TR 2017/D2 - Income tax: Foreign Incorporated Companies: Central Management and Control test of residency

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Draft Taxation Ruling

Income tax: Foreign Incorporated Companies: Central Management and Control test of residency

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Summary – what this ruling is about

1. This draft Ruling sets out the Commissioner's preliminary but considered view on how to apply the central management and control test of company residency[1] following *Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation* [2016] HCA 45; 2016 ATC 20-589 *(Bywater).*

Background

2. A company is a resident or a resident of Australia under the central management and control test of residency[2] if it:

(a) carries on business in Australia, and

(b) has its central management and control in Australia.

[1] Paragraph (b) of the definition of 'resident or resident of Australia' in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)

[2] Under paragraph (b) of the definition of *resident or resident of Australia* in subsection 6(1) of the ITAA 1936. Alternatively, a company may be a resident or resident of Australia if:
(a) it is incorporated in Australia (*the incorporation test*); or
(b) its voting power is controlled by shareholders who are Australian residents and it carries on business in Australia (*the voting power test*).

3. Four matters are relevant in determining whether a company meets these two criteria:

(1) Does the company carry on business in Australia? (see paragraph 4 of this draft Ruling)

(2) What does central management and control mean? (see paragraph 6 of this draft Ruling)

(3) Who exercises central management and control? (see paragraph 13 of this draft Ruling)

(4) Where is central management and control exercised? (see paragraph 26 of this draft Ruling)

Ruling

Does a company carry on business in Australia?

4. To be resident under the central management and control test, a company must carry on business in Australia.[3]

5. If a company has its central management and control in Australia, and it carries on business, it will carry on business in Australia within the meaning of the central management and control test of residency.[4] It is not necessary for any part of the actual trading or investment operations from which its profits are made to take place in Australia. This is because the central management and control of a business is factually part of carrying on that business. It follows that a company carrying on business does so both where its trading and investment activities take place, and where the central management and control of those activities occurs.[5]

[3] This ruling is not concerned with what amounts to carrying on business. However, generally, where a company is established or maintained to make profit or gain for its shareholders it is likely to carry on business. (*Brookton Co-operative Society Ltd v FCT (1981) 147 CLR 441 per Aicken J at 469; American Leaf Blending Co Sdn Bhd v D-G of IR* [1978] 3 All ER 1185 Per Lord Diplock at 1189; *Inland Revenue Commissioners v Westleigh Estates Company Ltd; South Behar Railway Company Ltd; Eccentric Club Ltd* [1924] 1 KB 390). This is so even if the company only holds passive investments, and its activities consist of receiving rents or returns on its investments and distributing them to shareholders. (*Brookton Co-operative Society Ltd v FCT (1981) 147 CLR 441 per Aicken J at 469; Inland Revenue Commissioners v Westleigh Estates Company Ltd; South Behar Railway Company Ltd; Eccentric Club Ltd* [1924] 1 KB 390; *Lilydale Pastoral Co. Pty. Ltd. v. FCT* 87 ATC 4235; *American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia)* [1978] 3 All E.R. 1185 at p 1189; *FCT v Total Holdings* 79 ATC 4279; *Ruhamah Property Co Ltd v Federal Commissioner of Taxation* [1928] HCA 22; (1928) 41 CLR 148; *FC of T v. E A Marr & Sons Sales Ltd* (1984) 2 FCR 326 at 330-1; 84 ATC 4580 at 4585-4586

[4] *Malayan Shipping Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156(*Malayan Shipping)* at 159-160; The view expressed by Williams J in *Malayan Shipping* was put beyond doubt by the majority in *Bywater* at [57]

[5] *Malayan Shipping* at 159-160

What does central management and control mean?

6. *Central management and control* is the control and direction of a company's operations.[6] The key element is 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.[7]

7. The control and direction of a company is different from the day-to-day conduct and management of its activities and operations.[8] The conduct of the company's day-to-day activities and operations is not an act of central management and control.[9] Nor is managing those activities under the authority and supervision of higher level managers or controllers.[10]

8. Merely because a person is a majority shareholder, or has the power to appoint those who control and direct a company's operations, does not, by itself mean the person controls and directs a company's operations and activities.[11]

What is 'decision making'?

9. A person, or group of people, make a decision if they actively consider and decide to do something based on it being in the best interests of the company.[12] It does not include the mere implementation of, or rubberstamping of decisions made by others (see paragraphs 21 to 24 of this draft Ruling).

Acts of central management and control

10. Exercising central management and control of a company can involve:

(1) setting investment and operational policy[13] including:

(a) setting the policy on disposal of trading stock, and/or the use and development of capital assets[14]

(b) deciding to buy and sell significant assets of the company[15]

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[6] *Bywater* at [40]; *Malayan Shipping*; *Waterloo Pastoral Co Ltd v FCT* (1946) 72 CLR 262 *(Waterloo)*; *Todd v The Egyptian Delta Land and Investment Co Ltd* (1926-28) 9 T.C. 342 *(Egyptian Delta)*; *Cesena Sulphur Co Ltd v Nicholson; The Calcutta Jute Mills Company Ltd v Nicholson (*1876) 1 Ex.D 428 (*Cesena Sulphur*) at 444

[7] *Bywater* at [41]

[8] *Bywater; Koitaiki Para Rubber Estates Ltd v FCT* (1941) 64 CLR 241(*Koitaki*) at 248

[9] *Bywater; Koitaki* at 248

[10] *Bywater Koitaiki* at 248

[11] *Bywater*; *Esquire Nominees Ltd v FCT* [1973] HCA 67; (1973) 129 CLR 177 (*Esquire*) at [28]; *New Zealand Forest Products Finance NV v Commissioner of Inland* Revenue (1995) 17 NZTC 12,073

[12] *Bywater* at [73] [75]

[13] *Bywater* at [45]; *De Beers Consolidated Mines Ltd v Howe* [1930-1911] 5 TC 198 *(De Beers)* at 213; *Koitaki* per Dixon J

[14] *De Beers* at 213

(2) appointing company officers and agents and granting them power to carry on the company's business(and the revocation of such appointments and powers)[16]

(3) overseeing and controlling those appointed to carry out the day-to-day business of the company, and[17]

(4) matters of finance[18] including determining how profits are used and the declaration of dividends.[19]

Matters of Company Administration

11. Matters of company administration are not acts of central management and control. These include:

(a) keeping a company's share register, including registering transfers of shares[20]

(b) keeping a company's accounts[21]

(c) where a company pays dividends[22] and

(d) the minimum acts necessary to maintain a company's registration.[23]

The relevance of a company's activities

12. The nature of a company's activities and business define which acts and decisions are an exercise of the central management and control of that company.[24] For example, where a company is a special purpose vehicle set up to conduct only two transactions – to buy and sell an asset – the decisions to buy and sell will be the only activities relevant to central management and control. For a company carrying on an ongoing business of mining and selling diamonds, the relevant decisions include determining policies on the operation and development of mines, and the sale of the mined diamonds.[25]

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[15] *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 (*Wood v Holden*); *De Beers* at 213
[16] *Bywater* [43], [45]; *Cesena Sulphur* at 455
[17] *Koitaiki*; *BW Noble Ltd v Mitchell* (1926-27) 11 TC 372 (*BW Noble*); Cf *Mitchell v Egyptian Hotels (*1911-15) (1915) AC 1022 (*Egyptian Hotels*)
[18] *Koitaki* per Dixon J
[19] *Bywater* [45]; *De Beers* at 455
[20] *The Swedish Railway Company Ltd v Thompson (HM Inspector of Taxes)* (1923-25) 9 TC 342 (*Swedish Railway*) at 355
[21] *Swedish Railway* at 355; *Egyptian Hotels* at 545-546
[22] *Swedish Railway* at 355
[23] *Egyptian Delta* at 142; *Union Corporation Limited v Commissioners of Inland Revenue* (1945-1963) 34 TC 207 (*Union Corp)* at 270
[24] *Bywater* at [85] [125]; *Waterloo*; *North Australian Pastoral Co Lt v FCT* (1946) 71 CLR 623 (*North Australian Pastoral)*; *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 (*Wood v Holden*)
[25] *De Beers*

Who exercises central management and control of a company?

13. Identifying who exercises central management and control is a question of fact. It is not determined by identifying who has the legal power or authority to control and direct a company.[26] The crucial question is who controls and directs a company's operations in reality.

A starting point

14. Normally, where a company is run in accordance with its constitution and the normal company law rules,[27] its directors will control and direct its operations.[28]

15. The actions of those directors, or others with the legal power and authority to act on behalf of the company, are a useful starting point but not the end of any enquiry. There is no presumption that the directors exercise central management and control unless proved otherwise.[29]

16. All relevant facts and circumstances, including the role of anyone who assumes the directors' role in managing and controlling the company's affairs or has a role or any input[30] in the decision-making processes or governance of the company, must be considered.[31]

Mere legal power or authority to manage a company is not sufficient to establish exercise of central management and control

17. A person who has legal power or authority to control and direct a company, but does not use it, does not exercise central management and control.[32] For example, in *Bywater*, the court disregarded the role of those directors who were formally appointed but did not play any real role in the affairs of the company.

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[26] *Bywater* at [40] 113]; *Unit Construction Co Ltd v Bullock (Inspector of Taxes)* [1960] AC 351 *(Unit Construction)*; at 362-363 (AC reports) [1956-60] 38 TC 712; *De Beers*

[27] For example see section 198A of the *Corporations Act 2001*

[28] *Bywater* at [41]

[29] In *Bywater* at [77] the High Court confirmed that the question of central management and control should not be approached on the premise that the directors of a company will exercise central management and control, unless an exception is established. The High Court observed that such an approach is inconsistent with the factual nature of the test and is unhelpful for identifying where a company's central management and control is actually located.

[30] *Bywater*

[31] *Bywater* at [41], [70]; *Unit Construction; Wood v Holden; De Beers; Cesena Sulphur; Koitaki; Esquire; Malayan Shipping*

[32] *Bywater*; *Unit Construction*; *Fundy Settlement v Canada* [2012] 1 SCR 520 (*Fundy Settlement)*; *Egyptian Hotels* at 551; *BW Noble* at 412

18. In limited circumstances a person may control and direct a company without ongoing active intervention in the company's affairs provided they:[33]

- have appointed agents or managers whom they tacitly control to conduct the company's day-to-day business
- tacitly control and regularly exercise oversight of the affairs of the company, including monitoring the company's performance, and
- do not need to actively intervene because the company's affairs are running smoothly and in the manner they desire.

Legal authority or power is not necessary for a person to exercise central management and control

19. A person without any legal power or authority to control or direct a company may exercise central management and control of that company.[34]

20. A person who exercises the powers of a director, even though not formally appointed, or a person whose instructions or wishes the validly appointed directors must or are accustomed to follow,[35] may exercise all or part of a company's central management and control.

Company outsiders – is a person merely influential over decision makers or do they exercise central management and control of that company?

21. An outsider who merely influences those with legal power to control and direct a company, even if they can and do exert strong influence, is not the relevant decision maker and does not exercise central management and control of the company.[36] However, if an outsider is more than merely influential, and actually dictates or controls the decisions made by the directors, the outsider will exercise central management and control of the company.[37]

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[33] *BW Noble* at 412.
[34] *Bywater* at [59],[67],[69], [113], [121]; *Unit Construction* at 362-362*; Fundy Settlement* at 526; *De Beers* at 213.
[35] Such persons being directors within the meaning of the *Corporations Act 2001* (Cth): see section 9 Definition of director.
[36] *Bywater at 73; Esquire at* 190-191; *Her Majesty's Revenue and Customs Commissioners v Smallwood* [2010] EWCA Civ 778 (*Smallwood*) *and Wood v Holden.*
[37] *Bywater.*

22. The distinction turns on what amounts to decision making for the central management and control test. In *Bywater*, the High Court observed that this turns on whether the people *said* to make the decisions of the company, actually *consider* whether to do what they are told, or are advised to do, and make a decision to do it because it is in the best interests of the company. If they do, they are the relevant decision maker and exercise central management and control of the company.[38] If they do not, and merely mechanically implement or rubberstamp company decisions already made by others based on what they are told or advised to do, the person who gave the instruction is the real decision-maker and exercises central management and control of the company.[39]

23. It is relevant to consider whether the directors would refuse to follow advice or directions of outsiders that are improper or inadvisable.[40] If they would, it is more likely the directors are the real decision-makers. If not, it is more likely the outsider who exercises central management and control.

24. The directors' knowledge of the business is also relevant. A lack of knowledge of the business sufficient to enable them to determine if following advice or instructions would be improper or inadvisable, suggests they are not the real decision makers and are more likely rubberstamping or implementing decisions already made by others.[41]

The relevance of formal documentation

25. Documents recording decisions are relevant evidence of who makes the decisions of a company (and where they make them).[42] However, if the documents record a state of affairs that the evidence shows did not exist, they will be disregarded in favour of the evidence showing what actually happened.[43] In *Bywater,* the High Court disregarded board minutes recording that decisions of the companies were made by their directors. While the minutes indicated that the directors made the decisions recorded, the evidence proved that in reality they took no part in making those decisions. The meetings of the board were found to be 'mere window dressing serving only to rubberstamp decisions actually made by others in another place'.[44] Central management and control was exercised by the person who actually made the decisions, not the directors who simply recorded the decisions.

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[38] *Wood v Holden; Esquire; Smallwood;* Cf *Bywater.*
[39] *Bywater* at [73].
[40] *Esquire* at 190-191; *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392 at 416.
[41] *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392 at [416]
[42] *Bywater; Koitaki*; *John Hood & Company Ltd v Magee* (1913-1921) 7 TC 327 (*John Hood*) at 357; *De Beers*; *Re Little Olympian Each Ways* Ltd [1994] 4 All ER 561 (*Re Little Olympian*).
[43] *Bywater* at [60] – [64] [75].
[44] *Bywater* at [63].

Where is central management and control of a company exercised?

26. A company will be controlled and directed where those making its decisions do so as a matter of fact and substance. It is not where decisions are merely recorded and formalised,[45] or where the company's constitution, bylaws or articles of association require it be controlled and directed, if in reality it occurs elsewhere.[46]

Multiple places of central management and control

27. The courts have recognised a company's central management and control may be divided between multiple places.[47]To establish central management and control is exercised in multiple places, a substantial part of the control and direction of the company must occur in each place it is said to be found.[48] However, the courts have observed this will be rare.[49]

Relevance of a company's activities

28. Central management and control of a company is not necessarily exercised where the trading or investment activities of the company are carried on.[50] However, the nature of a company's activities may dictate where key decisions of a company must be made as a matter of practice.[51] In *North Australian Pastoral,* the need to make essential decisions on the company's business activities, where those activities took place, was relevant to the court's conclusion that the central management and control was located where the company's business activities took place.

Relevant considerations

29. Matters that the courts have considered when identifying where those who control and direct the operations of a company do so from include:

- where the governing body of the company meets[52]
- where the company declares and pays dividends[53]
- where the shareholder's meetings are held[54]

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[45] *Bywater* at [51], [56]*; Fundy Settlement; John Hood* at 357
[46] *Bywater* at [40], [121]; *Unit Construction* at 741*; De Beers* at 213
[47] *Swedish Railway* at 372 and 375*; Koitaki; Re Little Olympian* at 569*; Egyptian Delta at 128-130 ;Union Corp at 267*
[48] *Union Corp* at 271;
[49] *Re Little Olympian at* 569*; Unit Construction* at 739
[50] *Bywater; Koitaki; Malayan; De Beers; Cesena Sulphur*
[51] *Waterloo; North Australian Pastoral*
[52] *Bywater* at [44], [53], [116*]; John Hood* at 357
[53] *Bywater* at [44]; *John Hood* at 357

- where the company's register of shareholders is kept[55]
- where the company's books are kept[56]
- where its registered office is located[57]
- where those who control and direct the company's operations live[58]
- where its shareholders reside[59]
- the nature of the business and whether it dictates where control and management decisions are made in practice[60]
- minutes or other documents recording where high-level decisions are made.[61]

30. None of these factors alone necessarily identify or determine where central management and control of a company is exercised.[62] The relevance and weight to be given to each will depend on the facts and circumstances of the case.[63]

Date of effect

31. When the final ruling is issued, it is proposed to apply from 15 March 2017.

32. The Commissioner's previous view of the central management and control test was contained 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* (now withdrawn).

33. This draft 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 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
15 March 2017

[54] *Bywater* at [46] [116]; *John Hood* at 357; *Koitaki; Cesena Sulphur* at 446
[55] *Bywater* at [46]; *Koitaki*
[56] *Bywater* at [43], [116]
[57] *Bywater* at [43], [116]
[58] *Bywater* at [58]; *Koitaki; North Australia Pastoral*
[59] *Bywater* at [116]
[60] *North Australian Pastoral* at 633-634; *Waterloo Pastoral*
[61] *John Hood* at 357; *Koitaki*; *Bywater*
[62] See for *example Bywater; Swedish Railway* at 386; *Unit Construction; North Australian Pastoral*
[63] *Re Little Olympian* at 569

Appendix 1 – Your comments

34. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

35. You can also join an online conversation and provide comments about this ruling here.

36. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**12 May 2017**
Contact officer:	**Andrew Harnisch**
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1936 6(1)
- Corporations Act 2001 9
- Corporations Act 2001 198A
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ATO references

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