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Review of Australia's corporate tax residency rules
Board of Taxation Secretariat
C/- The Treasury
Langton Crescent
PARKES ACT 2600

By Email: *CorporateResidency@taxboard.gov.au*

Dear Sir/Madam

CORPORATE TAX RESIDENCY REVIEW - REFORM OPTIONS PAPER

1. Thank you for the opportunity to provide comments on the Board of Taxation's ("**the Board**") Corporate Tax Residency Reform Options Paper ("**Options Paper**") which deals with the current operation of Australia's residency rules for companies ("**Residency Rules**") and the extent to which they can be reformed in light of modern practices.

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many taxpayers that are impacted by the Residency Rules.

GENERAL COMMENTS

3. While we note that the Board has not expressed a preference for any particular reform option and is not limiting its consideration to the two reform options in the Options Paper, we commend the Board for its consideration of a modified CMAC test and an incorporation-only test.

4. We encourage the Board to continue to explore these options to develop a solution that will provide commercial certainty, reduction of compliance costs and appropriate outcomes for the majority of taxpayers who establish companies in foreign countries for commercial rather than tax reasons.

Support for Option 2

5. We reiterate our preference from our earlier submission and endorse the adoption of an incorporation-only test under Reform Option 2.

6. This option is by far the simplest to apply and administer and would allow taxpayers to focus on their business and not be burdened with the uncertainty associated with any type of "facts and circumstances" test that requires constant monitoring at great expense.

7. No area of income tax is subject to more integrity measures and disclosure requirements than those relating to international tax as outlined in page 4 of the Options Paper. With further global initiatives on the horizon (e.g. Pillar One, Pillar Two, digital services taxes, etc), the concept of corporate residency is becoming less and less relevant in determining the corporate tax base of a particular country.

8. Whether ultimately the Residency Rules are reformed pursuant to Option 1 (modified CMAC), Option 2 (incorporation-only) or not reformed at all (such that the status quo persists), we believe that there will always be a small handful of taxpayers seeking to exploit and undermine such rules (e.g. by ensuring CMAC is exercised outside Australia). The Commissioner of Taxation will always be required to dedicate resources to ensuring such taxpayers are paying the appropriate share of tax in Australia and the Commissioner has several tools at his disposal to do so.

9. That being said, we do not believe an incorporation-only test will lead to inappropriate integrity risks under the current Australian income tax regime. The residency provisions are supported by a significant number of integrity provisions, including: the CFC provisions; transfer pricing; hybrid mismatch rules; the DPT and the MAAL. We would also support consideration of an additional supporting integrity provision, as outlined below, to the extent that this is considered necessary.

10. In our view, most taxpayers that seek to comply with the law will generally end up being subject to the same amount of tax on their profits in Australia whether resident or non-resident. However, the incorporation-test has by far the least compliance costs and promotes commercial certainty. This would also ease the burden on revenue authorities dealing with numerous applications for a competent authority determination in a post-MLI world and allow them to focus their efforts at more pointed issues in the international tax landscape.

11. Additionally, as outlined in the Options Paper, we believe that an incorporation only test would likely give rise to additional revenue in certain circumstances. Overall, taking into account all of the above, we believe that the risk to revenue under Option 2 would be low.

Consideration of an additional integrity provision under Option 2

12. In further exploring the incorporation-only option, we would support the Board considering specific integrity rules that may be considered necessary to complement such an approach including a rule to deal with "stateless" companies that are not tax residents anywhere.

13. Such a measure could be based on the hybrid mismatch rules which already deals with dual non-inclusion outcomes under the branch hybrid mismatch rules (e.g. both the residence country and the branch country fails to tax an item of income). For example, if an item of income derived by a company is not taxed in Australia or another country but would be if both countries had the same rules for determining residency, then the amount could be deemed to be income from Australian sources such that it would become subject to tax. If this is included within Part IVA, this would also prevail over Australia's tax treaties (e.g. Article 7) such that it remains taxable.

14. By focusing on items of income, rather than when a company is or is not a tax resident, this could allow integrity measures to be targeted towards addressing concerns regarding income not being taxed anywhere and may overcome the other issues that arise when a foreign incorporated entity is treated as an Australian tax resident (as outlined in page 5 of the Options Paper).

Legislative modification of the CMAC test

15. While not our preferred approach, we encourage the Board in its consideration of Option 1 to develop recommendations that are simple to apply and lead to certain commercial outcomes for the vast majority of taxpayers that would, for example, lead Australian headquartered taxpayers certain that their foreign-incorporated subsidiaries established to conduct substantial commercial operations overseas are at no or minimal risk of being considered to be an Australian tax resident regardless of where directors attend board meetings from.

16. On this point, if Option 1 were to be considered, we would recommend that the following options be considered as part of Option 1:

    16.1. That the CMAC test be a legislative test, which provides for rules that are similar to those contained in TR 2004/15. That is, as outlined in paragraph 5 and 6 of the ruling, the provision would have two requirements: the first being the carrying on of business in Australia and the second being the central management and control being exercised in Australia. Ordinarily, the second test would not be sufficient to satisfy the first test.

    16.2. This could be implemented in a statutory sense by ensuring that in determining whether a company carries on business in a jurisdiction, the place where it exercises its central management and control is to be excluded. It must also be coupled with a test that only picks up the place where it conducts substantial business.

17. However, any modified CMAC test should only be developed where it provides for certainty to the majority of taxpayers applying the rules. This will be to ensure that those taxpayers do not need to spend significant time and resources to manage the risk of changing tax residency. This may require additional rules to deem certain companies as not being Australian residents for an income year if, for example over 90% of their ordinary income would be exempt under section 23AH if they were a resident.

18. We would encourage the Board to explore shortcuts of this nature to provide certainty to taxpayers conducting genuine commercial operations offshore.

If you would like to discuss any aspect of this submission, please contact either Theo Sakell on (03) 8610 5503 or Leo Gouzenfiter on (03) 8612 9674.

Yours sincerely

T SAKELL
Executive Director