Public advice and guidance compendium – TR 2018/5

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2017/D2 – *Income tax: Foreign Incorporated Companies: Central Management and Control test of residency*

This compendium of comments has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

Issue No.	Issue raised	ATO response / action taken
1	It was unnecessary to withdraw Taxation Ruling TR 2004/15 *Income tax: residence of companies not incorporated in Australia - carrying on business in Australia and central management and control*. It ought to be reinstated.	TR 2017/D2 has been finalised along with a practical compliance guideline to assist companies apply the principles. TR 2004/15 will not be reinstated.
2	There should be a clearer 'bright line test' as to whether or not a company is resident as in the old ruling.	The central management and control test of residency is not by its nature a bright line test. It involves the considerations of fact and degree to determine where a company's central management and control is really exercised. Additional practical guidance has been provided in draft Practical Compliance Guideline PCG 2018/D3 *Income tax: central management and control test of residency: identifying where a company's central management and control is located*, which sets out the Commissioner's approach to applying the principles contained in the finalised ruling. This guidance will assist companies apply the central management and control test of corporate residency.
3	In paragraph 2 'and' is missing after the word 'Australia in paragraph 2(a).	This was an error made in the initial publishing of the draft. This has been corrected.
4	More detail is required re paragraph 26 on where a company's central management and control is located.	This issue has been clarified in the finalised ruling at (paragraphs 30–31) and further guidance is contained in draft PCG 2018/D3.

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5	The ruling should make clear in opening observation that the question of residency will turn on its facts for every case.	This has been clarified in the finalised ruling at paragraph 5.
6	The ruling does not deal with the 'voting power test' and doesn't make it clear that central management and control is not the only test of residency	This has been clarified in the finalised ruling at paragraph 2.
7	The list of 10 examples in paragraph 29 should be divided into categories to highlight their importance to determining where central management and control is located.	This list of considerations has now been split into two categories in the final ruling, comprising (a) 'matters most likely to influence a court's decision' and (b) 'matters the courts have considered of lesser importance' at paragraphs 36 and 37.
8	The ruling contains insufficient practical guidance on how to apply the principles it sets out. This creates uncertainty as to how the principles in it will be applied. It would be desirable to have examples to provide additional practical certainty as to how the ATO will apply the principles set out in the ruling. This creates uncertainty in how to determine where central management and control is located in practice. Specific issues raised: • When a person is merely influential over the directors or exercises central management and control. - The concept of 'rubberstamping' and decisions 'actually made by others'. • How does the existence of a decision making structure affect the location of central management and control? What about requirement to obtain signoff of decisions? • Do the outcomes in the examples in TR 2004/15	Additional practical guidance has been provided on the application of the principles and relevant evidence in draft PCG 2018/D3. This includes examples which illustrate the application of the principles and the evidence the ATO will consider in determining where a company's central management and control is located. Where a person is merely influential, even if that influence is strong, this will not of itself amount to an exercise of central management and control. See the finalised ruling at paragraph 27). Examples illustrating this, and the distinction between being merely influential and actually exercising central management and control, have been included in draft PCG 2018/D3.

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	change as a result of the change in view? • What level of documentary evidence will be required? Board minutes recording the reasons for decision, alternatives and options considered. • The changing nature of commerce and circumstances of a director. • The distinction between a company whose business involved minor operations (for example, management of investment of assets, and more substantive operations). • Examples similar to TR 2004/15 updated to reflect the changed views. • Provide guidance on identifying where a company's central management and control is exercised. • The ruling ought to deal with sole director companies, and refer to the judgements in *North Australian Pastoral* and *John Hood* in this respect. The ruling ought to specifically state that where a company's directors live, while relevant is not determinative. • The ruling does not sufficiently address who controls a company when its decision-making is outsourced. • Changes in global business over time including the development of video conferencing emails etc have made it difficult to determine whether the central management and control of a company is or where it 'keeps house and does business'.	

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9	What are the consequences for the voting power test of company residency?	The application of the voting power test of corporate residency is outside of the scope of the finalised ruling which deals only with the central management and control test of residency. The voting power test of company residency is a separate test. The view in the finalised ruling will only affect the outcome under the voting power test of company residency if a company carries on business, has its voting power controlled by shareholders who are residents of Australia, and also its central management and control in Australia, such that it would carry on business in Australia. A company in these circumstances would in any event be an Australian resident under the central management and control test of corporate residency.
10	The ruling has wide consequences and will cause significant numbers of offshore subsidiaries of Australian resident companies to become resident.	The finalised ruling will only affect overseas subsidiaries of Australian companies if their central management and control is actually exercised in Australia. A transitional administrative arrangement for those companies who having relied on the ATO's prior view on the central management and control test of residency as set out in TR 2004/15, but would be resident under the ATO's revised views in the finalised ruling, is set out in draft PCG 2018/D3.
11	The ATO should provide guidance on the broader consequences of becoming a resident, including: • The effect of a controlled foreign company becoming resident and a member of a consolidated group. • The possibility of refunds requirement for amounts of tax in relation to royalties and interest to be refunded where they are no-longer taxable as a result of the controlled foreign company becoming resident.	The application of other provisions of the Tax Acts that turn on whether a company is an Australian resident or not, and Treaty Tie breaker tests including Place of Effective Management (POEM), are beyond the scope of the finalised ruling. Consideration as to whether to provide public guidance on these matters will be considered as part of the normal processes for determining whether we provide guidance on a topic.

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	• Taxpayer Alert TA 2016/7 *Arrangements involving offshore permanent establishments* consequences. • Importation of foreign losses into the Australian tax system. • Adjustments required in relation to the Australian tax treatment of TOFA deductions, foreign exchange differences, withholding tax and CFI balances. • Adjustment to procedures in relation to compliance with the controlled foreign company measures, International Dealings Schedule and CbC reporting. • Dealing with other consequences of "dual residence" and change in residence including local country dual resident limitations, exit charges, relief from double taxation, access to tax treaties (for example, the multilateral instrument proposals to remove treaty residence tie breaker rules) and generation of new hybrid outcomes. • How to apply the Tie breaker tests, including POEM.	
12	What does carrying on a business mean, in the voting power test?	Both the 'carrying on a business' and the voting power test are outside of the scope of the finalised ruling. Additional guidance has been provided by the ATO on when a company carries on business which will address this issue. See Taxation Ruling TR 2017/D7 *Income tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986?*
13	Will the ATO provide guidance on when a company carries on a business?	Additional guidance has been provided by the ATO on when a company carries on business which will address this issue. See TR 2017/D7.

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14	Is the change in view about the meaning of *Malayan Shipping Co Ltd v. Federal Commissioner of Taxation* (1946) 71 CLR 156 correct? The analysis on this point ought to be expanded.	The ATO maintains its view that the ruling accurately reflects the law. The High Court authority is clear on this point. In *Malayan Shipping* Williams J unequivocally observed: *… 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."* This basic proposition is evident in the earliest cases involving the concept of central management and control such as *Cesena Sulphur Co Ltd v. Nicholson; The Calcutta Jute Mills Company Ltd v. Nicholson (*1876) 1 Ex.D 428 and *De Beers Consolidated Mines Ltd v. Howe* [1930-1911] 5 TC 198 *at 213* which have been consistently endorsed by the High Court*: North Australian Pastoral Co Ltd v. FCT* (1946) 71 CLR 623*; Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation* [2016] HCA 45; 2016 ATC 20-589 *at [45]; Esquire Nominees Ltd v. FCT* [1973] HCA 67; (1973) 129 CLR 177 *at [27]; Koitaki v. FCT (1941) 64 CLR 241 per Rich ACJ at 241; Koitaki v. FCT (1940) 64 CLR 15 per Dixon J at 19-20.* Additional references on this point are now included in the finalised ruling at footnotes 5 to 7.
15	The ruling does not distinguish between companies that carry on an active trading business versus those companies that solely carry on investment management activities and which act as collective investment vehicles. There should be a carve-out for active trading businesses.	There is no basis in legislation or case law to support the application of different principles for active trading businesses from more passive investment based business. As noted in the finalised ruling at paragraph 18, the acts that amount to central management and control may vary depending on the nature of the business a company carries on. Further guidance on the Commissioner's approach to determining what acts amount to the exercise of central management and control is contained in draft PCG 2018/D3.

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16	Whether the requirement to carry on a business and central management and control are separate tests. The draft ruling effectively conflates the two tests.	There are two legislative requirements in the test. The inclusion of the two limbs serves to ensure that foreign incorporated companies that merely carry on business in Australia are not resident here by mere virtue of that fact alone. However, as confirmed by case law, the central management and control of a company is factually part of that company's business. It follows that where a company is carrying on business, it will do so both where the trading and investment operations of that business are conducted and where its central management and control is located.
17	The ATO ought to include instructive commentary on the importance of statutory construction.	The ATO view in the finalised ruling is supported by case law which interprets and applies the central management and control test of company residency. There is no need to conduct a detailed analysis by reference to basic principles of statutory interpretation in the ruling, as it relies on the interpretation and application of the test by the High Court.
18	The ATO should outline circumstances in which board activities amount to carrying on business in Australia.	The finalised ruling provides a list of factors which assist in determining where and who exercises the central management and control of a company. We have provided additional practical guidance on identifying who and where central management and control is located in draft PCG 2018/D3.
19	The ruling will have an adverse effect on small businesses that have offshore operations as they will not have experience in international tax matters and will not focus on international tax residency and assume foreign subsidiaries are non-resident as a starting point.	Additional practical guidance has been provided in draft PCG 2018/D3, which sets out the ATO's approach to applying the principles outlined in the finalised ruling. This guidance will assist companies apply the central management and control test of corporate residency.
20	The ruling will affect companies that have not paid proper attention to their management structures.	This may be correct. The ATO has provided a transitional compliance arrangement for companies who have relied on the views expressed in TR 2004/15. See PCG 2018/D3.
21	The change in view re *Malayan Shipping* will force foreign incorporated subsidiaries of Australian companies that	Additional practical guidance has been provided in draft PCG 2018/D3, which sets out the ATO's approach to applying the

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	trade and operate outside Australia to expend substantially more resources to assess and substantiate their residency. It will create uncertainty because it provides inadequate practical guidance. This is at odds with Government's commitment to 'cut the red tape'.	principles outlined in the finalised ruling. This guidance will assist companies apply the central management and control test of corporate residency.
22	The application date: should it apply from the 2017/2018 income year rather than 15 March. This will allow taxpayers to work through transitional issues including: • Evaluating whether all foreign subsidiaries remain non-resident. • Determining the consequences of becoming a dual resident from a particular date. • Implementing changes to ensure central management and control is not in Australia.	There is no change to the proposed application date. The finalised ruling will apply from 15 March 2017, the date of the withdrawal of TR 2004/15 which it replaced. However, the ATO will apply a transitional compliance arrangement for companies who have relied on the views expressed in TR 2004/15. See PCG 2018/D3.
23	The ATO ought to undertake not to apply Part IVA to changes in: • Governance processes necessary in order to ensure that an entities residence is not affected by the change in view. • Residency caused as a result of the change in view.	The central management and control test of company residency is a test of substance not legal form. The ATO is of the view that Part IVA would not apply to changes in how a company is managed merely in order to ensure that it remains non-resident after the withdrawal of TR 2004/15. We have also provided a transitional compliance arrangement for companies who have relied on the views expressed in TR 2004/15. See PCG 2018/D3.
24	The ATO should not assume that directors do not exercise their duties and that by default the parent exercises central management and control of a subsidiary. The emphasis in paragraph 14 of the draft ruling is too skewed towards artificial and extreme cases. This should	Neither the draft, nor final ruling starts from an assumption that the directors of a company are not exercising central management and control. The ATO is of the view ordinarily, where the directors of a company exercise their duties as directors to manage a company and act

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	be noted as such. The ATO should make it clear that a subsidiary can still follow the directions of its head office with the directors still exercising their judgement and remain non-resident. Highlighted a concern that the ATO was taking the position that 'directors are often not exercising central management and control'. This position should be limited to instances where there are sham directors or where there are 'fake structures'.	within the standards expected of them under the *Corporations Act 2001* and its foreign equivalents, the company's central management and control will be exercised by its directors. This is made clearer in the finalised ruling at paragraph 20 and additional practical guidance contained in PCG 2018/D3. The ATO accepts that the directors of a subsidiary company may act in accordance with the interests and wishes of its parent, and still exercise central management and control of that company, provided they exercise their own judgement and actually make the high level decisions of the company. Additional practical guidance on the ATO's approach to this issue is contained in PCG 2018/D3.