New ATO draft ruling on company tax residence - TR 2017/D2

The Australian Taxation Office (ATO) has issued a new draft ruling on Central Management and Control (CMAC) and Australian tax residency of foreign incorporated companies following last year’s High Court decision in Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation (Bywater). The draft ruling presents a substantial departure in the interpretation of CMAC from the ATO’s previous ruling, TR 2004/15.

Background

On 15 March 2017 the ATO released Draft Taxation Ruling TR 2017/D2 and withdrew Taxation Ruling 2004/15. These moves came in response to the High Court’s 2016 decision in Bywater Investments. This decision, and the tax rulings, concerned the residence of companies not incorporated in Australia.

Under section 6(1) of the Income Tax Assessment Act 1936 a company, not incorporated in Australia, is resident if it carries on business in Australia and has either its central management and control in Australia or its voting power controlled by Australian resident shareholders.

Bywater case

Bywater concerned a foreign-incorporated company that held meetings of its Board of Directors outside of Australia. The taxpayer argued that its court was bound to find that central management and control (CMAC) was exercised abroad. The High Court rejected this approach and held that the location of CMAC of a company was not to be determined by its formal structure, but was rather a question of fact.

The Court found that, as a matter of fact, the real business of the appellant was conducted by an individual from Sydney (Mr Vander Gould), without the involvement of the foreign directors. The directors had abrogated their decision making in favour of Mr Gould and only met to rubber-stamp decisions made by him in Australia.

The situation in Bywater was contrasted with that in the previous case of Esquire Nominees Ltd v. FCT [1973] 129 CLR 177. In Esquire Nominees, a firm of Australian accountants exerted significant influence over the foreign directors. Nevertheless, it was found that CMAC was exercised by the directors, as they would not have acted on the accountants’ instructions had these instructions been improper or inadvisable.

TR 2017/D2 – Foreign Incorporated Companies: Central Management and Control test of residency

The draft ruling sets out the ATO’s revised view on how to apply the CMAC test of company residency, following the Bywater decision.
The ATO now considers that CMAC is always part of a company’s business, so if CMAC is in Australia then the company will be resident here. Previously, in TR 2004/15, the ATO’s position was that, depending on the business, these could be two separate things, so CMAC could be in Australia without the company carrying on business here or causing it to be a resident.

This position represents a significant change from the view expressed in TR 2004/15 which was that other acts of carrying on a business generally need to exist before the CMAC test is satisfied. TR 2004/15 had argued that only where a company’s business is management of its investment assets and where it undertakes only minor operational activities, will both tests (carrying on a business and CMAC) be satisfied by the same set of facts.

Like TR 2004/15, the draft ruling states that CMAC involves the making of high-level decisions that set the company’s general policies, and determine the direction of its operations and the type of transactions it will enter. This is to be contrasted with day-to-day conduct and management of operational activities. The new ruling adds, in a reference to Bywater, that decision making involves active consideration and does not include the mere implementation of, or rubberstamping of decisions made by others.

Previously, the Commissioner’s view was that CMAC is usually exercised by the company’s board and therefore the place where the board meets is highly relevant in determining where CMAC is located. The new ruling however downgrades the actions of directors to a “useful starting point” and states that “there is no presumption that the directors exercise central management and control unless proved otherwise”. All relevant facts must be considered.

It follows that mere legal power or authority to manage a company is not sufficient to establish exercise of CMAC, particularly where this authority is not used. Furthermore, legal authority is not necessary for a person to exercise CMAC - if an outsider dictates or controls the decisions made by the directors, the outsider will exercise CMAC of the company.

The key questions are whether the people with formal decision-making authority actively consider whether to do what they are told or advised to do and make a decision in the best interests of the company and whether they would refuse to follow advice or directions that are improper or inadvisable.

**Practical considerations**

A common issue for international groups is how much influence/control an Australian parent company can have over an overseas subsidiary before that subsidiary becomes a resident. To demonstrate that the parent company is merely influential and does not itself exercise CMAC, it may be suggested that:

- The directors of the company have the required skills, experience and qualifications to perform their duties and sufficient knowledge of the business to make informed decisions;
- The directors actively consider all information and advice before making decisions in the best interests of the company;
- The directors meet frequently enough to actually exercise CMAC and these meetings take place outside of Australia; and
- Board minutes record, not only what decisions were made, but why the directors made them to evidence that decisions were actually made at the meetings.

The ruling, when finalised, is proposed to apply from 15 March 2017.

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