TR 2004/D7 - Income tax: residence of companies not incorporated in Australia - carrying on business in Australia and central management and control

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Draft Taxation Ruling

Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.*

What this Ruling is about

1. The ruling provides guidelines for determining whether a company, not incorporated in Australia, is a resident of Australia under the second statutory test in paragraph (b) of the definition of 'resident' or 'resident of Australia' in subsection 6(1) in the *Income Tax Assessment Act 1936* (ITAA 1936).[1]

2. While every case turns on its facts, this ruling gives guidance to companies determining their residence under the second statutory test.

Date of effect

3. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

[1] The phase second statutory test used in this Ruling refers to the requirements in s6(1)(b) of the ITAA 1936 that a company that is not incorporated in Australia must carry on business in Australia and have its central management and control in Australia in order to be a 'resident of Australia'.

Ruling

4. The definition of resident in subsection 6(1) of the ITAA 1936 provides that a company that is not incorporated in Australia must be carrying on business in Australia and either have its central management and control in Australia or have its voting power controlled by shareholders who are residents of Australia, in order to be a 'resident' or 'resident of Australia'.[2]

Two requirements

5. For a company to be a resident under the second statutory test two separate requirements must be met. The first is that the company must carry on business in Australia, and the second is that the company's central management and control (CM&C) must be located in Australia.

6. If no business is carried on in Australia, the company cannot meet the requirements of the second statutory test and, in these circumstances, if it is not incorporated in Australia then it is not a resident of Australia. In these situations there is no need to determine the location of the company's CM&C, separate from its consideration of whether the company carries on business in Australia. If the company carries on business in Australia it also has to have its CM&C in Australia to meet the second statutory test.

7. However, there are situations where the nature of the business or the level of control over the business requires the exercise of CM&C at the place where the business is carried on. Where a company's business is management of its investment assets and it undertakes only minor operational activities, the factors determining where a company is carrying on a business may be similar to those determining where it is exercising CM&C. In these situations the location of CM&C is indicative of where the company carries on business and vice versa.

8. The fact that a company, not incorporated in Australia, is carrying on a business in Australia does not, of itself, necessarily mean that the company has its CM&C in Australia.

Carries on business in Australia

9. The question of where business is carried on is one of fact, dependent on the facts and circumstances of a case. However, the Commissioner's approach to this factual determination is to draw a distinction between a company with operational activities (for example trading, manufacturing or mining activities) and a company which is more passive in its dealings.

[2] This Ruling does not deal with the question of voting power controlled by shareholders who are not residents of Australia.

10. For the purposes of the second statutory test, a company that has major operational activities carries on business wherever those activities take place and not necessarily where its CM&C is located. Operational activities refer to major trading, manufacturing or mining activities. For example, the place of business of a large industrial concern is wherever its offices, factories or mines are situated.

11. On the other hand, a company whose income earning outcomes are dependent on the investment decisions made in respect of its assets, carries on its business where these decisions are made.

12. It is considered that for the purposes of s6(1)(b), the concept of business may be wider than its ordinary meaning and extends to undertakings of a business or a commercial character. For example, for the purposes of the second statutory test, a company may be carrying on business even if its only activity is the management of its investment assets.

Central management and control

13. The second statutory test focuses on management and control decisions that guide and control the company's business activities. This level of management and control involves the high level decision making processes, including activities involving high level company matters such as general policies and strategic directions, major agreements and significant financial matters. It also includes activities such as the monitoring of the company's overall corporate performance and the review of strategic recommendations made in the light of the company's performance.

14. Possession of the mere legal right to the CM&C of a company is not, of itself, sufficient to constitute CM&C of the company. However, a person with the legal right to CM&C may participate in the CM&C of the company even if they delegate all or part of that power to another, provided that they at least review or consider the actions of the delegated decision maker before deciding whether any further or different action is required.

Location of central management and control

15. The location of the company's CM&C is a question of fact to be determined in light of all the relevant facts and circumstances. In order to reduce uncertainty, the Commissioner as a matter of practical compliance will accept for those companies whose CM&C is exercised by a board of directors at board meetings that the CM&C is in Australia if the majority of the board meetings are held in Australia. The exception to this is cases where the circumstances indicate an artificial or contrived CM&C outcome.

16. For the purposes of paragraph 15, a board meeting is treated as being held in Australia when the majority of directors of the company meet in Australia. This is also subject to the exception for cases where the circumstances indicate an artificial or contrived CM&C outcome.

17. On the other hand, if a majority of board meetings are held in a single jurisdiction outside Australia, the company's CM&C will not be located in Australia. Again, this is subject to the exception for cases where the circumstances indicate an artificial or contrived CM&C outcome. A further exception may be where the location of CM&C is in more than one country in accordance with paragraph 20.

18. A parent company that does not involve itself in the CM&C of a subsidiary but ultimately has the power to remove the board in a manner consistent with the constitution of the company does not, for this reason alone, exercise the CM&C of the subsidiary for the purpose of the residence test. This approach is consistent with the framework of Australia's tax treaties which treat parents and subsidiaries as separate entities and accept that parents and subsidiaries are often resident in different countries (see the Associated Enterprises article in tax treaties).

19. Where a parent company exercises CM&C in Australia over a subsidiary (but does not conduct the day-to-day activities of the business in the way that the managing director did in *Malayan Shipping Co Ltd v. FCT* (1946) 71 CLR 156; (1946) 8 ATD 75; (1946) 3 AITR 256 (*Malayan Shipping*)), the subsidiary would need to also be carrying on business in Australia for it to be a resident under the second statutory test.

Location of central management and control in more than one country

20. It is possible for CM&C to exist in more than one country. Therefore the company can have CM&C in Australia notwithstanding that it also has its CM&C in another country. CM&C can be located where there is some part of the superior or directing authority by means of which the relevant affairs of the company are controlled. However, for CM&C to exist in that location a substantial degree of power and authority must be exercised there.

Explanation

21. Subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) provides that a person (which includes a company) is an 'Australian resident' if that person is a resident of Australia for the purposes of the ITAA 1936.

22. The definition of 'resident' or 'resident of Australia' in subsection 6(1) of the ITAA 1936 sets out the statutory tests of residence. Paragraph (b) of that definition states that a company is a

'resident' or 'resident of Australia' if it is incorporated in Australia, or if it is not incorporated in Australia, it 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.

Carries on business in Australia

23. It is necessary to examine all the relevant facts and circumstances of a company's activities to determine whether it carries on business in Australia.

24. A practical approach which provides a starting point for determining the location of the business is to draw a distinction between a company with operational activities (for example, major trading, manufacturing, or mining activities) and a company that is more passive in its operations.

25. It is arguable that a large industrial company carries on business wherever its major operational activities take place, notwithstanding that its CM&C may be located elsewhere. However, operational activities alone are not sufficient to make a company resident in Australia under the second statutory test, the company's CM&C must also be in Australia.

26. Where a company does not carry on major operational activities and the essence of its business is the investment of assets, it carries on business where those high level investment decisions are made – that is, where its CM&C is located. In these situations, the location of a CM&C is indicative of where the company carries on business and vice-versa.

Statutory construction

27. Support for the view that the 'carries on business in Australia' requirement is additional to and separate from the requirement for CM&C comes from a basic rule of statutory interpretation that the plain words of an Act must be given full meaning and effect: *Broken Hill South Ltd (Public Officer) v. Commr of Taxation (NSW)* (1937) 56 CLR 337 at 371 per Dixon J; *Jackson v. Secretary, Department of Health* (1987) 75 ALR 561 at 571, per Northrop J. A corollary of that rule is that Courts should not easily consider any word or sentence used in an Act as superfluous or of limited meaning: *Beckwith v. R* (1976) 135 CLR 569 at 574, per Gibbs J; *Project Blue Sky Inc v. Australian Broadcasting Authority* (1998) 194 CLR 355. Gibbs J stated in *Beckwith v. R* that, '[a]s a general rule a court will adopt that construction of a statute which will give some effect to all the words which it contains'.

28. Thus, it is arguable that an interpretation giving effect to all the words of the second statutory test is preferable to one making the words 'carries on business in Australia' superfluous and unnecessary.

29. Further, the fact that a company, not incorporated in Australia, is carrying on a business in Australia does not, of itself, mean that the company has its CM&C in Australia.

Alternative view

30. Some commentators[3] have interpreted comments by Williams J in *Malayan Shipping* as setting out a general principle that if a company's CM&C is located in Australia then this means that the company is also carrying on business in Australia for the purposes of the second statutory test.

31. *Malayan Shipping* involved a company incorporated and with its registered office in Singapore.[4] 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. He also paid the charterer out of his own funds and did not remit to the company the balance due to it under the voyage charters.

32. Williams J stated that the managing director 'exercised an equally complete management and control over the business operations and internal administration of the company' and found that this degree of control amounted not only to CM&C but also to carrying on of the business. He also found that the income in question had an Australian source because of the activities of the managing director in Australia.

33. Thus, in *Malayan Shipping* the two separate requirements in the second statutory test were met by the same set of facts and activities. The nature of the business and the managing director's complete management and control over the business operations and internal administration of the company resulted in a situation where his powers and actions evidenced CM&C, the carrying on of a business and also the source of the income as being in Australia.

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[3] For example, Tom Magney, 'Australian Singapore Taxation aspects of carrying on business in Singapore', June 1975 Australian Tax Review at page 69.

[4] It is noted that the Australian cases on CM&C, apart from Malayan Shipping, do not turn on the residence of the company under the second statutory test, for example, *Esquire Nominees Ltd v. FCT* (1973) 129 CLR 177; 72 ATC 4076; *Waterloo Pastoral Co Ltd v. FCT* [1946] 72 CLR 262, 266 (*Waterloo Pastoral*); *North Australian Pastoral Co Ltd v. FCT* (1946) 71 CLR 623; *Koitaki Para Rubber Estates Ltd v. FCT* (1940) 64 CLR 15 (High Court); (1941) 64 CLR 241(Full High Court) (*Koitaki Para Rubber*). In all of these the relevant provision referred to a person being a 'resident' in a particular place. It did not concern if the company was a resident of Australia, which is what the statutory definition is concerned with.

34. On the question of whether the company was carrying on business in Australia, Williams J acknowledged that the question of where business is carried on is in every case one of fact.

35. In the course of his judgment, Williams J considered whether the carrying on of business referred to just the actual operations themselves, or also to the control of the operations of the business from which the profits arose. After indicating that he was not prepared to accept the former construction of the second statutory test, he stated:

> In *Mitchell v. Egyptian Hotels Ltd* (1915) AC 1022 at 1037 Lord Parker said: 'Where the brain which controls the operations from which the profits and gains arise is in this country the trade or business is, at any rate partly, carried on in this country.' The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business or the controlling shareholders must be situate or resident 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.

36. The reference to *Mitchell v Egyptian Hotels Ltd* (1915) AC 1022 indicates that mere trading is not sufficient and that there also has to be CM&C in order for a company to be resident in Australia under the second statutory test. However, it does not necessarily support the further proposition that if you have CM&C you are also invariably carrying on a business in that jurisdiction.[5] In *Malayan Shipping* his Honour considered that the business carried on by the company consisted of or included its CM&C. However, the comments are explicable by the facts of the case in which both elements of the second statutory test were satisfied because of the nature of the particular business. In *Mitchell*, the company was held to be carrying on a business wholly outside the United Kingdom, notwithstanding that its CM&C was in the United Kingdom.

37. It may be argued that a wide application of the comments by Williams J in *Malayan Shipping* is supported by the statement by Lord Loreburn in *De Beers Consolidated Mines Ltd v. Howe* [1906] AC 455 at 458 that a company resides where its 'real' business is carried on and that the real business is carried on where the central management and control actually abides.[6] However, it must be

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[5] Note that the courts have cautioned that judicial statements regarding the construction of an Act must never supplant or supersede the actual words of the statute itself and that ultimately, each case must be governed by the Act, and not judicial formulae: *Paisner v. Goodrich* [1955] 2 QB 353 at 358; *John v. FCT* (1989) 166 CLR 417; 89 ATC 4101; (1989) 20 ATR 1; *Ogden Industries Pty Ltd v. Lucas* [1970] AC 113 at 127 (per Lord Upjohn); *Brennan v. Comcare* (1994) 50 FCR 555; (1994) 122 ALR 615 at 634.

[6] This principle was first stated in *De Beers* and has been subsequently adopted in *Koitaki Para Rubber Estates v. FCT*; *North Australian Pastoral Co Ltd v. FCT*; *Unit Construction Co Ltd v. Bullock* [1960] AC 351; [1959] 3 All ER 831; Gibbs J in

remembered that *Mitchell* and *De Beers* were cases involving the question of the residence of a company under taxation laws that did not include a statutory definition of that concept.

38. While it is clear that mere trading is not sufficient on its own to satisfy the second statutory test, and that CM&C can be relevant to determining where the business is being carried on, it is considered that major operational activities which are the essence of a company's income earning activities and which are carried out with a high degree of autonomy would be sufficient to constitute the carrying on of business in Australia where those activities occur in Australia.

Carries on business

39. It is considered that the second statutory test refers to a wide concept of business. For example, if the objects of a company are business objects and the company actually carries out these business objects, then the company is carrying on business: *IRC v. Westleigh Estates* [1924] 1 KB 390 at 408, 409 (per Sir Ernest Pollock, MR). Similarly, where a company gainfully uses its property in letting it out for rent, the inference is that the company is carrying on business: *American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia)* [1978] 3 All ER 1185 at 1189 (per Lord Diplock). This is because 'the purchase of property to rent out, whether or not after renovating it, and the proprietorship of that property, constitute an undertaking of a business or commercial kind': Pincus J in *Lilydale Pastoral Co Pty Ltd v. FC of T*.[7]

40. This means that a company may be carrying on business for the purposes of the second statutory test of residence even if its main activity is the management of its investment assets. Examples of the types of returns a company may receive from the management of its investment assets include rent, dividends, interest and royalties.

41. Accordingly, both companies with active business operations (for example, major trading, manufacturing or mining operations) and those whose business is the management of their investment assets (for example, investments in property or shares to generate rental or dividend income) can carry on business for the purposes of the second statutory test of residence.

Esquire Nominees Ltd v. FCT (1973) 129 CLR 177; 73 ATC 4114; (1973) 4 ATR 75 and many other cases.

[7] (1987) 15 FCR 19; 87 ATC 4235; 18 ATR 508; (1987) 72 ALR 70; see also *California Copper Syndicate (Limited and Reduced) v. Harris* (1904) 5 TC 159; *Esquire Nominees Ltd v. FCT* (1973) 129 CLR 204 at 221; 73 ATC 4123; (1973) 4 ATR 75 at 85 (per Menzies J) and (1973) 129 CLR 204 at 229; 73 ATR 4123 at 4128; (1973) 4 ATR 75 at 91 (per Stephen J) (*Esquire Nominees*); *FCT v. Total Holdings (Australia) Pty Ltd* 79 ATC 4279; (1973) 9 ATR 885.

Alternative view

42. An alternative view is that the second statutory test refers to a narrow concept of carrying on of a business. Under this approach a company that invests with the purpose of obtaining gains from that investment may not be carrying on a business.[8] However, the statutory context seems to assume that all companies (other than dormant companies) are carrying on a business.

Central management and control

43. The term 'central management and control' was developed by the courts as a common law rule for determining the residence of a company. As Lord Loreburn stated in *De Beers Consolidated Mines Ltd v. Howe* [1906] AC 455 at 458:

> In applying the concept of residence to a company, we ought, I think, to proceed as nearly as we can upon an analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Kelly C.B. and Huddleston B. in the *Calcutta Jute Mills* and *Cesna Sulphur* cases, involved the principle that a company resides for purposes of income tax where its real business is carried on. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.
>
> It remains to be considered whether the present case falls within that rule. This is a pure question of fact to be determined, not according to the construction of this or that regulation or ruling, but on a scrutiny of the course of business and trading.

44. The idea that a company both keeps house and does business is replicated in the two requirements of the second statutory test that the company carries on business in Australia and has its CM&C in Australia. However, as explained above, it is not considered axiomatic that the two requirements are satisfied where the CMC actually abides. As observed by the authors in the *Guidebook to Australian International Taxation*, the view that once CM&C is established it can be inferred that the company is carrying on business 'may now be viewed as a somewhat simplistic conclusion and it may be true to say that to be resident it must be positively shown that the acts of management and control are genuinely accompanied by acts of carrying on business.'[9]

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[8] *Charles v. FC of T* (1954) 90 CLR 598; 6 AITR 85; *Radnor Pty Ltd v. FC of T* (1990) 21 ATR 608; 90 ATC 4637.

[9] RL Hamilton, RL Deutsch and JC Raneri, *Guidebook to Australian International Taxation*, Prospect Media Pty Ltd, 2001 at page 2-16.

Nature of central management and control

45. Determining CM&C involves a focus on the who, when and where of the strategic decision making of a company. CM&C includes the setting of directions and goals, and the evaluation of the company's performance measured against these benchmarks and emerging market risks and opportunities. Accordingly, the second statutory test focuses on management and control decisions made at the highest levels in the company: *Koitaki Para Rubber Estates Ltd v. FCT* (1941) 64 CLR 241 at 244; (1941) 6 ATD 82; (1941) 2 AITR 167.

Location of central management and control

46. Usually these high level decisions are made by the company's board of directors and therefore the place where the board meets is highly relevant in determining where CM&C is located.[10] However, the place where the board meets is not the sole factor for consideration (Lord Radcliffe in *Unit Construction v. Bullock* [1959] 3 All ER 831 (*Unit Construction*)), although it provides a prima facie indicator of where the CM&C is located. However, there may be cases where the company's board is not in fact the high level decision maker (for example, *Malayan Shipping*).

47. Where board meetings are conducted via electronic facilities (rather than physical attendance) the focus is on where the participants contributing to the high level decisions are located rather than where the electronic facilities are based. The fact that a majority of these high level decision makers regularly participate from a jurisdiction other than Australia would support a conclusion that the CM&C is not. located in Australia, particularly where the majority of decision makers usually undertake their company duties and participate in the company's high level decision making processes in that other jurisdiction.

48. In cases where the nature of the business requires the exercise of CM&C at the place where the active business is carried on, the place where the company's business operations occur may be relevant in determining where the CM&C of the company is located: *North Australian Pastoral Co Ltd v. FCT* (1946) 71 CLR 623 at 634 per Williams J.

49. The place where most of the company's high level decision makers are resident, does not of itself determine where the company is resident but may indicate the place where the CM&C of the company is likely to be located: *John Hood and Company Ltd v. Magee* (1918) 7 TC 327.

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[10] When determining tax residence the common law places significant weight on CM&C and the role of the board of directors. This may be contrasted with the approach of many European jurisdictions which use a 'place of management' test that also includes consideration of the location of the senior day-to-day management of the company (for example the chief executive officer). For some countries this test is determinative of residence status.

Third party control

50. A subsidiary whose board of directors does not meet in Australia will nevertheless have its CM&C in Australia if a third party such as the board of an Australian parent exercises CM&C of the subsidiary in Australia.

51. This situation will usually arise where the high level decision makers of a parent company resident in Australia make decisions in Australia regarding the subsidiary's major contracts, finance and general policy and strategic direction.

52. For CM&C to exist the parent company must be participating, in some form, in the high level decision making process of the subsidiary. This could involve some form of decision making in the actual decisions about, for example, trading activities, key personnel, capital allocation, funding and major expenditure.

53. As well as being active, participation in the management and control of the company can be conducted through the 'passive oversight and tacit control' of the affairs of the company: *Mitchell v. Egyptian Hotels Ltd* [1915] AC 1022 at 1039 per Lord Sumner. However, there is still a requirement for some positive action by the third party. For example in *BW Noble Ltd v. Mitchell* (1926) 11 TC 372 (*BW Noble*), CM&C was held to reside with a board that had delegated full power to carry on the companies business in France to a resident of France, but monitored progress reports and gave agreement to a number of proposals.

54. *BW Noble* can be contrasted with *Egyptian Delta Land and Investments Company Ltd v Todd* [1929] AC 1 where it was considered that the mere existence of the capacity for ultimate control was not sufficient to constitute CM&C where the control was not exercised in practice. This is supported in *Mitchell v. Egyptian Hotels Ltd* [1915] AC 1022 at 1039-1040, per Lord Sumner, where it was considered that the legal right to interfere in the making of the company's high level decisions is not of itself CM&C.

55. The parent's high level decision makers cannot exercise CM&C of the subsidiary by merely exerting influence over the high level decision makers of the subsidiary. Further, the power to exercise the rights generally held by a majority shareholder is insufficient, of itself, to establish that CM&C of the company is exercised by the person holding those rights: *FCT v. Commonwealth Aluminium Corporation Ltd* (1980) 143 CLR 646; 80 ATC 4371; (1980) 11 ATR 42; *New Zealand Forest Products Finance NV v. Commissioner of Inland Revenue* 17 NZTC 12,073 (*New Zealand Forest Products Finance*); *Bedford Overseas Freighters Ltd v. Minister of National Revenue*, 70 DTC 6072 at 6080, per Kerr J.

56. The power to remove a high level decision maker or decision makers of the company is also not sufficient, of itself, to establish that CM&C of the company is exercised by the person holding the right. In order to exercise CM&C of the company, the person holding the right

must also be a high level decision maker of the company: *New Zealand Forest Products Finance*; *Esquire Nominees*.

57. The granting of a power of attorney to a person so that they can manage the company's affairs, of itself, does not mean that the person with the power of attorney exercises CM&C of the company. It is possible that other persons (for example persons with the legal right to make high level decisions regarding the company's affairs) continue to participate in the high level decision making by monitoring and evaluating the performance of the person with power of attorney: *Koitaki Para Rubber*.

Board of directors standing aside

58. The fact that a board of directors meets in Australia does not necessarily indicate that CM&C is being exercised if the board is not undertaking high level decision making. For example, the board may be nominees of the real controllers, stand aside from their role and simply rubber stamp decisions made by those controllers.

59. An example of a board standing aside from its role is *Unit Construction*, where the court held that the CM&C of the company was not exercised by its board even though the board had the legal right to exercise CM&C under the company's constitution. The directors did not meet as a board and did not have access to all the information and documents concerning their companies. They were considered as standing aside to the extent that they failed to function as a board. Another example can be found in *Malayan Shipping*, where Williams J acknowledged that the CM&C of the company was in fact exercised by the managing director in Australia and implicitly not at the Singapore meetings of the two Singapore based directors.

60. However, CM&C will be undertaken by a board notwithstanding that it acts on advice or direction, provided it makes the actual decisions for the company. Gibbs J stated at first instance in *Esquire Nominees*[11] that even if it was accepted that the decision makers of the company did what the company's advisers told them to do, it did not necessarily follow that the control and management of the company's affairs lay with the advisers. He acknowledged the possibility that the advisers in *Esquire Nominees* exerted strong influence on the company directors but found that even though the advisers had power to exert influence on the company directors, that power of itself did not amount to the advisers exercising control and management of the company. He also considered that had the advisers instructed the company's directors to 'do something which they considered improper or inadvisable' that he did not believe that the directors would have acted on the instruction. He found that the directors in fact complied with the wishes of the advisers because they accepted that it was in the interest of the beneficiaries, having regard to the tax position, that they should give effect to the scheme.

[11] (1973) 129 CLR 177; 72 ATC 4076.

He decided, on the facts of *Esquire Nominees*, that the company directors were the high level decision makers of the company.

Location of central management and control in more than one country

61. Generally the CM&C of the company is located in one place. However, in some situations the courts have acknowledged the possibility that the company's CM&C could be divided between two or more places: *The Swedish Central Railway Company Ltd v. Thompson* (1925) 9 TC 342; *Egyptian Delta Land and Investments Company Ltd v Todd* [1929] AC 1; *Koitaki Para Rubber Estates Ltd v. FCT* (1940) 64 CLR 15 at 19, (1940) 6 ATD 42 at 45, per Dixon J, (1941) 64 CLR 241 (Full High Court). This is where the control of the company's general affairs (that is, 'the superior or directing authority by means of which the affairs of the company are controlled') is located in several places, and the control of the company's general affairs is divided between the places in such a way that on the facts it is not 'centred' in one place in particular. However, it is necessary that 'the exercise of that power and authority is to some substantial degree found' in a place for the CM&C to be located there (and elsewhere): *Union Corporation Ltd v. Inland Revenue Commissioner* (1952) 34 TC 207 at 271.

Examples

Example 1 – mere trading in Australia without CM&C in Australia

Example 1(a)

62. Cup Co is incorporated in Singapore, where its directors and the majority of its shareholders are resident. Some of Cup Co's business activities are conducted in Australia, other business activities take place outside Australia. All meetings of the board of directors take place in Singapore. At these meetings, decisions on the major contracts entered into by Cup Co, its finance, major policies and strategic directions are made. The members of the board also undertake their other directorial duties in Singapore.

63. Cup Co is not a resident of Australia under the second statutory test. Although Cup Co is carrying on business in Australia, its CM&C is located in Singapore and not in Australia. The mere fact that Cup Co carries on a business in Australia is not enough, in the absence of the exercise of CM&C in Australia, to satisfy the second statutory test.

Example 1(b)

64. The facts are the same as Example 1(a), but one out of every four Board meetings is held in Australia. It is considered that high level decision making is not exercised to a 'substantial degree' by the

board of Cup Co in Australia. Thus, holding a minority of board meetings in Australia would not by itself constitute CM&C in Australia and Cup Co would not be a resident of Australia under the second statutory test.

Example 1(c)

65. The facts are the same as Example 1(a), but two of Cup Co's ten directors are resident in Australia. Cup Co would not be a resident of Australia under the second statutory test, as having a minority of board members resident in Australia would not by itself constitute CM&C in Australia.

Example 1(d)

66. The facts are the same as for Example 1(c), but the two Australian directors participate in the Board meetings held in Singapore from Australia by videoconference. As with Example 1(b), high level decision making is not exercised to a 'substantial degree' by the board of Cup Co in Australia. The fact that a minority of board members located in Australia participate by videoconferencing in a Board meeting held by a majority of members in Singapore will not be sufficient to constitute CM&C and Cup Co would not be a resident of Australia under the second statutory test.

Example 1(e)

67. The facts are the same as for Example 1(d), but one out of every four Board meetings (Example 1 (b)) is also held in Australia. Having only one in every four Board meetings in Australia, and two (out of ten) Australian directors participate in Singapore meetings by videoconference would not mean that high level decision making is exercised to a 'substantial degree' by the board of Cup Co in Australia. Thus, Cup Co would not have its CM&C in Australia and would not be a resident of Australia under the second statutory test. However, if a majority of board meetings were to be held in Australia, the position is likely to be different.

Example 2 – CM&C in Australia with trading outside Australia

68. Trade Co is incorporated in Papua New Guinea, but its board of directors holds the majority of its meetings in Australia where decisions on the major contracts entered into by Trade Co, its finance, major policies and strategic directions are made. Trade Co undertakes all its trading activities in Papua New Guinea.

69. Trade Co is not a resident of Australia under the second statutory test. Although Trade Co has its CM&C in Australia, it is not carrying on business in Australia.

70. The fact that Trade Co has Board related, administrative support in Australia does not change this outcome, as such activity is considered to be part of the activities of the Board, and not the carrying on of a business of the company.

Example 3 – Investment company – resident in Australia

71. Worldwide Investments Co. Limited is incorporated in New Zealand and is an investment company. Its board of directors, which always meets in Sydney, makes all the decisions as to which companies' shares it will buy. For example the board decides to dispose of its investment in X Co and reinvest the funds equally in Y Co and Z Co. The CM&C rests with the Board.

72. As the directors are not only exercising the CM&C of the company, but also carrying out the business of the company by deciding which shares to buy, the company is carrying on business in Australia. As Worldwide Investments Co. Limited's CM&C is located in Australia and it is carrying on business in Australia, it is a resident of Australia under the second statutory test.

Example 4 – Investment company – not resident in Australia

73. Equity Corporation is a company managing a large portfolio of investments and is incorporated in New Zealand. It holds shares in companies around the world. The Board of Directors of the company regularly meets in Australia where they determine the types and locations of companies where the company's portfolio will be invested. For example, they decide to favour investments in high technology stocks as follows: 40% in United States shares, 40% in European shares and 20% in Japanese shares. However, the decisions as to which companies' shares should be purchased and all other associated activities are made by Equity Corporation's officers in New Zealand.

74. While the directors are exercising the CM&C of the company, it is considered that they are not carrying out the business of the company as they are not deciding which shares to buy. Thus, the company's CM&C is located in Australia but it is carrying on its business of investment in New Zealand. As the company does not carry on business in Australia, the company is not a resident of Australia under the second statutory test.

Example 5 – Investment company – possible Australian controller

75. Boom Co was set up by Ben, an Australian resident. It is incorporated in Hong Kong and has two directors who are resident in Hong Kong and who hold board meetings in Hong Kong. Each director has two shares in Boom Co which they hold on trust for Ben. Boom Co owns real property all of which is outside Australia and

makes its profits from commercial property leases on a large scale. Ben does not attend the board meetings in Hong Kong, however, the constitution of Boom Co provides that the decisions of the directors are only effective if Ben concurs with them. The directors carry on all operational activities such as collecting rent, paying commission, finding tenants, making minor repairs and maintaining the buildings.

76. The residence status of Boom Co under the second statutory test will differ depending on the types of decisions and activities that Ben undertakes.

77. *Possibility 1* – The level of control that Ben exercises is so minor that he is not making high level management decisions and his activities are so insubstantial that he is not participating in the business of the company. Such activities might include contacting the directors irregularly for an update on the business without interfering in their decisions or checking property prices and rents in the area without giving directions to the company. Boom Co is not a resident of Australia as it is not carrying on business in Australia nor is its CM&C in Australia.

78. *Possibility 2* – Both the directors and Ben exercise a sufficient degree of control over the high level decisions of the company that CM&C is exercised in both places. Such high level decisions might include directions that the company only concentrate on commercial leases, the rents be increased by 20% across the board or that major refurbishments take place. The activities that constitute the business of the company, such as the actual investment decisions, the execution of leases, finding tenants, collection of rent, paying commission, making minor repairs and maintaining the buildings are only carried out offshore. Boom Co is not a resident of Australia as it is not carrying on business in Australia, but its CM&C is located in both Australia and Hong Kong.

79. *Possibility 3* –Ben solely exercises the power to make high level decisions regarding the company's leases, funding, leasing policies, strategies etc, but not participating in the management of the company, such as the actual investment decisions, the execution of leases, finding tenants, the collection of rents, paying commission, making minor repairs and maintaining the buildings. Boom Co is not a resident of Australia as it is not carrying on business in Australia, but its CM&C is solely located in Australia.

80. *Possibility 4* - Ben makes all high level decisions regarding the company's leases, funding, leasing policies, strategies and investment decisions, as well as managing Boom Co’s day to day activities. Ben makes the key investment decisions in Australia and the associated activities are conducted in Australia (for example, the payment of all expenditure, vetting of all tenants and the detailed monitoring of rental payments via the internet). The directors step aside from making any decisions in respect of the company. In this regard, the facts are similar to those in *Malayan Shipping* in that all high level and operational decisions in respect of Boom Co are made

in Australia. Boom Co is a resident of Australia as it is carrying on business in Australia and its CM&C is located in Australia.

Example 6 – company carrying on an active business

81. Watch Co is a company that is not incorporated in Australia. Watch Co distributes watches in the Australian market and warehouses its goods in Australia for distribution in the South East Asian market. Half of the board of directors of Watch Co reside in the country in which Watch Co is incorporated and the remaining board members reside in Australia and also participate in the process in Australia leading up to the making of high level decisions. The board holds the majority of its meetings in Australia where it makes high level decisions regarding the company's major contracts, finance and general policies and strategic directions in respect of its business operations.

82. As the majority of board meetings occur in Australia then Watch Co will be taken to have its CM&C in Australia under the approach set out in paragraph 15. Watch Co is resident in Australia under the second statutory test as it carries on business in Australia (for example, its trading activities) and has its CM&C located in Australia.

Example 7 – Parent company – subsidiary does not carry on a business in Australia

83. Parent Co is incorporated and has its CM&C in Australia. Its wholly owned subsidiary, Sub Co, is incorporated in Hong Kong, has all of its board meetings in Hong Kong and carries on a trading business wholly outside Australia. As Sub Co is not carrying on a business in Australia, nor has its CM&C in Australia it is not a resident of Australia under the second statutory test.

84. As Sub Co is not carrying on a business in Australia, it will not be a resident of Australia under the second statutory test even if some or all of its board meetings are undertaken in Australia, or some or all of its high level decision making is undertaken by Parent Co.

Example 8 – Parent – subsidiary company carries on business in Australia

85. Australian Co is incorporated and has its CM&C in Australia. Its wholly owned subsidiary, Worldwide Co, is incorporated in Hong Kong, has all of its board meetings in Hong Kong, and carries on part of its business in Australia. All contracts relating to the business of Worldwide Co are signed by its board of directors in Hong Kong. Australian Co controls the finance provided to Worldwide Co and approves the major items of expenditure but does not make any other high level decisions regarding the operations of Worldwide Co.

86. As Worldwide Co trades in Australia, it satisfies the first requirement of the second statutory test because it carries on business in Australia. However, the CM&C of Worldwide Co rests with its board of directors in Hong Kong because the board participates in the high level decision making process offshore. The functions exercised by Australia Co are not sufficient for it to be undertaking CM&C of Worldwide Co. Therefore, Worldwide Co does not satisfy the second requirement of the test and is not a resident of Australia. Nevertheless, Worldwide Co satisfies the third company residence test (that is, its voting power is controlled by shareholders resident in Australia and it carries on business in Australia).

Example 9 – manager conducting business on company's behalf

87. Yellozz Co is a small company incorporated in Hong Kong. It carries on business in Australia and other parts of the world. The directors of Yellozz Co reside, hold board meetings and undertake their other duties as high level decision-makers, in Hong Kong. The majority of Yellozz Co's shareholders reside outside Australia.

88. The board appoints one of the company's employees as the Australian manager of the business. The Australian manager has a power of attorney to conduct business in Australia on the company's behalf, including the power to make decisions regarding major contracts in Australia, sources of loans and general policies and strategies for the Australian business.

89. The Australian manager has the power to implement these decisions without reference to the board and often does so. However, the board retains the power to override any decision before Yellozz Co is bound by that decision. The board can also remove the Australian manager as a decision maker of the company. During board meetings the board makes high level decisions regarding Yellozz Co. In addition, during the board meetings the board monitors and evaluates the Australian manager's performance. The board finds that the Australian manager is performing competently and decides that there is no need to take any action in respect of the decisions made by the manager.

90. Yellozz Co is not an Australian resident under the second statutory test. The high level decision making of Yellozz Co is ultimately exercised by its board of directors in Hong Kong (that is, outside Australia) as the board oversees the decisions made by the Australian manager (an employee of Yellozz Co), actively makes other decisions regarding Yellozz Co (particularly decisions regarding its business operations outside Australia) and undertakes other high level functions in the country of incorporation.

91. Although the Australian manager makes some high level decisions regarding Yellozz Co's Australian operations, this does not of itself mean that the CM&C of Yellozz Co also lies with the manager in Australia. Other factors indicate that the CM&C of the company is

exercised by the board of directors outside Australia and not by the company's manager in Australia, in particular:

(a) the board continues to participate in the high level decision making of Yellozz Co by monitoring and evaluating the performance of the Australian manager in the manager's exercise of the power of attorney;

(b) the board actively makes other high level decisions regarding Yellozz Co including decisions that impact upon its Australian business. The Australian manager makes no decisions regarding the overseas business operations of Yellozz Co – these decisions remain with the board of directors. Therefore the board deals with a range of high level issues outside of Australia; and

(c) the board can revoke the Australian manager's power of attorney and make all decisions itself in relation to the Australian operations (that is, has both the power to remove the decision maker and the power to make the decisions itself).

Consequently the CM&C of Yellozz Co is with its board outside Australia.

Example 10 – sole employee company

92. ByteT Co, a company not incorporated in Australia, provides computer consultancy services. These services are provided by its sole director, shareholder and employee, Stuart, who also manages and controls the company. The company accepts a contract in Australia for a period of four months. Stuart usually resides outside Australia and is non-resident for Australian income tax purposes during his time in Australia. Whilst in Australia, Stuart also accepts two additional short-term contracts from other Australian entities on behalf of ByteT Co. These two contracts are to be undertaken concurrently with the existing contract by Stuart in Australia.

93. ByteT Co is not a resident of Australia under the second statutory test. The high level decision making of the company is not normally exercised in Australia and indeed may not actually be exercised while Stuart is in Australia. Therefore the CM&C of ByteT Co is not located in Australia even though it carries on business in Australia during the term of the contracts.

Your comments

94. We invite you to comment on this draft Taxation Ruling. We are allowing 6 weeks for comments before we finalise the Ruling. If you want your comments to be considered, please provide them to us within this period.

Comments by Date: **6 August 2004**
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Detailed contents list

95. Below is a detailed contents list for this draft Taxation Ruling:

Commissioner of Taxation
23 June 2004

Previous draft:
Not previously released as a draft

Related Rulings/Determinations:
TR 92/20

Subject references:
- carries on business in Australia
- central management and control
- residence of companies
- resident

Legislative references:
- ITAA 1936 6(1)
- ITAA 1936 6(1)(b)
- ITAA 1997 995-1(1)
- TAA 1953 Pt IVAAA

Case references:
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- Beckwith v. R (1976) 135 CLR 569
- Bedford Overseas Freighters Ltd v. Minister of National Revenue, 70 DTC 6072
- Brennan v. Comcare (1994) 50 FCR 555; (1994) 122 ALR 615
- Broken Hill South Ltd (Public Officer) v. Commr of Taxation (NSW) (1937) 56 CLR 337
- BW Noble Ltd v. Mitchell (1926) 11 TC 372

- California Copper Syndicate (Limited and Reduced) v. Harris (1904) 5 TC 159
- Charles v. FC of T (1954) 90 CLR 598; 6 AITR 85
- De Beers Consolidated Mines Ltd v. Howe [1906] AC 455
- Egyptian Delta Land and Investment Company Ltd v Todd [1929] AC 1
- Esquire Nominees Ltd v. FCT (1973) 129 CLR 177; 72 ATC 4076 (High Court); (1973) 129 CLR 177; 73 ATC 4114; (1973) 4 ATR 75 (Full High Court)
- FCT v. Commonwealth Aluminium Corporation Ltd (1980) 143 CLR 646; 80 ATC 4371; (1980) 11 ATR 42
- FCT v. Total Holdings (Australia) Pty Ltd 79 ATC 4279; (1973) 9 ATR 885
- IRC v. Westleigh Estates [1924] 1 KB 390
- Jackson v. Secretary, Department of Health (1987) 75 ALR 561
- John Hood and Company Ltd v. Magee (1918) 7 TC 327
- John v. FCT (1989) 166 CLR 417; 89 ATC 4101; (1989) 20 ATR 1
- Koitaki Para Rubber Estates Ltd v. FCT (1941) 64 CLR 15 (High Court); (1941) 64 CLR 241; (1941) 6 ATD 82; (1941) 2 AITR 167 (Full High Court)
- Lilydale Pastoral Co Pty Ltd v. FCT (1987) 15 FCR 19; 87 ATC 4235; 18 ATR 508; (1987) 72 ALR 70
- Malayan Shipping Co Ltd v. FCT (1946) 71 CLR 156; (1946) 8 ATD 75; (1946) 3 AITR 256
- Mitchell v. Egyptian Hotels Ltd (1915) AC 1022
- New Zealand Forest Products Finance NV v. Commissioner of Inland Revenue 17 NZTC 12,073
- North Australian Pastoral Co Ltd v. FCT (1946) 71 CLR 623; (1946) 8 ATD 121; (1946) 3 AITR 314
- Ogden Industries Pty Ltd v. Lucas [1970] AC 113
- Paisner v. Goodrich [1955] 2 QB 353 at 358
- Project Blue Sky Inc v. Australian Broadcasting Authority (1998) 194 CLR 355
- Radnor Pty Ltd v. FC of T (1990) 21 ATR 608; 90 ATC 4637
- The Swedish Central Railway Company Ltd v. Thompson (1925) 9 TC 342
- Union Corporation Ltd v. Inland Revenue [1953] 34 TC 207
- Unit Construction Co Ltd v. Bullock [1960] AC 351; [1959] 3 All ER 831
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Other references:

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