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Submission to The Board of Taxation Review of Corporate Tax Residency Consultation Guide

The Business Council of Australia (BCA) and the Corporate Tax Association (CTA) welcome the opportunity to provide a submission to The Board of Taxation Corporate Tax Residency Consultation Guide (the Guide). We also appreciated the opportunity to discuss the issues with the Board's Working Group and other stakeholders in Melbourne on 2 October.

Overview

This consultation is a timely opportunity for a considered debate on the issue of corporate residency particularly against the backdrop of the OECD work on the tax issues associated with the digitalisation of the economy.

Tax outcomes are important for attracting investment, and a competitive tax system should be complemented by robust tax integrity measures.

But individual tax integrity arrangements (which one could argue is the ATO's position in Practical Compliance Guideline PCG 2018/9) need to reflect, and be mindful of, the modern business environment and the full tax integrity suite in the Income Tax Assessment Acts, Australian Tax Treaties and the Multilateral Instrument.

The residency rules (the law and the taxation rulings and practical compliance guides that support them) should operate to encourage and not hinder economic growth or place unnecessary compliance costs on taxpayers. They should also operate in a way that provide companies with a high level of certainty of outcomes.

Key recommendations

In our view:

1. The working group should consider as a first option a recommendation to codify the purpose and effect of the withdrawn Taxation Ruling TR 2004/15, appropriately adjusted to reflect changes in modern business structures and communication technologies that have occurred in the 15 years since the withdrawn Ruling was first issued; and

2. Any such change should be reviewed when the outcomes of the OECD deliberations on its current work on the Taxation of the Digitalisation of the Economy are known.

Context

Australia's economic environment is being shaped and framed by major forces, including:

- The ongoing economic shift toward Asia
- The impact of demographic change and population ageing
- The increasing emergence of 'disruption' as a new and dynamic element of innovation.

Economic growth has slowed this past decade, as has real wages growth, with weak productivity growth the underlying driver. Both the Productivity Commission and the Treasury have recently noted the importance of investment – capital deepening – for Australia's long-run growth prospects. Capital deepening (that is, investment) has been the largest contributor to labour productivity growth. However, as the Treasury recently noted, "capital deepening has also softened, recently reaching the point of 'capital shallowing'. This has been broad-based and is not only related to the end of the mining-investment boom."[1] A competitive tax system is a critical component to attracting investment to Australia.

At the same time, globalisation and the liberalisation and integration of markets and value chains have made capital increasingly mobile. Australia is enjoying the benefits of increased integration with the global economy, and Australian businesses have increased opportunities to operate globally. As noted above, retaining and attracting foreign investment from inbound investors is critical to building Australia's capital base and increasing productivity. Multinational companies account for around a third of global GDP and around two-thirds of global exports.[2] The subsidiaries of multinationals account for around 10 per cent of global GDP and are critical for the entire value chain as they cooperate and contract with domestic companies. The success of large and small business is closely linked as multinationals "typically rely on SMEs to become global firms and expand internationally." Treasury analysis has also found that larger businesses tend to be more productive and pay higher wages. The key is 'capital per worker', in other words, how much investment the business has done over time.[3]

Australia's policy settings must reflect the realities of our economy and the need to be competitive with the dynamic economies in our region. This includes critically evaluating and where possible reducing the cost of compliance of tax rules and interpretations thereof that restrain people and businesses from realising their full potential, including by discouraging investment, increasing compliance costs and driving uncertainty. This of course needs to be appropriately balanced against ensuring the integrity of Australia's tax base.

There is a high degree of uncertainty around the central management and control (CM&C) test for corporate tax residency as articulated in Taxation Ruling TR 2018/5 and Practical Compliance Guideline PCG 2018/9. This uncertainty, coupled with the consequences of a non-resident Australian company becoming a resident of Australia (or a prescribed dual resident of Australia or a foreign jurisdiction), has created undue compliance burdens on Australian and overseas based corporates that need to be addressed.

Modern business practices

Like previous waves of technological change including transportation, communications and computer applications, digitalisation has had a profound effect on consumers and businesses in both Australia and around the world. Individuals can more readily purchase goods and services from overseas, or invest in the shares of overseas companies, than ever before. Similarly, businesses small and large can more readily connect to customers locally and overseas.

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[1] Quinn, M 2019, Keeping pace with technological change: the role of capabilities and dynamism, viewed 4 October 2019, https://treasury.gov.au/speech/s2019-390085

[2] De Backer, K, Miroudot, S & Rigo, D 2019, Multinational enterprises in the global economy: Heavily discussed, hardly measured, viewed 27 September 2019, https://voxeu.org/article/multinational-enterprises-global-economy

[3] The Australian Government the Treasury 2017, Analysis of wage growth, November 2017.

Consumers and businesses have always been able to interact across borders, without a physical presence. However, the scale of these capabilities has increased with the digital economy. To illustrate, a modern multinational company can have:

- shareholders scattered across the world;
- a parent company resident in one country, and listed in another country;
- subsidiaries undertaking an array of activities, such as management, R&D, production, marketing and finance across many countries; and
- consumers around the world.

The location of activities and operations can be based on factors which include access to capital, labour, services, and tax and regulatory environments. Research shows that trust plays an important role in a company's willingness to decentralise decisions from corporate headquarters.[4] In turn, trust increases aggregate productivity by facilitating the reallocation of resources between firms and allowing more efficient firms to grow, as decisions can increasingly be decentralised.

Board meetings are typically held in a single location with directors there in person. This was particularly the case in the past, but advances in communication and the integration of supply chains across the globe have changed modern corporate governance. Management and control of different business lines and operations can be split across multiple locations – and potentially at the same time. In the context of a corporate tax residency test, no single test may reflect these circumstances – particularly as they arise for subsidiaries.

Why does corporate tax residency matter?

Corporate residency matters because it determines, in conjunction with sourcing rules, how the operations and profits of a company will be subject to Australia's tax rules, or those of other countries. It impacts, amongst other things, whether a company can distribute franking credits to shareholders, be part of a consolidated group, whether withholding taxes apply and the application of Australia's tax treaties.

As the Board of Taxation's Consultation Guide outlines (and ignoring the voting power test for current purposes), a company incorporated outside of Australia is taken to be a resident in Australia for tax purposes if it carries on business here and has its central management and control in Australia. As the Guide notes at page 6, it is a two-limbed test. Effectively it is a facts and circumstances test, and thus by its nature can be difficult to provide certainty in application as the same facts may be applied to both limbs in some cases. The ATO's recent Ruling and PCG can be seen as a valiant attempt to provide some legal and practical certainty off the back of an ATO view that the withdrawn Taxation Ruling TR 2004/15 did not reflect the current law.

The Guide provides an excellent technical summary of the context for the review in Chapter 4 and we note in particular the summary of the *Malayan Shipping* case. This was a case of determining whether the company carried on business in Australia and not a CM&C case as the latter was conceded by the taxpayer. The *Bywater* decision in our view is a case where the same facts were applied to satisfy the separate limbs of the test and not a case which merged the carrying on of a business and the separate CM&C limbs. It is not new law.

As noted in the *Bywater* decision, the corporate tax residency test was introduced in 1930 into the Income Tax Assessment Act 1930 and was a statutory adoption of an English case from 1876,[5] some 143 years prior. This was the same year in which the first direct telegraph line was established between Britain and New Zealand.[6] Some four years later in 1880, the first telephone exchanges were introduced into Australia.[7]

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[4] Bloom, N, Sadun, R & Van Reenen, J 2012, 'The Organization of Firms Across Countries', *The Quarterly Journal of Economics*, vol. 127, issue 4, pp. 1663-1705

[5] Bywater and Commissioner of Taxation [2016] HCA 45 at page 15, paragraph 40.

[6] https://www.onthisday.com/events/date/1876

[7] https://www.vintagephones.com.au/ccp0-display/history-of-the-telephone-exchange-in-australia.html

Whilst commerce and thus business practices have evolved since 1930, Australia's tax integrity laws have also changed over this time to deal with integrity concerns, building off the 143 year old CM&C principles. Successive parliaments have sought to maintain the integrity of the tax system by updating measures such as transfer pricing rules, the foreign source income anti-tax-deferral regime, general anti-avoidance rules, the diverted profits tax, thin capitalisation rules and anti-hybrid rules to name a few. These measures complement each other and provide Australia with a robust and holistic set of integrity measures. Indeed, Treasury recently observed that "prior to the implementation of the BEPS recommendations, Australia had some of the strongest tax integrity rules in the world. Since 2015, Australia has implemented a number of the BEPS recommendations, further strengthening our tax laws to protect against profit shifting by multinational enterprises".[8] The ATO has measured the tax gap for large companies to be $1.8 billion or (4.4 per cent) in 2015-16.[9] It has recently suggested that this figure is approaching 2 per cent.[10]

It is our view, that whilst there may be an argument the *Bywater* case is justification for saying Taxation Ruling TR 2004/15 should be withdrawn, there is a better view that nothing has changed with *Bywater*. This is because the CM&C issue is essentially applying the facts to settled principles and not a new interpretation of the law. Whilst the ATO may hold a view the TR 2004/15 did not reflect that law, in our view there is nothing that required the ruling to be withdrawn, particularly given the context in which the withdrawn ruling was originally drafted as outlined in the Board Guide at page 9. If a change was required, possibly due to some of the inherent "practical guides" in that ruling, the withdrawn ruling could simply be amended and the "guideposts" placed into a revised Practical Compliance Guideline.

In this light, it is our view that the practical application of the corporate tax residency test should be clear, practical and compatible with modern corporations (and business structures such as dual listed companies) and not be driven by the extreme facts in the *Bywater* case. The rules should operate in the context of Australia's robust integrity regime and well-resourced and extremely competent tax administration. The test should minimise compliance costs and not unduly hinder the operation of companies by requiring them to rearrange their affairs to comply with the test – often for little or no practical benefit. On this point, it is still not clear what revenue is at risk from changing from the approach adopted in withdrawn Tax Ruling TR 2004/15.

1 What are some of the practical issues with the current rules and ATO guidance?

As part of collating this submission, the CTA undertook a brief survey of its members to seek their views on the current state of the law and the ATO's current ruling and PCG. A copy of the results of the survey are attached as an Appendix to this submission. The survey elicited 25 responses (or about 20% of the CTA membership base). It is worth noting not all CTA members have overseas operations, so in our view the survey is representative, covering both outbound and inbound groups and most industry sectors including financial services, mining, energy and manufacturing.

The first question asked in the survey was for a "yes" or "no" response to nine questions. The responses indicate a clear view that the current law, and the ATO's interpretation of that law through Taxation Ruling TR 2018/5 and Practical Compliance Guideline PCG 2018/9, are not aligned with the practical realities of modern business. They are creating unnecessary conservatism in the approach of large corporates to managing the CM&C test of residency.

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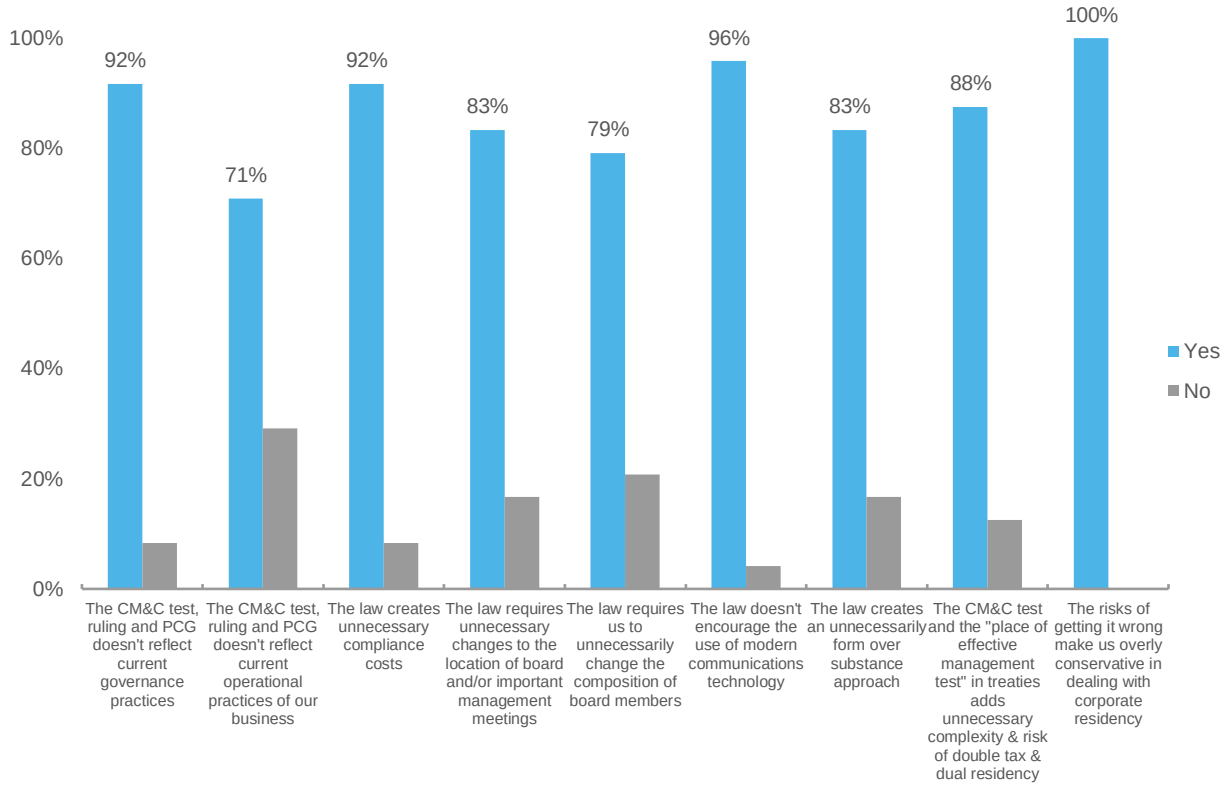
[8] The Australian Government the Treasury (2018), The Digital Economy and Australia's Corporate Tax System, Treasury Discussion Paper, October 2018.

[9] https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/?anchor=Summaryfindings#Summaryfindings

[10] McIlroy, T 2019, *Multinational compliance at 98pc: ATO*, The Australian Financial Review, viewed 1 October 2019, https://www.afr.com/politics/federal/multinational-compliance-at-98pc-ato-20190920-p52t85

Figure 1: Practical difficulties with the current CM&C test



Comments were provided as context to the answers including many examples of the technical uncertainties with a potential Australian resident status (note for example comments 1 and 8 on pages 3 and 4 of the Appendix).

It is clear the current corporate tax residency test (in practice the current ruling and PCG) creates several practical uncertainties, can be onerous and unnecessarily increase compliance costs as the risk of getting it wrong has driven organisations to be overly conservative in dealing with corporate residency. The practical implications are:

- Australian executives must be offshore to avoid the risk that an offshore subsidiary that is majority Australian owned could be considered to carry on business in Australia
- Australian executives must travel offshore to attend board meetings – even attendance via telephone or video conferences can be problematic
- Australian resident directors may avoid board meetings when they cannot, for whatever reason, travel offshore (and where attendance by phone or videoconference is problematic under the current test)
- it encourages the appointment of non-Australian resident directors and executives to the management and boards of offshore subsidiaries and joint ventures; and
- it discourages the use of Australia as a location for the regional or global management and strategic oversight of offshore subsidiaries.

Some further examples from the survey of how corporates have reacted to the current Ruling and PCG include:

- Where directors are located in more than one country, corporates are flying non-Australian based directors to Australia for monthly board meetings.

- Tax managers dictating to business which individuals can be directors of foreign subsidiaries and where meetings can take place and by what means they can occur.

- Flying general managers out of the country for board meetings, with the "complete waste of time, cost, environmental impact and the message it sends when organisations more broadly are trying to encourage the take up and use of electronic meeting and collaboration facilities".

As one respondent noted:

> "The consequences of getting it wrong is in most cases hard to quantify and even more difficult to articulate to a non-tax audience (e.g. company secretary, senior management and board members). [The] only way of easily articulating is that it places the company in an uncertain position on the tax outcomes of its tax structure which would not be feasible to any multinational. This then unhelpfully feeds into perception[s] of Australia as a sovereign risk jurisdiction".

These outcomes are not in the interests of Australia as a hub for internationally-focused companies. The steps required to comply with the test interfere with the efficient operation of companies, create uncertainty and increase compliance costs. The tax consequences of triggering Australian residency can be significant and in some cases outweigh the costs of complying/practical implications noted above. Accordingly, companies will tend to take the approach that minimises these risks and thus it will be compliance that drives outcomes rather than the most efficient way to do business. Indeed, all respondents to the CTA's survey agreed with the statement "the risks of getting it wrong make us overly conservative in dealing with corporate residency".

The operation of the test in this way can reduce the involvement of an Australian parent company and inhibit talented Australian managers from using modern technology to fulfil their duties from Australia. The restricted Australian involvement in, and supervision of, overseas subsidiaries reduces the ability to properly manage overseas operations – which is necessary at times. Ultimately, these potential outcomes are contributing to Australia being a less competitive investment destination.

2 What are potential improvements to the test?

The BCA and CTA support a corporate tax residency outcome that is pragmatic, provides for ease of operation and balances compliance and administration costs, the integrity of our tax system and Australia's taxing rights versus those of other countries.

It may be difficult in practice to reflect the day-to-day management of business through a test. A common concern throughout the Board of Taxation's Guide, and indeed reflected in the OECD's Model Tax Convention 2017 is the following:

> *It is therefore concluded that a better solution to the issue… was to deal with such situations on a case-by-case basis.*

That is, there may be inherent uncertainty regardless of the approach taken. A move to a "place of effective management" test from a CM&C test could address some of the issues, but would ultimately lead to its own definitional issues. Furthermore, a change may be open to further interpretation issues from the ATO and a further period of uncertainty until those issues are settled. However, the CTA member survey highlights it is not an alternative that receives strong support among members.

Another viable solution could be to codify the views expressed in TR 2004/15, possibly adjusted for changes in business practices over the past 15 years. This could be achieved whilst retaining the ATO's right to apply its resources and integrity rules to prevent manipulation of residency status along similar lines to that articulated in sub-paragraph 107(c) of PCG 2018/9. That paragraph states that the ongoing compliance approach for listed groups will not apply if:

(c) the company has undertaken or entered:

(i) any artificial or contrived arrangement affecting the location of its central management and control, including previous or subsequent 'migration' of residency
(ii) a tax avoidance scheme whose outcome depends, in whole or part, on the location of its residence
(iii) arrangements to conceal ultimate beneficial or economic ownership, or
(iv) arrangements involving abuse of board processes including backdating of documents or the board not truly executing its functions.

3 What are the preferences for improvements to the residency issue?

The CTA survey includes some detailed suggestions by respondents for alternative tests that could be considered. It also provides an indication of the preferences of large inbound and outbound groups of five potential tests including:

1. Adopting a place of incorporation test only with an integrity rule to stop manipulation of residency status

2. Aligning the CM&C test with a place of effective management test as per Australia's treaties

3. Returning to the effective two limb view of residency requiring CM&C and carrying on of a business in Australia as per withdrawn ruling TR 2004/15

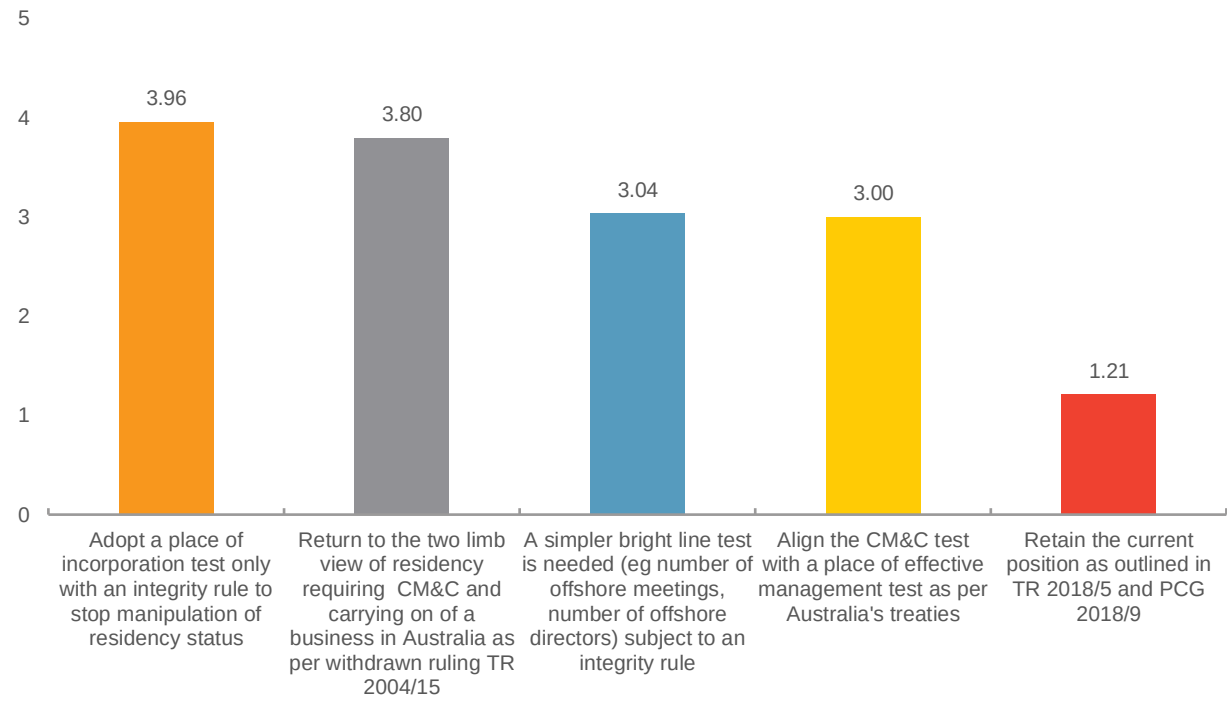
4. A simpler bright line test (e.g. number of offshore meetings, number of offshore directors) subject to an integrity rule

5. Retaining the current position as outlined in TR 2018/5 and PCG 2018/9.

One survey question asked respondents to rank from 1 to 5 these five options (with 1 being the first preference and 5 the last preference). A weighted average of responses (calculated by multiplying its individual ranking by the share of respondents who gave that ranking - that is, a first preference receives a 5, second a 4 and so on) shows there to be very little difference in respondent's preferences for adopting an incorporation test with an integrity measure (3.96 out of 5) or a return to the position adopted in withdrawn ruling TR 2004/15 (3.80 out of 5). A "simpler bright line" test or a test based on place of effective management scored ranked similarly with a score of around 3 out of 5.

The existing position as outlined in TR 2018/5 and PCG 2018/9 received a significantly lower weighted average at 1.21. It is worth noting that if 100% of respondents had adopted this option as their last preference, the score would be a "1".

Figure A4: Weighted average of preferences – maximum score of 5



The full results for each preference are contained in the Appendix.

4 A place of incorporation test

The BCA and CTA note a move to a residence test based on country of incorporation would be simple to apply in practice, significantly reduce compliance costs and deal with most issues raised in both this submission and the Board of Taxation's Guide. Such a move however should be carefully considered, mindful of its interaction with Australia's existing strong integrity measures, potential revenue impacts and interaction with Australia's treaty network and the Multilateral Instrument. It could include an integrity rule to stop manipulation of residency status.

5 The voting power test

The Appendix at page 14 deals with Consultation Question 6 asking whether there is any compelling reason for retaining the alternative voting power test in the event the CM&C test is replaced. 92% of respondents did not see a compelling reason to retain this test. Detailed comments are provided in the Appendix.

It is worth noting that there is an argument that a slight tweaking of the voting power test to allow the test to apply to the ultimate shareholder or controller being an Australian resident as opposed to the immediate shareholder may have dealt with the concerns expressed in the *Bywater* case and possibly cases where the CFC rules would not operate to tax the income of the non-resident CFC.

6 Other General Comments

We would encourage the working group to read the general comments section of the Appendix at page 16.

We note in passing one (amongst many) insightful observations:

> "An overly complicated application of the tests of residency or an expanded scope of residency is not justified and runs contrary to the Government's "cutting red tape" agenda. It leads to further uncertainty for corporates and additional compliance costs as noted on page 18 of the BOT Consultation Guide. From a policy perspective, the Government should encourage Australian

headquartered corporates to grow and expand offshore with the aim of facilitating Australian jobs growth and other economic benefits such as increasing shareholder value. A strict and overly complicated residence test does not help promote such policy objectives and could act as an impediment to growth or increase costs and the competitiveness of Australian businesses particularly in a global environment where Australian has one of the highest corporate tax rates in the world.

Furthermore, Australia has also adopted the tie-breaker rule in Article 4(1) (as modified by Article 4(3)(e)) of the Multilateral Instrument (MLI). Article 4(1) of the MLI requires that the two competent authorities determine, by mutual agreement, the jurisdiction in which the dual resident is deemed to be a tax resident. Due to the combined effect of the new tie-breaker test and the ATO's broader interpretation of the CM&C test, entities which could be viewed as dual residents will face increased administrative burdens and costs in establishing their tax residence for treaty purposes and will need to engage with the ATO and other relevant tax authorities. There is also the risk of a loss of treaty benefits if a mutual agreement cannot not be reached by the two relevant competent authorities."

Please feel free to contact us directly should you wish to discuss any aspect of this submission or the Appendix.

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Executive Director
Corporate Tax Association

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Appendix 1

CTA Corporate Residency Survey

Contents

BACKGROUND

The CTA undertook a survey of membership on questions raised in the Board of Taxation Consultation Guide on corporate residency receiving 25 responses. The following provides the outcomes of the survey and includes all comments received by respondents.

Figure A1: Ownership of respondents

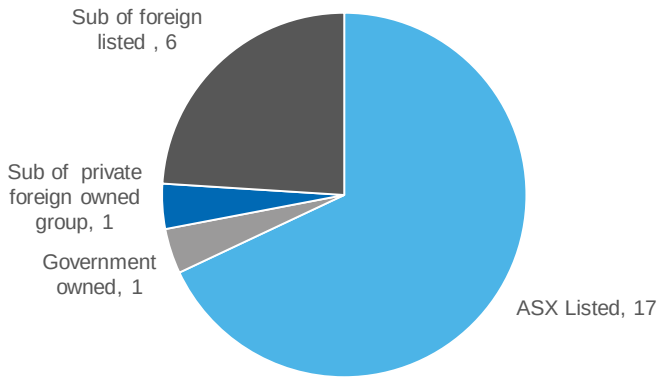
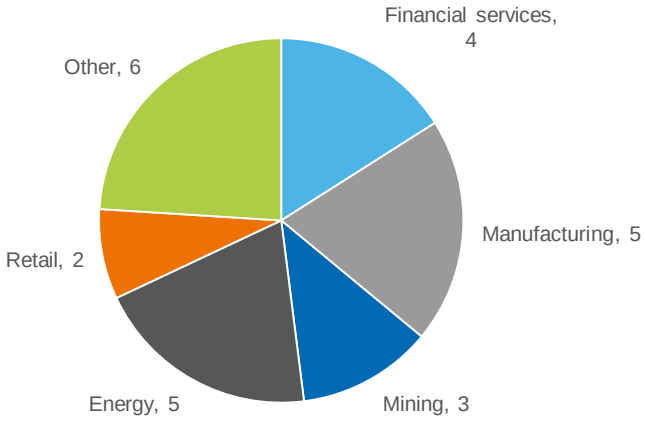


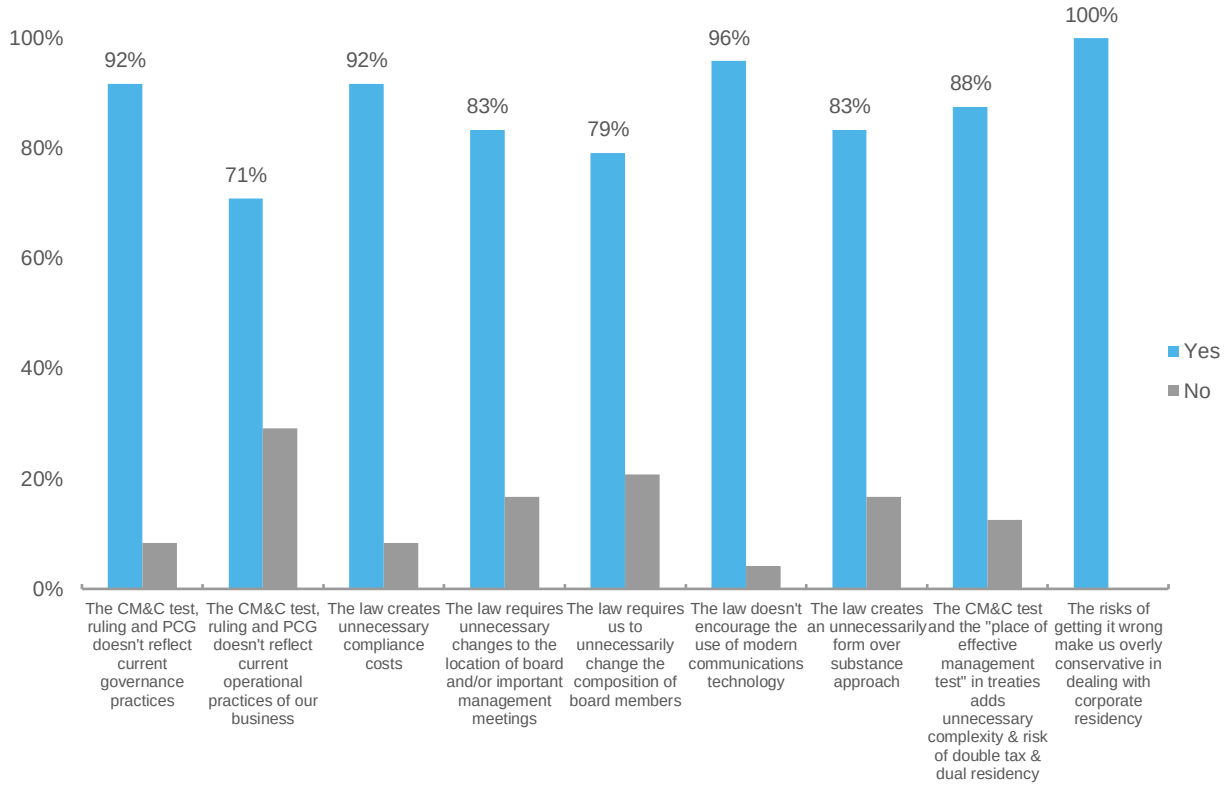
Figure A2: Industry coverage



PRACTICAL DIFFICULTIES WITH THE CURRENT CM&C TEST

The first question asked for a "yes" or "no" response to nine questions. The responses indicate a clear view that the current law, the ATO's interpretation of that law, Taxation Ruling TR 2018/5 and Practical Compliance Guideline PCG 2018/9 are not aligned with the practical realities of modern business and are creating unnecessary conservatism in large corporates approach to managing the central management and control (CM&C) test of residency.

Figure A3: Practical difficulties with the current CM&C test



Comments received

1. The biggest issue for our group (given we are a foreign owned inbound group) is to ensure we are not considered a Prescribed Dual Resident (PDR). Chinese Government (SASAC) require that there be Chinese Board representatives on the companies of all their foreign investments. It's very much a cultural thing and very unlikely to change. The composition of our Australian Board is 2 Chinese directors, 2 Australian directors & 1 Chilean. The concern is that if we were considered to be a PDR then we would be unable to consolidate for tax purposes. We have significant carried forward tax losses that would be lost if we were unable to consolidate.

   To ensure that it cannot be argued that CM&C is outside Australia our Chinese Directors fly to Melbourne every month for board meetings. This is expensive, disruptive, and inefficient. It has come at a large compliance cost in obtaining external advice for a number of constitutional changes that have been implemented over recent years to comply with Chinese SASC requirements for foreign investment. The advice was required as a result of the uncertainty and ambiguity around the current laws and how the ATO would interpret CM&C in the context of foreign shareholder type activities v's local management activities.
2. The law of itself doesn't necessarily provide practical difficulties but the ATO's interpretation and administration of the CM&C test coupled with the potential significant downsides do lead us to be

conservative when dealing with corporate residency. This conservatism leads to additional compliance costs and potentially non optimal board outcomes from a commercial perspective.

3. Other additional compliance costs not mentioned in the discussion paper include the obligation to file an Australian income tax return (if the foreign entity is a prescribed dual resident) and potential increased penalties if the foreign entity is a significant global entity plus potential double taxation where the foreign entity is also tax resident in a country which does not have a tax treaty with Australia.

4. We take actions to ensure we comply with the CM&C test and current ruling which we may not continue with if the standards were relaxed.

5. I think the issue is the CM&C test itself. It is no longer an appropriate test given globalisation and modern technology and the increasing way in which business units within companies are managed on a global or regional basis rather than a country basis.

6. We have had to make governance changes to cater for the amnesty

7. The problem is not with the law, but with the ATO's interpretation of the law. The ATO's view in TR 2018/5 and PCG 2018/9 is too broad, unfounded and impractical. It is even acknowledged in the Consultation Paper that there is no clear authority which supports the ATO's view.

8. To illustrate the impact of this on our organisation:

   - Our Australian resident directors on foreign subsidiaries have had to fly for 10 hours to physically attend a 1-hour board meetings when they could've easily used a video conferencing facility. It is expensive, decreases productivity and has adverse environmental impacts.
   - Our US incorporated subsidiary became an Australian tax resident under the new ATO's view. However, as there is no tie-breaker rule in the US-Australian DTA, it is a tax resident in each country but not a prescribed dual resident. It also became a member of our tax consolidated group. This has caused a number of asymmetric and unreasonable tax outcomes. For example, cost recharges by US subsidiary to Australia are not deductible in Australia (as within a tax consolidated group) but are assessable in the US. A dividend from the US subsidiary will be subject to US withholding tax but the Australian parent cannot obtain a foreign tax credit (as the dividend within a consolidated group is ignored for Australian tax purposes).

9. There is now a misalignment between the law and ATO practice, so the references to the ""law"" above have been read as references to the legislation, the ruling and the PCG.

10. The current CM&C test creates uncertainty for business, increases compliance costs and reduces productivity/efficiency. Importantly, it is inconsistent with best practice corporate governance in large multinational groups. Under the current ATO view, there is a risk that a parent's oversight/approval of subsidiary decision-making (e.g. approval of investment decisions/capital spend/repatriation, setting of group wide strategy etc.) may constitute CM&C.

11. But for the new ruling and PCG (administrative concession for listed companies) we would have answered "YES" to questions 3 through 8 in the list above.

12. The consequences of getting it wrong is in most cases hard to quantify and even more difficult to articulate to a non-tax audience (e.g. company secretarial, senior management and board members). Only way of easily articulating is that it places the company in an uncertain position on the tax outcomes of its tax structure which would not be feasible to any multinational. This then unhelpfully feeds into perception of Australia as a sovereign risk jurisdiction.

13. The current approach of the ATO is unnecessarily rigid and promotes forms over substance. The heart of Bywater is where the traditional approach regarding the place where the board locates is usurped by the owner/management, and it is an anti-avoidance case. The practical guidance makes it difficult for multinational group to operate, in particular where the board is held and physical attendance by directors, etc. These seem to defeat the substance of Bywater, that is where the economic activities actually conducted. This approach is adopted by the ECJ in Cadbury Schweppes case. Also, of note is that ""the place of effective management"" test is also hard to apply and even the OECD in the 2017 convention is moving away from it by adopting mutual negotiation approach.

14. Australian based multinationals are forced to limit skilled Australian management from their foreign subsidiary boards for fear of tripping into Australian tax residency under the current CM&C rules. This is counter to good governance and good business practice when the tax outcomes under the CFC regime and its associated provisions give a similar outcome to Australian residency.

15. I think even an effective management test would be better but can have its own challenges where there is a mix of local management and board management roles.

16. This has resulted in a huge amount of analysis and changes and wasted time and money to get back to the same logical position that active foreign subs should be all residents.

17. Broader regional/Australasia operations for management reporting and alignment purposes. even though each end market company has own directors and majority of directors are local and all board meetings are held in the relevant country.

18. The ATO's ruling has created concern for us that our GM's role could trigger a residency risk for the non-Australian companies. He is influential person, even though majority of other non-Australian directors.

19. We are flying GM out of the country for board meetings (complete waste of time on travel, cost, environmental impact, sends wrong message when we are trying to encourage take up and use of electronic meeting and collaboration facilities).

20. We find ourselves dictating to the business which individuals can be directors of foreign subsidiaries and where meetings can take place and, in the rare occasion where an Australian tax resident is a director of a foreign subsidiary we then have to provide guidance as to whether that individual should attend the meeting in person or via phone/video from Australia.

21. CM&C test requires directors to travel to outbound locations en masse. This is unnecessary and not reflective of current business practices. Incorporation, together with having substantive business operations in that location, would solve this.

22. The law was complex enough. The new ATO rulings and PCG do not reflect the already complex law and create an unnecessary administrative and costly burden.

23. I answered ""no"" to the first 2 questions only because we have implemented Governance and operational practices to limit risk of dual residency. These governance and operational practices are onerous, costly and widely regarded as being uncommercial and burdensome on the business.

24. Foreign laws that have nothing to do with tax (e.g. licencing rules for specific industries such as right to brew / sell alcohol) impact flexibility of operating structure (e.g. must incorporated company to get a licence, local credit, operating lease for premises...). These interact with residency rules particularly during early stages of set up / operating where strategic decisions are being made by an Australian leadership team, yet economic substance of operations is in a foreign country (with no real business operations or income generated from Australian customers.

PREFERENCES FOR A RESIDENCY TEST

This question asked respondents to rank from 1 to 5 (with 1 being the first preference and 5 last preference) five potential options for a corporate residency test. The question did not consider the voting power test.

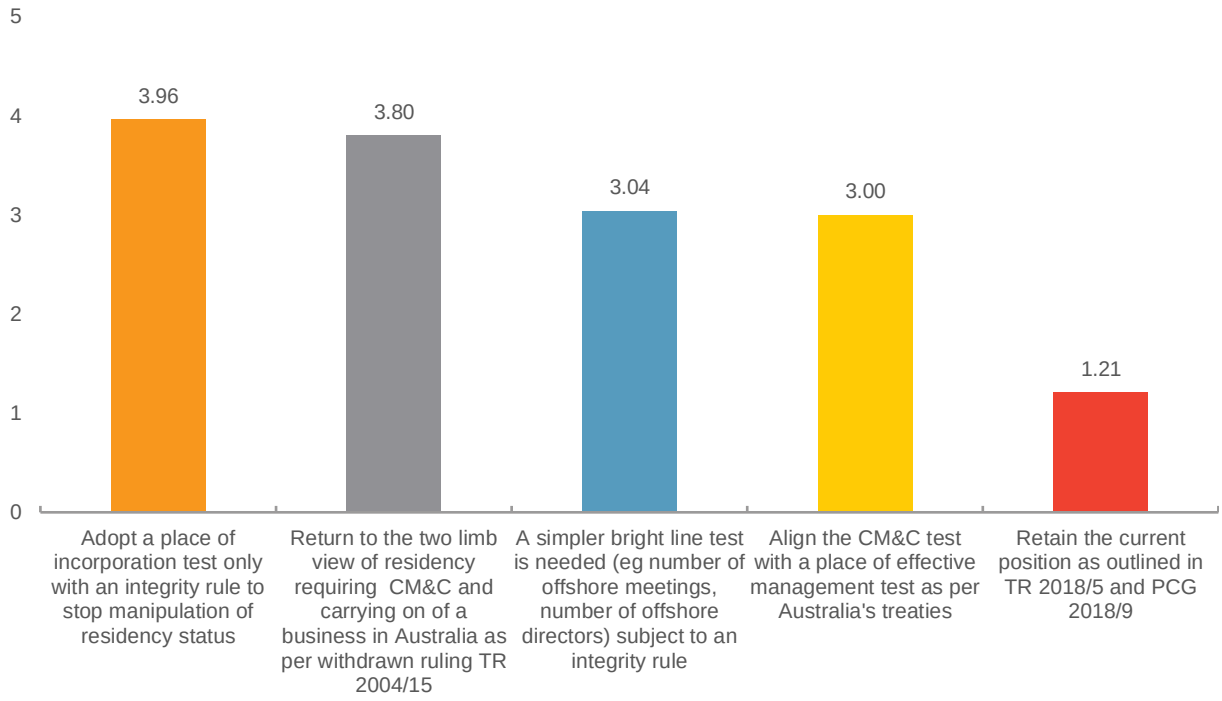
Weighted average preference

By applying a weighted average to each of the five options (calculated by multiplying its individual ranking by the percentage of respondents who gave that ranking - that is, a first preference receives a 5, second a 4 and so on) shows there appears very little difference in respondent's preference for adopting an incorporation test with an integrity measure (3.96 out of 5) or a return to the position adopted in withdrawn ruling TR 2004/15 (3.8 out of 5).

A "simpler bright line" test or a test based of place of effective management scored almost the same as each other at 3.0 and 3.04 out of 5 respectively.

The existing position as outlined in TR 2018/5 and PCG 2018/9 receives a significantly lower weighted average at 1.21. It is worth noting that if 100% of respondents had adopted this option as their last preference, the score would be a "1").

Figure A4: Weighted average of preferences – maximum score of 5



Individual preferences

The following graphs show the relevant percentages of each of the 5 options as a first, second, third, fourth or last preference.

48% of respondents saw their first preference as an incorporation test subject to an integrity rule to deal with the potential manipulation of residency status. 32% had a first preference for a return to the two-limb test as articulated in the withdrawn ruling TR2004/15. No one saw the current interpretation of the law as articulated in TR 2018/5 and PCG 2018/9 as their first or second preference. Only 4% saw the current position as their third preference, 14% saw it as their fourth preference and 83% see the current position as their last preference.

Figure A5: First preference

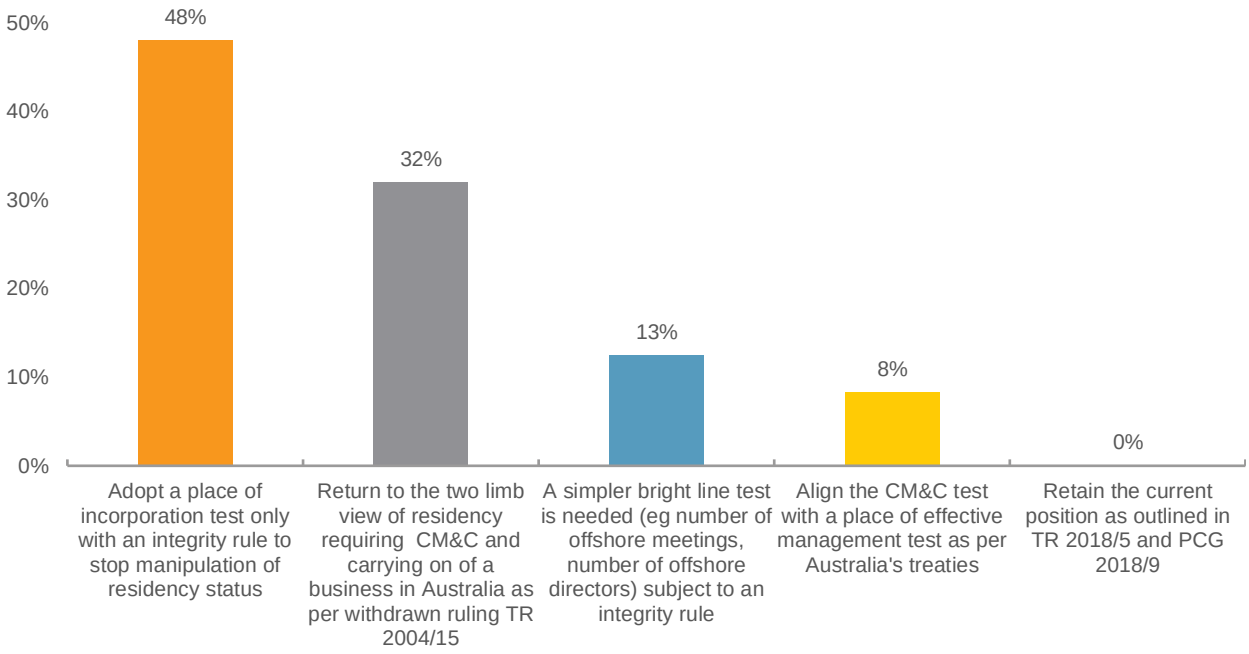


Figure A6: Second preference

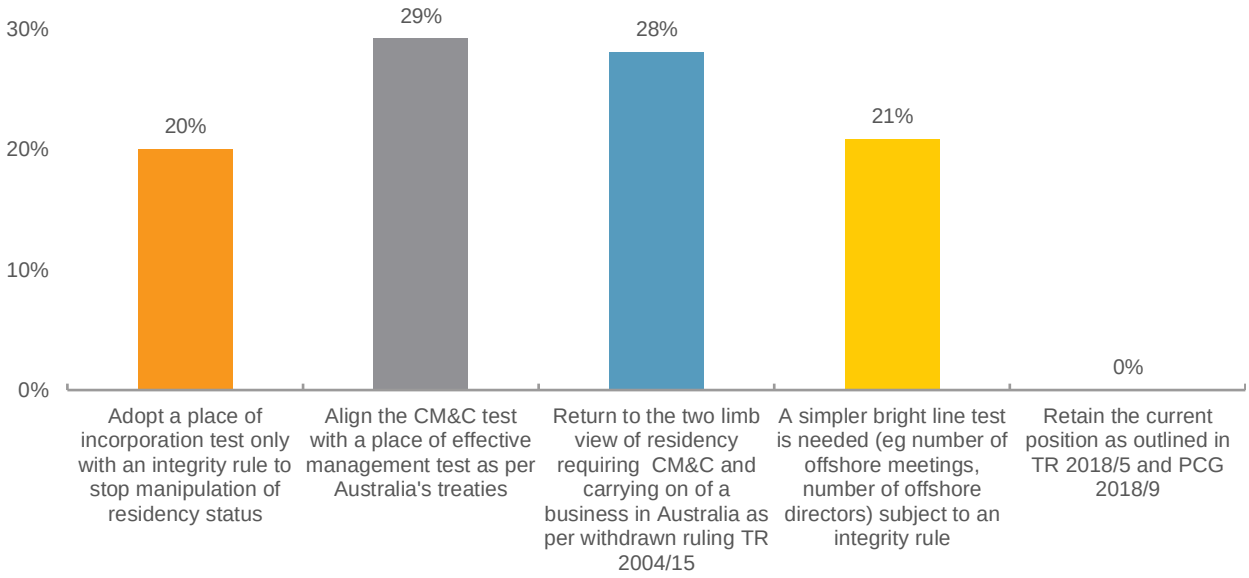


Figure A7: Third preference

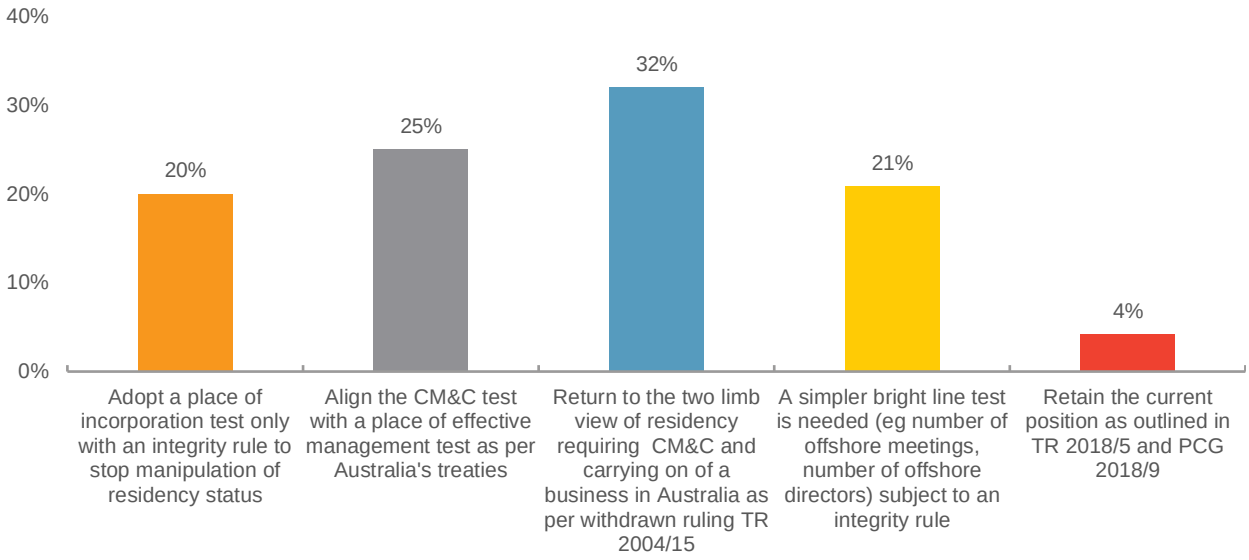


Figure A8: Fourth preference

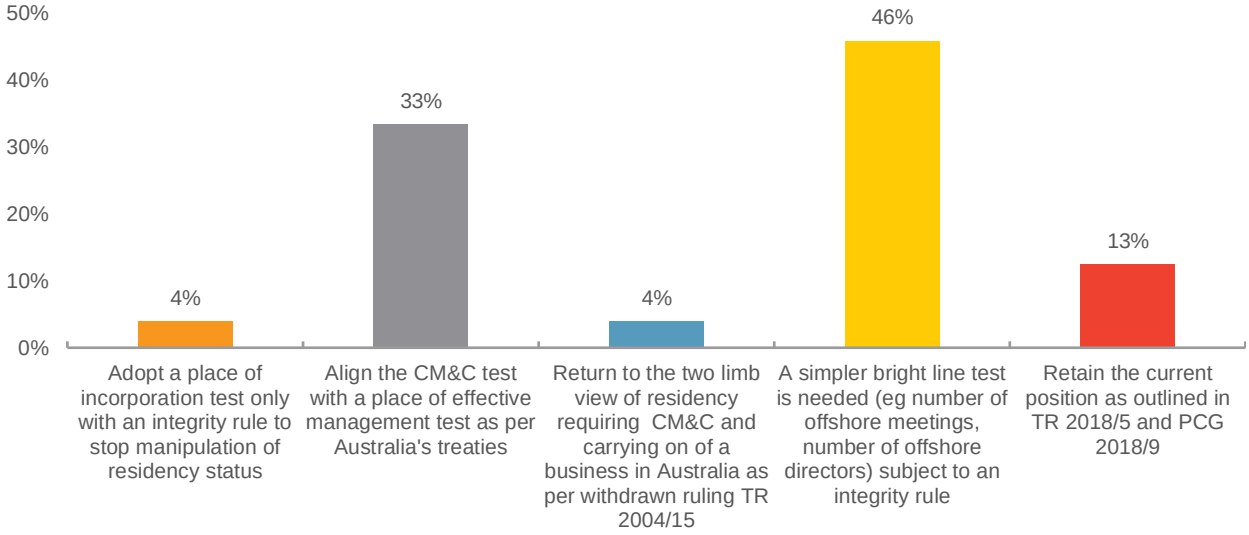
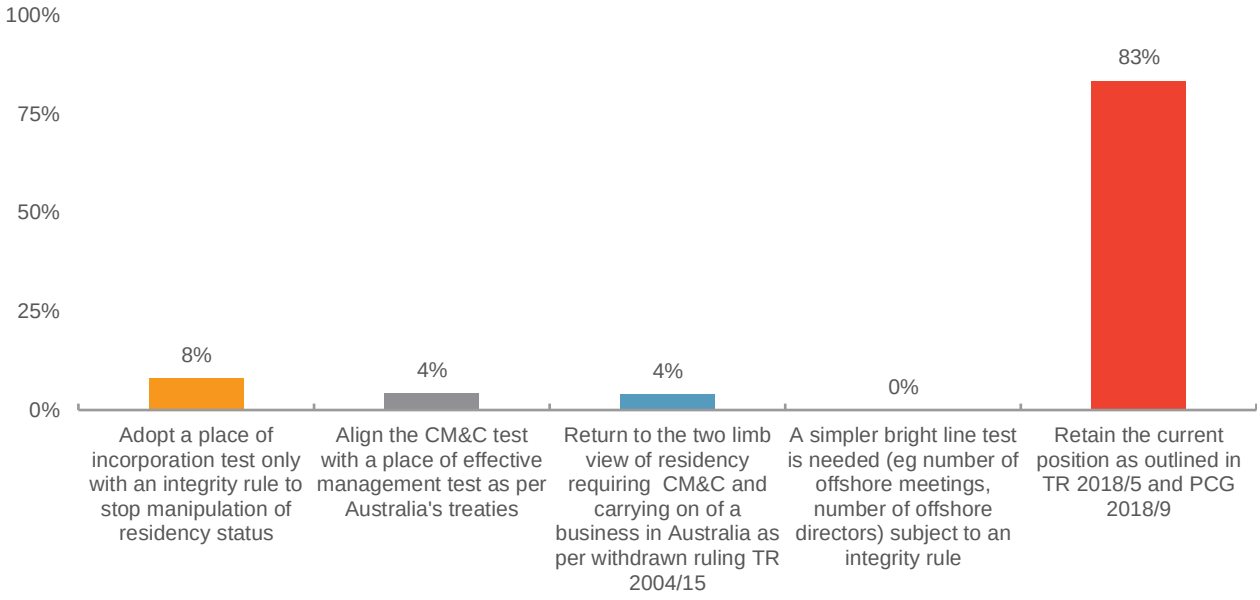


Figure A9: Last preference



IS THERE A BETTER SOLUTION?

The next question sought comments to the question "If you have a suggestion for a better solution to the CM&C residency issue, please provide your suggestion." Many responses indicated that the current integrity rules, and changes afoot internationally are addressing perceived revenue risks.

Comments received

1. We note that a place of incorporation test may not require an extensive integrity rule given as explained in the Board's paper, the Australian tax system in respect of corporates broadly operates on the basis that Australian- sourced profits and activities should be taxed in Australia and that foreign-sourced profits and activities should not be taxed in Australia, e.g. Subdivisions 768-A and 768-G of the Income Tax Assessment Act 1997 (ITAA 1997), and section 23AH of the lncome Tax Assessment Act 1936 (ITAA 1936).

2. These principles are supported by effective integrity measures in Division 815, Part IVA and the CFC provisions, in cases where an Australian group has a foreign subsidiary. For example, one would expect the aforementioned provisions to have been capable of preventing the mischief in Bywater. Furthermore, developments in international taxation from the OECD Base Erosion and Profit Shifting work and potentially further changes depending on the outcome of the OECD's work on the taxation of the digitalization of the economy makes the CM&C test a far less important feature of the Australian tax law than at the time it was introduced.

3. Introducing a place of effective management test may be seen to have some value from a perspective of increasing simplicity by aligning this to the test in Australia's tax treaties but the same problems with the current CM&C test would exist with this test. Additionally, given the lack of OECD or juridical authority globally on the meaning of effective management (particularly compared to a reasonably extensive list of authority on CM&C from Australia and abroad) this is likely to lead to more uncertainty at least in the short term such that a place of effective management test may not be preferred.

4. If we moved to a test of effective management, we would like foreign directors to be able to participate via video link or phone, provided board meetings were still chaired in the country of incorporation.

5. If CMAC is to be retained as a key pillar of the residency test, it should be supplemented by:

    a) **Option 1** – Limited, clear and objective exemptions, which could include:
        a. If ForCo is a controlled foreign company (CFC) of an Australian resident
        b. If (a) does not apply, if ForCo:
            i. passes the ‘active income test’ (as defined in the CFC rules) [note that this is intended to be a proxy for whether ForCo’s operating business is truly carried on outside Australia]
            ii. is incorporated in a Listed Country (as defined in the CFC rules)
            iii. is subject to a rate of tax that is at least 80% of the Australian tax rate or
        c. In all other cases, codify a simplified version of the Commissioner’s multinational concession in paragraph 107(b) of PCG 2018/9 (e.g. “if a majority of CMAC is exercised in a foreign jurisdiction where it is treated as a resident for tax purposes under that jurisdiction's law through (i) board meetings that are held outside Australia, or (ii) board meetings or decisions (including decisions undertaken by circular resolution or meetings via the use of modern communication technologies including teleconferencing) where the majority of directors are not present in Australia when such meetings take place”) or alternatively

b) **Option 2** – amending the definition of 'resident' so that the test about where a company carries on business is de-coupled from where it exercises CMAC (i.e. CMAC factors are disregarded for the carries on business test). This would largely restore the ATO's view in TR 2004/15 or

c) **Option 3** – Legislating that where ForCo is a resident of a country that has entered into a double tax agreement with Australia under that entity's domestic tax laws, ForCo is automatically incapable of being a resident of Australia.

6. The ATO's view in TR 2004/15 was sensible and provided relatively clear guidance on corporate tax residency. In particular, the nature of the business (active vs passive) should be an important factor. For an active company which consisted of operational activities (e.g. provision of services, manufacturing or mining), the location of the company's business would be where the main operational activities took place, not necessarily where the CM&C was located. For a passive company involved in passive or investment management, the location of the company's business would be where major decisions were made i.e. often where the CM&C was located. This is consistent with the principles in the CFC regime.

7. Aligning the CM&C test with the 'place of effective management' (POEM) test was put as our least desirable option as it will create further uncertainty (due to its ambiguity and lack of existing body of domestic case law) and may require businesses to restructure (if substantially different to the CM&C test). POEM is also becoming less important to Australia's tax treaty network due to the MLI.

8. Not necessarily a better solution, but query whether the "integrity rule" referred to in connection with a place of incorporation is already in place. The MLI Principal Purpose Test would seem to deny access to the treaty definition of residence in "sham" situations. Obviously untested though, so some thought would have to be given to multiple scenarios.

9. It may be worth considering the substance legislation that has been adopted by Caymans, BVI, etc. at behest of the EU. That legislation has clear carve outs to application based on a substance over form basis - not perfect in any sense but potentially a point of reference.

10. POEM is not the same as CM&C (noted by HMRC in ITH349), even though Bywater seems to have move that closer. CM&C conceptually supports the split in locations where Central Management and Control may be different. The economic substance approach is a better connecting factor as demonstrating the economic contribution to the country of incorporation. The presumption is that a company incorporated outside of Australia, unless it cannot demonstrate the genuine exercise of the activities in the country of incorporation. The test can incorporate some common factors, e.g. premises, staff, etc. Also, there should be a fail-safe alternative for holding/investment companies, and these can be where they are regulated. POEM should be incorporated as the alternative test for companies.

11. I think the effective management test should have greater guidance around it as at present its guidance means it can run in a similar pattern to the CM&C test.

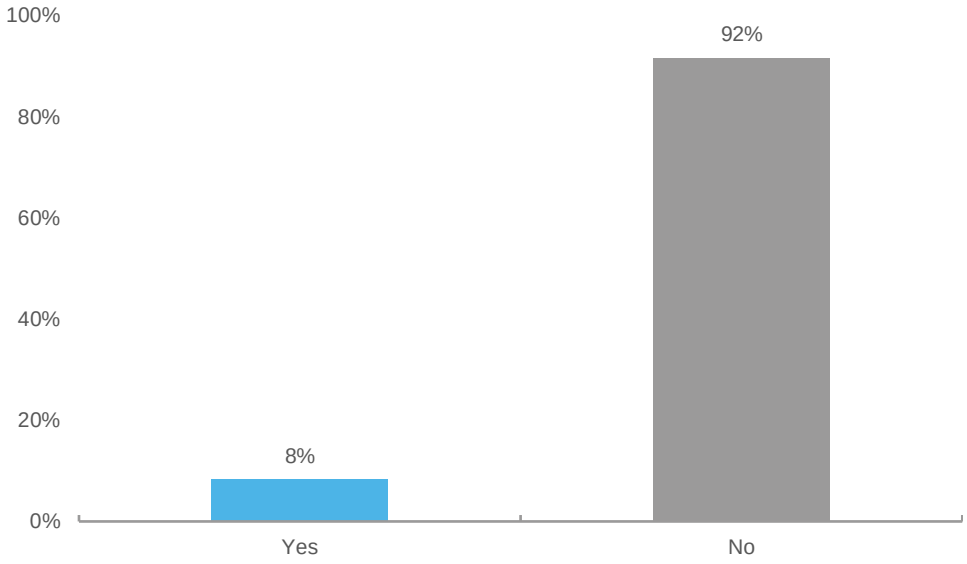
12. Incorporation, together with substantive business operations in that location, should be the primary test. This would cover most businesses. A secondary test of effective management should then cover digital/non-substantive operations.

13. Make a place of incorporation test as per 1 above.

RETENTION OF THE VOTING POWER TEST

The next question dealt with Consultation Question 6 and asked whether there was any compelling reason for retaining the alternative voting power test in the event the CM&C test is replaced. 92% did not see a compelling reason.

Figure A10: Is there a compelling reason for retaining the alternative voting power test in the event that the CM&C test is replaced with an alternative test?



Comments received

1. The voting power test is potentially problematic for any Australian outbound particularly given the ATO's interpretation that CM&C is automatically seen as carrying on business within Australia.

2. Based on the ATO's current view, the voting power test is almost redundant as CM&C decides whether a company carries on a business and you only consider voting power if a company carries on business in Australia. The ATO's view basically reduced the residency definition to incorporation or CM&C.

3. Voting power test doesn't seem to be a test for corporate tax residency in the other countries set out in Ch 6 of the Consultation Paper. Also, given it is seldomly resorted to, I don't believe there is a compelling reason to retain it.

4. The test has little practical value.

5. As mentioned in the BoT Consultation Guide, it is understood that the alternative voting test is seldom resorted to.

6. Although this test is hardly applied, given that we have CFC regimes, the fact that it is majority owned should not have any bearing on tax residency.

7. Alternative voting power doesn't make sense to me where there is control by a group of Australian shareholders which then trips into the CFC rules.

8. But only if the company 'carries on business in Australia' first. On the basis that the 'carry on business' will not refer to a CM&C type test but to actual operations being undertaken in Australia.

GENERAL COMMENTS

The last question asked if respondents they had "any other comments on the residency issue or the Board's Consultation Guide".

Comments received

1. An overly complicated application of the tests of residency or an expanded scope of residency is not justified and runs contrary to the Government's "cutting red tape" agenda. It leads to further uncertainty for corporates and additional compliance costs as noted in page 18 of the BOT Consultation Guide. From a policy perspective, the Government should encourage Australian headquartered corporates to grow and expand offshore with the aim of facilitating Australian jobs growth and other economic benefits such as increasing shareholder value. A strict and overly complicated residence test does not help promote such policy objectives and could act as an impediment to growth or increase costs and the competitiveness of Australian businesses particularly in a global environment where Australian has one of the highest corporate tax rates in the world.

   Furthermore, Australia has also adopted the tie-breaker rule in Article 4(1) (as modified by Article 4(3)(e)) of the Multilateral Instrument (MLI). Article 4(1) of the MLI requires that the two competent authorities determine, by mutual agreement, the jurisdiction in which the dual resident is deemed to be a tax resident. Due to the combined effect of the new tie-breaker test and the ATO's broader interpretation of the CM&C test, entities which could be viewed as dual residents will face increased administrative burdens and costs in establishing their tax residence for treaty purposes and will need to engage with the ATO and other relevant tax authorities. There is also the risk of a loss of treaty benefits if a mutual agreement cannot not be reached by the two relevant competent authorities.

2. It is not clear if interest is deductible under sec 25-90 if a foreign incorporated Australian resident company with a foreign branch borrowed to fund its operation.

3. The distinction between the CM&C test and the place of effective management test is becoming less clear over time and varies between industries. Therefore moving to POEM is unlikely to achieve the objective of greater certainty.

4. The ATO's interpretation of the Bywater decision is arguably incorrect given the facts in Bywater were extreme, far removed from the reality of multinational business. Further, it can be argued that Parliament intended for the 'carrying on business' limb to be an express limitation or a narrowing of the scope of the second corporate residency test (as compared to the Common Law test which was exclusively based on CM&C). For completeness, the foreign hybrid rules and Part IVA are other examples of subsequent additions to the ITAA which have imported at least some degree of redundancy into the CM&C test.

5. Attention could be drawn to the exponential increase in governance practices (as distinct from board practices) in a globalised age. Not just the mechanics (e.g. video conferences, email), but also community expectations and regulation (e.g. Sarbanes Oxley) have significantly increased the amount of governance expected of a multinational organisation, which has an effect on the type of decisions a subsidiary can/will be making.

6. We noted that, should the Board decide to adopt POEM as an alternative test, then regard to the South African Revenue Service Interpretation note No. 2 (2015) may be a useful guide on the factors that need to consider or discount in applying POEM. What corporates need are certainty and clarity. It would be unfortunate if a company could end up being an accidental Australian

company for a year if as it happens its only annual board meeting was held in Melbourne. As the POEM and CM&C tests are really anti-abuse tests, then it would be necessary to set out the rules clearly, including the factors that should be considered

7. Good luck - this is a vexed issue where some relaxation in approach is needed actually. With the changes to the taxation of the digital economy, is residency as important a construct to determine where tax is paid? Not as much as previously - it is activity and substance in country that will lead the charge in assigning taxing rights regardless of where residency lands.

8. The recommendation for an incorporation test is the logical solution. If people want to manipulate the rules, integrity rules should apply. The entire debacle is a perfect example of the ATO not seeing the woods for the trees, and the only winners here are the advisors!