PCG 2018/9EC5 - Compendium

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Australian Government
Australian Taxation Office

Public advice and guidance compendium – PCG 2018/9DC1

- **Relying on this Compendium**

This Compendium of comments provides responses to comments received on draft Practical Compliance Guideline PCG 2018/9DC1 *Central management and control test of residency: identifying where a company's central management and control is located*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
1	There has been some commentary made in the media about the problems that can be caused by the deeming of Australian tax residency of foreign registered companies because of the company's central management and control being in Australia, however, the similarity of tax treatment compared to a controlled foreign company is rarely mentioned in these commentaries. It is suggested that the final update to the Guideline refers to the relevant provisions (section 23AH of the *Income Tax Assessment Act 1936* (ITAA 1936), Subdivisions 768-A and 768-G of the *Income Tax Assessment Act 1997* (ITAA 1997) and Part X of ITAA 1936) and provides a more detailed explanation and examples of how they give a similar treatment. This may allay some unfounded concerns about the tax effect of subsidiaries being deemed to be an Australian tax resident under the central management and control test of residency.	Footnotes 1A and 1B have been added to paragraph 5B in the final update of the Guideline to refer to the relevant legislative provisions referenced and provide further explanation. Detailed examples have not been included as this is beyond the scope of this targeted update to the Guideline.

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2	It is suggested that the final update to the Guideline comment that in cases where there are some differences in tax treatment between a foreign-incorporated company with its central management and control in Australia compared with if it was a controlled foreign company, the relevant treaty requirements would have to be considered (if there is a double taxation agreement with Australia and the other jurisdiction).	The application of double taxation agreements is outside the scope of this Guideline.
3	The final update to the Guideline needs a more appropriate balance between the nominal tax risk and cost of compliance for both public groups and the ATO. There is unwarranted uncertainty (and compliance costs) for taxpayers who represent an extremely low tax risk.	The Commissioner recognises that the residence of a company will often be a 'low-risk' issue for the ATO (for example, in the circumstances outlined at paragraph 5B of the Guideline). As recognised in the Guideline, public groups that meet certain requirements can rely on the ongoing compliance approach for public groups for ongoing certainty. Additional guidance has been included in the ongoing compliance approach regarding circumstances considered to be low risk (from paragraphs 105 to 107G of the final update to the Guideline) to reduce compliance costs for public groups and provide greater certainty. This includes additional guidance for wholly offshore operating subsidiaries of public groups (subparagraph 107(b) of the final update to the Guideline) and guidance regarding how companies in public groups can evidence falling within the ongoing compliance approach (paragraphs 105 to 107G of the final update to the Guideline). The ongoing compliance approach does not extend to private groups as they have a lower level of public transparency and a greater level of diversity in the ways in which they are structured and operate.
4	Greater certainty could be achieved by creating a no-risk 'white zone' that would only apply to public groups with active businesses in foreign jurisdictions subject to the normal caveats regarding tax avoidance, etc. White zones are used in other Guidelines such as those dealing with marketing hubs and related party interest rates. The white zone is also suggested to include foreign-incorporated companies that hold, directly or indirectly, shares in a foreign-incorporated company with an active business in a foreign jurisdiction for public groups.	'White zones' in other Guidelines are generally used where there has already been one-to-one ATO engagement on the issue (for example, through an advance pricing arrangement, settlement, or court decision). As such, a 'white zone' has been not included in the Risk assessment framework in the Appendix to the Guideline. However, additional guidance on circumstances considered to be low risk has been included in the ongoing compliance approach (from paragraphs 105 to 107G of the final update to the Guideline) to reduce compliance costs for public groups and provide greater certainty. This guidance addresses public groups with subsidiaries with active businesses in foreign jurisdictions where certain

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		circumstances apply (see subparagraph 107(b) of the final update to the Guideline). See also amendments to paragraphs 105 to 107G of the Guideline. Foreign-incorporated companies that hold shares in other foreign-incorporated companies, directly or indirectly, may rely on subparagraphs 107(a) and (b) of the Guideline in relation to the ongoing compliance approach where the requirements are met.
5	There has not been sufficient time provided to indicate the transitional compliance period was ending. Some companies have generally been working on an assumption that the law would be changed in accordance with the former Government's 2020–21 Budget announcement, which would mean a return in a practical sense to the position in Taxation Ruling TR 2004/15 *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control* (Withdrawn).	It was indicated in December 2022 that the transitional compliance approach was not being further extended beyond 30 June 2023. The expanded ongoing compliance approach for public groups and the Risk assessment framework in the Appendix to the Guideline provide additional guidance on the ATO's compliance approach based on specific circumstances, including for companies that relied on the transitional compliance approach. It is understood that some companies have been relying on the former Government's 2020–21 Budget announcement. Announced measures that are not yet law are subject to consideration by the Government. For more information refer to Law Administration Practice Statement PS LA 2007/11 *Administrative treatment of taxpayers affected by announced but unenacted legislative measures which will apply retrospectively when enacted*.
6	It is of fundamental importance that the company's self-assessment of its Australian tax position is based on the application of the income tax law, not on this Guideline (once finalised). For that reason, we suggest an amendment to paragraph 109 in the final update to the Guideline to ensure that there is no confusion between a company's self-assessment of its taxable income and its determination of the risk that the Commissioner will take action to verify the position taken by the company.	Paragraph 109 has been altered in the final update to the Guideline to reflect this feedback. References to 'self-assessment' of risk zones have been removed throughout the Guideline (see updated paragraphs 112 and 115).

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7	We consider that amendments should be made to Table 2 of the Guideline outlining risk zone criteria to clarify the relationship between the 3 risk zones and to ensure that the criteria in the 'low-risk' zone accord with the description in paragraph 115 of the draft Guideline. Paragraph 115 of the draft Guideline provides, essentially, that a company falls within the 'low-risk' zone if 2 criteria are met: 1. the company does not fall within the 'moderate-risk' or 'high-risk' zone, and 2. the company maintains adequate accurate contemporaneous board minutes and governance documents that accurately reflect high-level decision making and support the company's assertion that it was not managed and controlled in Australia at the relevant time. The circumstances currently listed in the 'low-risk' section of Table 2 of the draft Guideline go to the question of whether criterion 2 outlined above is satisfied; they are not independent positive criteria, as currently presented in Table 2.	This point has been clarified in the final update to the Guideline to avoid any misunderstanding that the factors in Table 2 were separate to the requirements referenced in paragraph 115 of the Guideline. Additional sentences have been added and amendments have been made at the beginning of the low and moderate-risk zones in Table 2. To fall in the low-risk zone of the risk assessment framework, one or more of the factors in the low-risk zone of Table 2 need to exist, in addition to the company not falling within the moderate or high-risk zones. Paragraphs 115 to 117 of the final update to the Guideline provide detail regarding how companies and groups evidence falling within the low-risk zone. This is now explicitly referenced in the low-risk zone of Table 2. For completeness, if an entity falls within the high-risk zone, they do not fall within the low or moderate-risk zones.
8	For a company to fall within the 'moderate-risk' zone in Table 2 of the draft Guideline, it must not fall within the 'high-risk' zone. At present, this is not stated in Table 2.	Consistent with the response for Issue 7 of this Compendium, Table 2 has been amended to clarify that to fall within the moderate-risk zone, companies must not have any high-risk factors identified in Table 2.
9	We suggest changes to paragraph 119 in the final update to the Guideline to ensure it is known that Table 2 applies to a company which is not incorporated in Australia and asserts that it is not managed and controlled in Australia.	No change has been made as the Risk assessment framework in the Appendix to the Guideline only applies to foreign-incorporated companies and each of the factors in the 3 risk zones in Table 2 of the Guideline commence by stating that the company has self-assessed as a non-resident.

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10	We consider that the concepts of 'resident of a foreign jurisdiction' and 'resident of a tax haven' are vague and unhelpful and should not be used at all in Table 2 of the final update to the Guideline.	Footnote 6 has been added in the final update to the Guideline to clarify what is meant by the term 'resident of a foreign jurisdiction' for the purposes of the Guideline. A company is a 'resident of a foreign jurisdiction' for the purposes of the Guideline if it is a resident (or equivalent) under that jurisdiction's law such that it is subject to comprehensive liability to tax in the jurisdiction and not subject only to taxation limited to income from sources in that jurisdiction. For avoidance of doubt, a company is not excluded from this definition where it is a resident (or equivalent) under a foreign jurisdiction's law and subject to comprehensive liability to tax in that jurisdiction, and that jurisdiction has a territorial tax system. The reference to a 'resident of a tax haven' in Table 2 of the Guideline has been revised to include a reference to a 'resident of a specified country' with a new footnote (footnote 16) referring to the *International dealings schedule instructions 2023* in the moderate and high-risk zones.
11	We submit that the following changes should be made to the wording of particular points in Table 2 in the final update to the Guideline to ensure that the points accurately reflect the law, are readily understood, and are internally consistent: (a) 'Low-risk' zone, point i: 'A majority of directors attending meetings' (to reflect the law on this point). (b) 'High-risk' zone point i: 'The company appears not to be subject to the tax laws of any foreign jurisdiction' (to replace the concept of 'residence', which may not be relevant in the foreign jurisdiction, with a more general concept). (c) 'High-risk' criteria, point iii: 'for example, where significant functions, assets and risks **relating to the company's operations** appear to be located in Australia including some high-level decision making, and no or minimal staff are employed in the relevant foreign jurisdiction' (*to improve clarity by making the point more specific*). (d) 'High-risk' criteria, point viii: 'Evidence indicates that there is no substantive high-level decision making in the jurisdiction in which the company is **incorporated** (or in the foreign	(a) The existing wording has been maintained as the Commissioner considers the situation of one or more directors attending meetings from Australia via modern communications technology as *a one-off or temporary arrangement* does not trigger a change of residency under the central management and control test of residency, consistent with the ATO view and is a low-risk issue. (See Example 13 of the Guideline.) (b) While it is not agreed that merely being subject to the tax laws of a foreign jurisdiction is a replacement for the concept of being a 'resident of a foreign jurisdiction' (see response to Issue 10 of this Compendium), this change has been adopted as an addition (rather than a replacement). Where a company appears to not be subject to source taxation in any foreign jurisdiction or not subject to comprehensive worldwide taxation as a resident of any foreign jurisdiction these are indicative of tax risk and the company would fall within the high-risk zone. (See new point ii of the final update to the Guideline). (c) This change has been adopted. (See point iv of the final update to the Guideline).

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	jurisdiction where it is asserted that central management and control is exercised), including evidence of mere implementation, or rubberstamping, of decisions made by others or by directors without the exercise of independent consideration or judgment' (*to replace the concept of 'residence', which may not be relevant in the foreign jurisdiction, with a specific, unambiguous term*). (e) 'High-risk' criteria, point viii: 'Companies that maintain effective corporate governance consistent with paragraphs 116 and 117 of the draft Guideline would not fall within this criterion' (*to ensure full consistency with paragraphs 116 and 117 and points ii, iii and iv in the 'low-risk zone' criteria*).	(d) The term 'incorporated' has been added in the factors as an alternative option to account for situations where the concept of 'resident of a foreign jurisdiction' as intended by the risk assessment framework in the Appendix to the Guideline (see Issue 10 of this Compendium) may not be applicable in that foreign jurisdiction. (See point ix of the final update to the Guideline.) (e) This change has been adopted but now refers to the new location of these paragraphs at 107D and 107E of the final update to the Guideline. (See point ix of the final update to the Guideline.)
12	The introduction to the 'low-risk' section of Table 2 of the draft Guideline states that a requirement for inclusion in the 'low-risk' category is that the company is a resident of a foreign jurisdiction that is not a tax haven. This requirement is not stated in paragraph 115 of the draft Guideline, and it introduces considerable uncertainty in 2 respects: (a) first, as to which residence criterion is applicable (for example, is this simply a reference to the place of incorporation or is it a reference to residence under the tax law of the foreign jurisdiction?) (b) second, as to whether a company being a 'resident' of a tax haven places it in the 'moderate' or 'high-risk' category.	As stated above, paragraph 115 of the Guideline was intended to support the substantive factors in Table 2. Note the changes made in respect of Issue 7 of this Compendium which clarify the intention of this point. In response to the 2 uncertainties raised: (a) it refers to the residency under the tax law of the foreign jurisdiction as clarified by footnote 6 of the final update to the Guideline (see response to Issue 10 of this Compendium), and (b) if a company is a resident of a tax haven, the company would not fall within the low-risk zone. Companies resident in tax havens may attract attention from the Commissioner for other purposes, for example, if moderate or high-risk factors apply to the company as outlined in Table 2 of the Appendix to the Guideline. Paragraph 113 of the final update to the Guideline clarifies that all companies may not fit squarely within the risk assessment framework.