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INTERNATIONAL TAX FACTSHEET: CORPORATE RESIDENCY AND THE CMC TEST

CORPORATE RESIDENCY AND THE CENTRAL MANAGEMENT & CONTROL TEST

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CHANGES TO THE APPLICATION OF THE 'CENTRAL MANAGEMENT AND CONTROL' (CMC) TEST HAS THE POTENTIAL TO EXPOSE NON-RESIDENT CORPORATIONS AND COMPANIES TO AUSTRALIAN TAX RESIDENCY STATUS.

A recent case before the Australian High Court has prompted the Australian Tax Commissioner to issue Tax Ruling 2018/5 and a draft Practical Compliance Guideline (PCG) to clarify how it applies the 'central management and control' test in determining corporate tax residency. The case related to companies that had been set up to be non-resident with a foreign-resident director and meetings held outside Australia. The High Court found that the foreign director was a 'mere puppet' of an Australian resident controller. The new ruling was significantly different to previous rulings, causing the ATO to release the PCG relating to the central management and control (CMC) test, which sets out the Australian Tax Commissioner's new approach to how it views corporate residency.

The ruling and PCG on how CMC is applied has potential to treat a significant number of foreign-incorporated companies as Australian tax resident, applying from 15 March 2017 with a 'grandfathering' of the former rulings with certain conditions until 21 December 2018.

So what does this mean for potentially affected organisations? Let's look first at how Australia defines a corporate resident for tax purposes.

HOW DOES AUSTRALIA DEFINE A RESIDENT FOR TAX PURPOSES?

The definition of resident (for a company) is set out in s6(1) of the ITAA36, which states:

"... a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.'

CMC as mentioned above, must be accompanied by 'carrying on business in Australia' as a requirement for residency. The new ruling, TR 2018/5, removes the distinction between carrying on a business and CMC,

and sets out the following questions for CMC:

1. Does the company carry on business in Australia?
2. What does 'central management and control' mean?
3. Who exercises central management and control?
4. Where is central management and control exercised?

There appear to be three considerations in applying CMC:

1. Does the company have its central management and control in Australia?
2. Does it carry on business in Australia as a result of its CMC being in Australia?
3. Does the actual trading and investment operations occurring in Australia determine residency?

The ruling and subsequent PCG now says that actual trading and investment operations occurring in Australia is not necessarily a determinant as the CMC activities are themselves part of carrying on a business. This is substantially different to previous rulings.

WHAT IS THE ISSUE WITH THE NEW APPROACH?

The new approach increases the risk for foreign companies to be treated as Australian residents for tax purposes, especially to foreign-operating subsidiaries of Australian groups with business operations, activities and directors that are based overseas.

WHICH COMPANIES COULD THIS IMPACT?

The new approach has potential consequences for:

- Foreign operating companies of Australian Groups (Outbound);
- Foreign intermediate holding companies controlled by Australian groups;
- Foreign holding companies of foreign-controlled Australian groups (inbound).

In addition to being treated as Australian tax resident, there are additional potential impacts such as:

- The potential for double-taxation as dividends of a foreign incorporated company are unlikely to be entitled to non-assessible, non-exempt treatment
- Membership of Australian consolidated tax groups may prove to be an issue, for example for 100% foreign-owned subsidiaries where CMC determines Australian tax residency
- Tax jurisdiction and double-tax treaty implications and tie-breaker rules becoming inoperative
- Ambiguity around corporate residency status - the PCG remains unclear about what 'a substantial degree' of exercise of CMC in Australia constitutes.
- Proposed hybrid rules that present new compliance obligations to the dual resident entity and its foreign branches.

SEEK ADVICE IF YOU HAVE A FOREIGN INCORPORATED BUSINESS OPERATING IN AUSTRALIA

This is a very complex area of cross-border taxation and organisations need to be aware of the implications of the new ruling. The lack of clarity in the PCG is also creating red flags about how some elements of the ruling may be applicable.

For more information, please contact us on +61 2 9957 4033 or email Matt Zhou for further discussion about your organisation's cross-border structure.

ABOUT US

Our Expertise

Domestically

Bates Cosgrave advises domestic and international businesses.

We provide highly personalised services across a wide range of industries with in-depth knowledge in real estate, renewable energy, import and distribution, health professionals, inbound and outbound investments, and innovative/start-up businesses.

Internationally

Although we are a boutique firm based in Sydney, we have access to a strong global network and specialise in advising cross-border transactions and global structuring.

OUR TEAM

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VIEW ONLINE PROFILE

Matt joined Bates Cosgrave in April of 2007 as a manager and was promoted to Director from 1 July 2009. Matt has a reputation for his technical expertise and experience in specialist advice to professionals including medical doctors, professional investors and family offices, multinational companies.

His diverse knowledge on International tax, expatriates tax, employee share schemes, business structuring including cross border issues, CGT and GST is formidable.

His industry knowledge is broad and includes medical services, real estate, pharmaceuticals and technology companies. As tax advisors, we must think ahead and consider not just the current situation but the future.

Good advice reflects not simply value now, but lasting value.

GLENN COSGRAVE

DIRECTOR

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VIEW ONLINE PROFILE

Glenn Cosgrave is a founding director of Bates Cosgrave, which was established in 1999. As a specialist in business structuring, financial strategy and mergers & acquisitions, he is able to bring considerable expertise, agility and insight to business owners as they move through the business lifecycle.Glenn offers strategic perspective on the many pivot points of business change, particularly as the business moves from start-up to commercialisation, through growth and ultimately to readiness for sale. His knowledge and expertise of business structure is highly sought after, as he ensures that clients are able to maximise the outcomes of restructuring for acquisition, sale or for better tax planning. He provides comprehensive tax structuring, strategic & financial management advice, commercialisation support, estate planning strategy and also oversees the management of back office support for Australian and international operations.

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