft version of the Taxation Ruling TR 2017/D2 in that regard.

In addition, the withdrawal of TR 2004/15 and the release of Practical Compliance Guideline (PCG) 2018/9 have given rise to significant uncertainty in relation to situations involving CMAC being located in multiple places. The examples in the PCG leave significant uncertainty in ordinary commercial situations as to whether CMAC is being exercised in Australia to a significant degree. Paragraphs 15, 16 and 50 of TR 2004/15 reflected a practical administrative approach for dealing with these situations whereas the "Ongoing compliance approach" in PCG 2018/9 is significantly narrower in its application.

---

[1] Bywater Investments Limited and Ors v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation [2016] HCA 45 (16 November 2016)

As a result of TR 2018/5 and PCG 2018/9 the residency test has become difficult to administer and creates higher compliance and governance requirements for foreign incorporated companies. In our view the key planks of good tax policy are fairness, certainty and appropriate attention to the cost of administration and compliance. The revised position of the ATO runs counter to all of these aspects.

Summary of CA ANZ submissions

CA ANZ supports reform of the corporate residency rules.

In summary, we believe that the Board should consider recommending an incorporation only test, without the need to take into account CMAC. This would be simple to apply and provides certainty for the taxpaying community and the ATO. It is also less distortionary and removes the need to restructure commercial arrangements to ensure that CMAC is, or is not, located in Australia.

We acknowledge that there may be avoidance concerns, however these should be able to be managed through other existing regimes such as the CFC and Hybrid rules.

If this option is not accepted we suggest that the Board consider recommending that the legislation is amended to ensure the position applying pre-TR 2018/5 is reinstated, that is the company must carry on a business in Australia as well as having its CMAC in Australia.

Further, consideration should be given to ensuring that CMAC can only be located in one place. The test for CMAC should be the place where the majority of decisions are made as reflected in TR 2004/15.

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

Difficulties with the central management and control test – Common Examples

Using the test, as described in TR 2018/5 to determine a company's residence is becoming increasingly difficult. As a result of the view that the mere existence of CMAC in Australia is sufficient for a company to be considered to be carrying on business in Australia, the potential reach of the CMAC test has been expanded.

The subjective CMAC test requires fact intensive inquiry. In some instances, CMAC may be impossible to determine because it is commonly spread over more than one country, and in some cases a number of jurisdictions. While there are a defined number of structural scenarios the real issues with ATO's current interpretation arise irrespective of the structure. Typical scenarios involving New Zealand companies include:

1. A New Zealand listed company with New Zealand directors. It may hold one meeting in Australia out of a total of say 10 in a year. The remaining meetings are held in New Zealand. The Australian meeting is held to review and consider its Australian subsidiary operations. As it holds a meeting in Australia it will not qualify for the "ongoing compliance approach".[2] Where decisions are made by the Board in Australia at that one meeting the company could be seen as having CMAC in Australia to a substantial degree sufficient to conclude that it is carrying on business in Australia and therefore deemed resident in Australia.

2. The directors of a New Zealand unlisted company include Australian directors, because either the company has some business in Australia or the directors have a particular expertise. The Australian directors do not travel for every meeting and participate via telephone or video-conferencing. The position adopted in the former Taxation Ruling TR 2004/15 was that where board meetings were conducted via electronic facilities (rather than physical attendance) the focus was on where the participants contributing to the high-level decisions were located. The fact that a majority of these high-level decision makers regularly participated from a jurisdiction other than Australia supported a conclusion that

[2] PCG 2018/9 paragraph 107

CMAC was not located in Australia, particularly where the majority of decision makers usually undertook their company duties and participated in the company's high level decision making processes in that other jurisdiction.[3] The difficulty with the current Practical Compliance Guideline PCG 2018/9 is that all the examples are based on a director not travelling because of a one-off situation, such as a broken leg. This leaves considerable uncertainty.

3. A New Zealand listed company that does not have a majority of its meetings in any one country because its' directors are geographically dispersed around the world. The company normally holds board meetings via video-conferencing. There is no clear majority of control exercised from New Zealand or Australia. The issue that needs to be addressed is, whether something in Australia is enough to be a "substantial degree".[4] Say, 2 out of 7 directors dial in from Australia?

4. A New Zealand subsidiary of an Australian Group with substantial operations in New Zealand. Where the directors are all Australian's, notwithstanding the subsidiary has no operations in Australia, it could easily become an Australian resident if either the directors do not travel to New Zealand for a board meeting or make decisions outside a board meeting.

5. The factual pattern is often not static. In one year, there may be a majority of meetings in Australia and in another year in New Zealand. This may depend on activity in the relevant jurisdictions. It is easy for CMAC to change from year to year.

It is important to note these are all commercially driven management structures. In the trans-Tasman context, they reflect the closeness of the markets and that Australia and New Zealand operations are often linked. They are not tax structures to arbitrage Australian and New Zealand

[3] R 2004/15 para 50
[4] PCG 2018/9 paragraph 74

tax differences. They do not give rise to double deductions or deductible-no taxable income type scenarios.

Due to the current interpretation and the uncertainty it creates, New Zealand corporates have to be incredibly diligent to minimise any risk of inadvertently becoming Australian resident. They have to alter their normal commercial operations and incur additional costs to ensure that they do not become an Australian tax resident. Boards have to actively ensure that board meetings are not held in Australia, Australian directors are physically attending meetings outside Australia, participation in meetings remotely from Australia is limited, and no decisions are made at the time of Australian site visits. Clearly, this is undesirable. Commercial decisions are being distorted, costs are increasing, inefficiencies are being created and the impact on the environment is increasing because tax law is not in step with modern commercial practice.

New Zealand implications of being a dual resident

While we accept that the implications under New Zealand domestic law are not a focus for the Board it should be aware that there are material disadvantages for a New Zealand company to inadvertently become an Australian tax resident. We note that these concerns can apply regardless of whether the New Zealand company actually files as a tax resident in Australia.

Under New Zealand domestic law a dual resident company is unable to:

- group loss offset;
- be part of a tax consolidated group;
- maintain an imputation credit account.

The effect is to potentially increase the New Zealand tax payable while the operation of the Australian consolidation rules and the branch exemption means there is no additional tax payable in Australia. This is an odd outcome of a rule designed to ensure that Australian tax is payable.

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

Significantly, the ATO's view of the CMAC test in Taxation Ruling TR 2018/5 and PCG 2018/9 creates uncertainty for New Zealand incorporated companies. Certainty is crucial. Corporations must know when the residency test is breached and the consequences of doing so. Based on the ATO's current view, it is easy to envisage a corporate being Australian tax resident one year and not the next. This scenario must be avoided if there is to be certainty.

Preferred approach: Incorporation only test

When it comes to evaluating the ongoing viability of the residency test, the question is what is the tax-residence test for corporates which best supports the policy of taxing Australian residents on world-wide income (subject of course to the branch exemptions amongst others). The key issue is how broad that test should be.

The current residency rule was developed many years ago when physical location was important. It was based on the assumption companies were incorporated in, and centrally managed and controlled from the one country and that this did not change easily. Modern methods of transportation, advanced technology and the communications revolution, such as air travel and video-conferencing are rendering many tax concepts based on an enduring physical presence, including CMAC and place of effective management (POEM), less appropriate and effective. This is because today company directors who are dispersed throughout the world are able to meet wherever they choose or may confer via videoconferencing without leaving their homes.5 This raises the question of whether a test which assumes enduring physical presence is appropriate.

A place of incorporation is a simple residence test. Additional tests of residency are essentially ways of buttressing residency based on the place of incorporation (and therefore the corporate tax base) so that the "true residency" can be determined when the place of incorporation is a merely mechanical process. These tests can therefore be seen as performing an "avoidance" function. There are now many specific rules which deal with arrangements which place income beyond the

[5] Developing a new test of fiscal residence for companies, Matthew Collett, UNSW Law Journal, Vol 26(3)

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

corporate tax base. These provisions include the CFC and hybrid rules. This raises the question of whether an extended residency test is still required.

Reinstate the position pre-TR 2018/5

If the Board is unable to reach a conclusion that the incorporation test alone should be sufficient, we recommend that consideration be given to reinstating the position regarding CMAC to that existing prior to TR 2018/5. That is to be tax resident in Australia the company must have both a business in Australia and its CMAC in Australia. The interpretation of the conclusions in Bywater has broadened the ambit of the residency test and placed more New Zealand corporates under its potential reach. This has simply expanded the uncertainty that existed and is placing undue restraints on normal commercial operations.

Single site of CMAC

In addition, we consider that the Board should consider recommending that the test of CMAC explicitly provides that it can only arise in one single place. This would help in removing a lot of uncertainty for New Zealand based companies.

Where decisions are made in more than one place TR 2018/5 creates considerable uncertainty on where the ATO will consider CMAC exists. It is clear from the guidance that CMAC can exist in more than one place. This is contrary to the test applied in the OECD's model tax convention. The Model applies the POEM test where a tie breaker is required to determine the place of residency for the Treaty. The POEM expressly concludes in a treaty context that this should only exist in one place.

If the Board does not believe that the incorporation test alone is sufficient, it should consider whether the alternative results in a single place. This should avoid many of the concerns that we raised above. Applying a CMAC test to the place where the majority of the Board decisions are made, consistent with the position in TR 2004/15, would provide greater certainty and flexibility for Boards to manage their residency in light of their commercial needs.

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915

Double Tax Agreement with New Zealand

A further option would be to insert appropriate tiebreaker rules in the Double Tax Agreement between Australia and New Zealand that have effect for domestic law.

A New Zealand incorporated company is required to have at least one New Zealand resident director. However, because of the unique relationship between Australia and New Zealand, this rule is relaxed for Australian residents. A company is allowed to solely have an Australian resident director(s) under our *Companies Act 1993*.[6] This reflects the fact that Australian directors are not perceived as creating a risk for New Zealand companies.

Under the Closer Economic Relations (CER) rules New Zealand and Australia are economically connected. If the solutions noted above are not adopted, we believe the Board should consider recommending an amendment to the DTA with New Zealand to provide certainty for New Zealand and Australian groups operating across the Tasman.

This could be by way of amendment to introduce a residency test that applied domestically in either country. This would deem certain trans-Tasman operating companies to be either resident of Australia or New Zealand and not dual-resident. This could in principle deal with the particular features of each country's rules which produce inappropriate results.

The Multilateral Instrument

Prior to the introduction of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument), if a company was a tax resident of both Australia and New Zealand, the tie breaker in the DTA would determine the tax residence of the company. The Multilateral Instrument has amended the DTA so that the tie breaker no longer

[6] Companies Act 1993 s 10(d)(ii)

applies. The tax residence of a dual resident company for the purposes of the DTA is determined by agreement of the New Zealand Inland Revenue and the ATO.

Eligible taxpayers can self-assess using the administrative approach. The administrative approach is overly complex and the qualifying thresholds are at a level such that it does not assist a lot of corporates. The lack of an automatic tie breaker is problematic for companies that cannot use the administrative approach. As noted above, due to the current CMAC interpretation New Zealand incorporated companies are doing everything possible to avoid being dual resident.

If you wish to discuss our submission please contact John Cuthbertson, telephone 64 27 202 6136, and we can set-up a conference call.

Yours sincerely

John Cuthbertson CA

New Zealand Tax Leader

Greg Haddon FCA

Chair, Tax Advisory Group

Chartered Accountants Australia and New Zealand
Carlaw Park, 12-16 Nicholls Lane, Parnell, Auckland 1010
PO Box 3334, Shortland Street, Auckland 1140 P +64 9 917 5915