Australian Government

The Board of Taxation

CORPORATE TAX RESIDENCY

Reform Options

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1 Introduction

On 6 September 2019, the Board of Taxation (the Board) published a Consultation Guide on its corporate residency review project. In that guide the Board specified the Terms of Reference provided by the Treasurer, and presented six consultation questions for stakeholder comment. The Terms of Reference specified that:

> *The purpose of the review is to ensure that the corporate tax residency rules are operating appropriately in light of modern, international, and commercial board practices and international tax integrity rules.*
>
> *In particular, the Board is asked to consider whether the existing rules:*
>
> *1. minimise commercial uncertainty and ambiguity;*
>
> *2. are consistent with and aligned with modern day corporate board practices;*
>
> *3. protect the tax system against multinational profit shifting; and*
>
> *4. otherwise support Australia's tax integrity rules as they apply to multinational corporations.*

Since that time the Board has received thirteen written submissions and has conducted roundtable discussions in Sydney, Melbourne and Perth. The extensive comments and feedback that have been collected by the Board during this process have been summarised in this paper (note that this paper has been drafted on the basis that the reader is familiar with the Consultation Guide, as the relevant background and context is given therein).

The strong feedback provided to the Board has emphasised that reform in this area is required to provide greater commercial certainty and better alignment with modern day board practices and corporate governance.

Two primary reform options have emerged from the Board's consultation activity to date, which the Board would like to explore through further consultation. These are:

1) retention of the existing 'carrying on business and central management and control' test (collectively referred to as the CMAC test) but with some form of legislative modification; and

2) adoption of an incorporation-only test.

The Board notes that its consideration of these two possible reform options does not mean that it is no longer contemplating other reform options. Similarly, in setting out what stakeholders have submitted in respect of the two primary reform options the Board is not, at this stage, expressing a preference for either. Rather, this paper is intended to represent a distillation of the outcomes of the consultation process to date in order to inform the next stage of consultation on reform options.

The Board notes that stakeholders expressed very little support for a test based on the international treaty standard of 'place of effective management'. The general consensus was that the introduction of a new test and terminology would be likely to increase uncertainty through the inability to rely on existing case law, and would ultimately not address the same threshold issues that have been associated with central management and control.

A secondary reform option in the form of the removal of the 'voting power' test from the company residency rules has also been identified. Most submissions to the Board expressed the view that there is no compelling basis to retain this test.

The Board is cognisant that any changes to the company residency rules may affect entities other than companies, such as trusts and 'corporate limited partnerships'. The Board is also aware of the current work being conducted by the OECD on the tax challenges arising from the digitisation of the economy and acknowledges that the scope of 'Pillar One' and 'Pillar Two' has the capacity to change international tax rules in a broader context, and therefore any changes to corporate residency being contemplated need to be considered alongside this work.

2 Summary of stakeholder views

In this chapter the Board presents a summary of the major findings that have emerged from the consultation activity it has conducted to date. At numerous places throughout the chapter the Board has referred to specific concerns that have been raised by stakeholders in order to provide some context for why reform may be necessary, or the form it may take. Where this is the case it does not necessarily mean that the Board concurs with the basis of the concern in question.

2.1 Is change required?

A threshold question tested by the Board is whether legislative change to the CMAC test, or the corporate residency rules more generally, is actually required. Strong feedback from stakeholders indicated that legislative amendment is necessary, with stakeholders consistently raising challenges largely focused on three factors:

- the impact of the *Bywater* case on the interpretation of the CMAC test;
- changes in the way multinational groups operate in today's economy;[1] and
- how the combination of the above two factors has been reflected in the ATO's re-issued written guidance on (and administration of) this test.

Stakeholders have indicated that these three factors result in substantial uncertainty that cannot be alleviated through further administrative guidance. Stakeholders provided examples of how this uncertainty curtails commercial enterprise in multinational groups (largely related to start-up and small/medium sized organisations), as well as increasing red tape and compliance costs across all groups regardless of size (both inbound and outbound). In some instances stakeholders were concerned about adverse impacts on their corporate governance, including the promotion of overly conservative practices and limitations on the director pool for subsidiary companies.

2.2 Basis of the view in TR 2018/5

Whilst stakeholders appreciated the need for the ATO to update its guidance in light of changing case law authority, they also raised questions around why the *Bywater* decision prompted the degree of change to the ATO view as expressed in TR 2018/5. The general consensus was that the outcome in that case represented the application of well-established principles to factual circumstances that were clearly egregious and capable of being addressed through other integrity measures.

The Board does not seek to make any observations in relation to the *Bywater* decision itself. Stakeholder comments do, however, prompt a consideration of the role of the CMAC test as an integrity measure.

2.3 The role of the CMAC test as an integrity measure

The Board notes that the Terms of Reference for this review include a consideration of whether the existing corporate tax residency rules are operating appropriately to support Australia's tax integrity rules as they apply to multinational corporations. On this basis, the second question in the Consultation Guide

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[1] Including as a result of increased globalisation of the economy and value chains, technological changes, evolving corporate governance and the resultant impact of each of these on the way modern boards operate.

considered the role of the CMAC test in relation to integrity. Through its consultation the Board explored whether this test operates as an integrity measure in itself, or rather plays a supporting role to other integrity rules included in the tax law.

Some stakeholders challenged the framing of the CMAC test as an integrity measure, instead submitting it is primarily concerned with establishing residency as a means of identifying those companies that are *prima facie* subject to tax on their worldwide income.

Many stakeholders outlined the extensive range of measures that are now in place to ensure that the income of a foreign incorporated company is appropriately taxed in the event that the company is not treated as an Australian resident under the CMAC test.[2] These measures include:

- Controlled foreign companies and permanent establishment rules (discussed at some length at pages 19 to 21 of the Consultation Guide).
- Transfer pricing rules.
- Thin capitalisation rules.
- Various withholding taxes.
- Hybrid mismatch rules.
- The general anti-avoidance rule in Part IVA.
- The Multinational Anti-Avoidance Law.
- The Diverted Profits Tax.
- The adoption of the Multilateral Instrument.
- Country-by-country reporting tax disclosure rules.

As noted by one stakeholder:

> *In 2019 the risk of a company artificially achieving favourable tax outcomes in the absence of a multilateral web of [central management and control] or similar tests is minimal. A combination of enhanced [controlled foreign companies] rules, plus unilateral and multilateral action on addressing hybrid mismatch arrangements have significantly restricted the legitimate opportunities for exploiting mismatches in tax rules between jurisdictions.*

This draws attention to whether there are any identifiable circumstances in which Australian residency (through the CMAC test) would be the only means of taxing the income (or gains) of a foreign incorporated company where it is thought that the income in question should be taxable in Australia but it cannot be brought within the tax base under any of the integrity measures cited above. Most stakeholders submitted

[2] A number of stakeholders also referred to the prospect of additional integrity measures arising from the current international tax reform activity being conducted by the OECD.

that any such circumstances are not readily identifiable. However, when asked they did acknowledge that Australia's relatively high corporate tax rate could increasingly incentivise such arrangements going forward.[3]

2.4 Further consequences of Australian tax residency triggered under the CMAC test

A number of stakeholders discussed the impact of uncertainty in the application of the central management and control aspect of the test, with reference to the significant differences in tax outcomes that arise if a foreign incorporated company is treated as an Australian resident under the CMAC test. They highlighted the practical difficulties that attach to determining where central management and control has been exercised "to a substantial degree" on a case-by-case basis, particularly in circumstances where it is being exercised concurrently from Australia and a foreign jurisdiction. These practical difficulties largely stem from the inherent subjectivity associated with concepts such as central management and control, the boundaries of which are difficult to define. The prospect of multiple residency 'flips' and the resultant capital gains tax (CGT) consequences were raised.

Examples provided to the Board of flow-on consequences within the income tax legislation included:

- If a company is a prescribed dual resident then it will be unable to join any tax consolidated group that its parent company is a member of, and any unfranked distribution made by the company will be taxable in the hands of the 'head company' of the consolidated group. Note also that in the event that the company is not a prescribed dual resident it will automatically become a member of the tax consolidated group, which will trigger the asset cost resetting rules.
- A distribution from the company will not be eligible for the foreign non-portfolio dividend exemption (Subdivision 768-A of the ITAA1997).[4]
- A disposal of shares in the company will not be eligible for the foreign participation exemption (Subdivision 768-G of the ITAA1997).
- A disposal of a CGT asset (other than taxable Australian property) by the company that gives rise to a capital gain will not be eligible for relief under Division 855 of the ITAA1997.
- Owners of interests in the company may not be eligible for flow-through taxation treatment under the foreign hybrid rules (Division 830 of the ITAA1997).
- If the company is a resident of both Australia and a foreign country with which Australia has a tax treaty that has been modified by the Multilateral Instrument in relation to dual resident companies then a referral to the relevant Competent Authorities will be required to determine the question of residence.[5] This mechanism may not result in a timely resolution, and the company will be denied treaty benefits until the question of its residency has been resolved.

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[3] For example incorporation in a listed country with a significantly lower corporate tax rate than Australia, where passive income is characterised as not connected to a permanent establishment in Australia or not attributable under the controlled foreign company rules.

[4] Note that Treasury Laws Amendment Bill 2019 (Miscellaneous Amendments), if passed into law, will have the effect of extending the relief to entities that are not Part X residents.

[5] Stakeholders noted administrative concessions provided in relation to dual residents under the Australia / New Zealand treaty.

Stakeholders also highlighted the asymmetric tax outcomes that can arise in circumstances that involve a tax treaty that does not include a corporate residence tie-breaker rule, as illustrated by the following example:

> *Our US incorporated subsidiary became an Australian tax resident under the new ATO's view. However, as there is no tie-breaker rule in the US-Australian DTA, it is also a tax resident in each country but not a prescribed dual resident. It also became a member of our tax consolidated group. This has caused a number of asymmetric and unreasonable tax outcomes. For example, cost recharges by [the] US subsidiary to Australia are not deductible in Australia (as within a tax consolidated group) but are assessable in the US. A dividend from the US subsidiary will be subject to US withholding tax but the Australian parent cannot obtain a foreign tax credit (as the dividend within a consolidated group is ignored for Australian tax purposes).*

The US tax treaty is an outlier in this respect, as most tax treaties include a corporate residence tie-breaker rule. It is still, however, a commercially significant issue given the volume of cross-border trade and investment with the US. It also needs to be acknowledged that as more tax treaties are modified by the Multilateral Instrument then outcomes such as that outlined above will become increasingly prevalent (and require Competent Authority resolution).

Another concern identified by numerous stakeholders involved the prospect of unexpected Australian residency of foreign incorporated companies that are members of a significant global entity group, which raises the possibility of substantial penalties for each failure to make a required lodgement. Significant global entity groups may be subject to administrative penalties in the range of $105,000 to $525,000 per tax document lodged late. Given the uncertainty in company residency status under the current CMAC test and the potential penalties, we understand that companies are taking additional corporate governance measures to mitigate their tax exposures.

2.5 Effect on board composition and corporate governance

There was very strong feedback from stakeholders that the uncertainty now attaching to the CMAC test has led to a host of conservative, costly and uncommercial corporate governance practices that are being pursued in an attempt to minimise the prospect that a foreign incorporated company will be treated as an Australian resident under the CMAC test. It was consistently questioned whether such practices are in any way congruous with the policy rationale underlying the CMAC test. Indeed, in this context it has been noted that different outcomes may arise under the CMAC test between entities that employ sophisticated governance practices and (usually smaller) entities that are limited to the use of a simpler governance framework.

Some of the practices in question that were identified by stakeholders included:

- Australian resident directors of foreign subsidiary companies (with no operations in Australia) are now travelling offshore to attend board meetings, notwithstanding that such board meetings could have been attended from Australia through the use of modern communications technology such as videoconferencing.
- Australian resident directors are not attending foreign subsidiary board meetings via videoconferencing if they are unable to travel offshore.
- Conversely, foreign directors of Australian resident companies are now travelling to Australia for board meetings rather than attend via videoconferencing, to ensure that they do not inadvertently move Australian tax residency offshore.

- Additionally, foreign directors of non-Australian companies (with no operations in Australia) are not attending the board meetings of these companies via videoconference to the extent that they happen to be physically present in Australia at the time.

- The number of Australian resident directors appointed to foreign subsidiary boards is being restricted, or in some cases completely prohibited. In certain cases, this has raised concerns with foreign regulators where the foreign subsidiary is operating in a highly regulated sector.

In discussing these practices, stakeholders were concerned with the significant cost being borne and the loss in efficiency (given lengthy travel times) for no purpose other than seeking to ensure that the tax residency of a foreign incorporated company (without Australian operations) remains outside Australia. They also noted that limiting the appointment of Australian directors to foreign boards (or attendance at particular meetings) is problematic as:

- It is often the case that foreign resident directors are not as easily identifiable and/or qualified for the role relative to their Australian counterparts.

- Start-ups and smaller corporate groups do not have a substantial globalised talent pool to draw appropriately skilled directors from.

- In cases of mergers and acquisitions it may not be possible to identify, vet and appoint replacement directors for some months.

Stakeholders also noted that in many instances the incorporation of a subsidiary in a foreign jurisdiction may be mandatory due to factors such as local regulatory requirements and securing eligibility to borrow funds from overseas debt markets or financial institutions.

In discussing how corporate governance practices have evolved, stakeholders noted that modern 'best practice' typically involves the parent company establishing group policies and committees to monitor compliance with those policies. For Australian based multinational groups, there is a concern that such governance practices could be seen as a basis for attributing central management and control to Australia.

Interestingly, a number of stakeholders noted that the use of modern communications technology had not created any significant practical difficulties prior to the issuance of TR 2018/5, even in circumstances where the use of such technology resulted in central management and control being split across more than one jurisdiction. This was presumably due to Australian residency status not being triggered due to operational activities (i.e. the carrying on of the business) being quarantined to jurisdictions outside Australia.

The Board observes that, as is the case with central management and control, it is possible that changes in the way companies operate (due to advances in communications technology, globalisation and globalised labour forces) may also have impacts on the meaning of the "carrying on business in Australia" limb of the CMAC test. Examples discussed through consultation included management structures that are set up along product or business unit lines (globally or regionally), the impact of where a product/business unit head is located, any impact of centralising group functions globally (such as legal, human resources or shared services) and to what extent this is relevant where there are no physical 'operational activities' occurring in Australia.

3 Reform option 1 - legislative modification of the CMAC test

3.1 The reform proposal

Under this reform proposal the CMAC test would be modified to ensure that it is to be applied in two steps, consistent with the application under the former tax ruling TR 2004/15. Furthermore, several stakeholders suggested that further legislative clarification of the meaning of both criteria ("carrying on business in Australia" and "central management and control") should also be pursued.

3.2 Stakeholder feedback

Most stakeholders expressed the view that clarification of the CMAC test was required within the legislation itself (rather than through administrative guidance) to ensure ongoing certainty. Stakeholders submitted that this would ensure that the exercise of a company's central management and control in a particular location is not, by itself, sufficient to establish that the company is also carrying on business in that same location.

Consultation question 1 The Board seeks stakeholder feedback on how the CMAC test may best be modified in order to ensure that having central management and control in Australia cannot, by itself, be taken to also constitute the carrying on of business in Australia for tax residency purposes. In thinking about this question, are there any integrity concerns (such as the prospect of 'importation' of tax losses) that will arise in the event that the CMAC test is modified to ensure that it is applied in two steps?

3.3 Additional clarification of the criteria

First limb - carrying on business in Australia

Numerous stakeholders also emphasised the importance of clarifying the requirements of the "carrying on business in Australia" limb of the CMAC test by legislative amendment.

Some of these stakeholders were of the view that there may be a greater need to provide clarification on this limb relative to the second limb, submitting that the "carrying on business in Australia" limb of the CMAC test is intended to limit or restrict the scope of the second limb.

Through consultation it has been submitted that the broader approach adopted by the ATO in TR 2018/5 is particularly problematic for Australian outbound groups. Foreign operating subsidiaries may be treated as dual residents and be subject to additional Australian compliance requirements (such as those imposed under the tax consolidation regime), even if they do not undertake any operational activities in Australia. Similarly, foreign incorporated companies with Australian resident directors also face increasing uncertainty in their Australian tax residency status and filing obligations.

Only a limited number of proposed modifications to the first limb were provided to the Board. One stakeholder suggested, for example, that a foreign incorporated company should only be considered to be carrying on business in Australia provided that it is not also carrying on business in a foreign jurisdiction.

The Board did observe through consultation that the "carrying on business in Australia" limb has generally been interpreted by reference to more traditional modes of enterprise. As noted above, this may create challenges in some cases due to the evolution of how modern businesses and corporate groups now operate. This may be due, for instance, to the digitalisation of businesses, the rise of cross border services and intangible assets, the impact of globalised work forces and the ramifications of modern communication technologies on business operations. It also raises practical difficulties in providing legislative clarity on what carrying on business in Australia for tax residency purposes now means (but also in the future), with any such clarification also needing to be capable of applying across all sectors and sized operations (from start-ups and private wealth groups to significant multinational companies).

The Board is also aware that there is a particular issue as to where a holding company should be considered to be carrying on business, given the limited activity carried on by such entities in some cases.

It is also important to recognise that the concept of carrying on business is employed in other parts of the income tax legislation,[6] and that consideration will need to be given to whether any clarification of the first limb will have effect only for the company residency rules or be applicable more broadly across the income tax rules.

Second limb - central management and control in Australia

A number of stakeholders were of the view that the location of central management and control should be established by reference to a set of objective criteria that, once identified, should be codified so as to ensure that taxpayers can apply this aspect of the CMAC test with certainty.

One stakeholder suggested, for example, that central management and control should be deemed to be outside Australia if more than 50 percent of all director decisions (in say, a particular income year) were made when the directors in question were outside Australia at the time those decisions were made. A number of stakeholders questioned whether the location of board meetings should be determinative at all in attributing central management and control. Examples were provided of two similar businesses potentially achieving different residency outcomes based on the location of board meetings and whether directors physically attended. Conversely, other stakeholders preferred an emphasis on board meetings given the roles that boards play and the ability to rely on existing guidance and case law.

Alternatively, another stakeholder submitted that although having central management and control in Australia is a question of fact it may be preferable to specify a range of factors that should not be taken into account when determining whether central management and control is, in fact, in Australia in a particular case.

In its Consultation Guide the Board noted the practical difficulties that attach to determining whether central management and control is located in Australia in those instances where it is exercised concurrently from Australia and a foreign jurisdiction.[7] In response to this a number of stakeholders suggested that the second limb should be modified so that, from a conceptual perspective, there can be only a single location to which central management and control can be attributed.

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[6] Such as section 328-110 of the ITAA1997.

[7] At page 17.

One proposed means of identifying the relevant location in this context would involve making an assessment as to where central management and control has been predominantly exercised over time. This would eliminate the need to make a determination as to where central management and control has been exercised to a substantial degree,[8] though it may be arguable that this alternative does not necessarily resolve the ambiguity associated with central management and control in the circumstances of modern corporate governance.

The Board also recognises that any codification of the second limb needs to take account of smaller entities in the corporate taxpayer population, and be capable of being applied (for example) to sole director companies and circumstances in which decision making processes are less hierarchical and more fluid in nature.

Consultation question 2

If the CMAC test is modified to be a two-step test then the Board seeks stakeholder comment on whether it is necessary to define (by legislative amendment) either the first limb or the second limb of the test.

In thinking about your response to this question consider the following:

- What requirements/factors do you consider to be important for inclusion in the test in order to clarify what is meant by "carrying on business in Australia" and "central management and control"?
- Should the "carrying on business in Australia" aspect of the CMAC test also include a *de minimis* mechanism under which a company will be deemed not to satisfy the requirements of the first limb in the event that a certain threshold level (such as, for example, Australian turnover of the company as a percentage of global turnover) is not exceeded?
- Should the "carrying on business in Australia" test only have effect for the company residence rules?
- If central management and control is being exercised in both Australia and a foreign jurisdiction what requirements/factors should be incorporated into a legislative tie-breaker test?

[8] As prescribed in PCG 2018/9.

4 Reform option 2 - adoption of an incorporation-only test

4.1 The reform proposal

Under this reform proposal, the residence of a company would be determined solely by the place of its incorporation. As such, the CMAC test and the voting power test would be removed.

4.2 Stakeholder feedback

Stakeholders favouring this approach submitted that an incorporation-only test would promote predictability and certainty, as well as eliminate the difficulties that arise from tests that involve nebulous concepts (such as central management and control and place of effective management). These difficulties have already been described at some length in this paper, and their elimination would presumably involve significant reductions in compliance costs.

Numerous stakeholders supported this approach, either as their preferred reform option or as an appropriate alternative to the retention of a modified CMAC test. Those who did support an incorporation-only test cited the range of integrity measures listed at page 4 of this paper. These stakeholders contended that these measures should ensure that the profits of a foreign incorporated company that carries on business in Australia will be taxable, and questioned the need for a CMAC test even in the event that modifications are made to it.

One stakeholder encapsulated this in the following terms:

> *It would provide certainty for companies, administrators, policy makers and the legislature, is consistent with corporate governance, recognises that companies carry on a wide range of business across different jurisdictions and are managed in different jurisdictions, that the place of CM&C is not simple and perhaps not relevant to anything but income tax, is consistent with the growth of digitalisation, is consistent with the reality of establishing holding companies in foreign jurisdictions, recognises that old expectations from the 1930s regarding how world-wide communication occurs are wholly inconsistent with technological changes, and is consistent with the practical reality that the other tests for residency are used infrequently.*

A number of submissions received by the Board have, however, drawn attention to a number of issues requiring further consideration.[9] These are:

- First, an incorporation-only test may result in an existing foreign incorporated resident company ceasing to be an Australian resident or even becoming 'stateless' or a 'resident of nowhere' for tax purposes. Such a change in company residency rules may give rise to unexpected Australian tax implications (e.g. the impact of CGT and tax consolidation) at the time such entities cease to be Australian residents.
- Secondly, an incorporation-only test is susceptible, by itself, to residency manipulation. Considering Australia's relatively high corporate tax rate, entities may be inclined to incorporate in a country with

[9] This does not mean that the Board is of the view that a modified CMAC test would itself be free of integrity concerns. The Board is, however, particularly interested in exploring the integrity concerns associated with an incorporation-only test given that it represents a more significant departure from the current residency tests.

a lower headline corporate tax rate. This may have significant implications for Australia's revenue base.

- Thirdly, Australia's taxing rights over foreign incorporated companies will be limited to income and gains generated from Australian sources, regardless of where their central management and control is exercised or where they carry on business.

- Lastly, there may be unpredictable and possibly detrimental effects on the operation of a number of tax treaties to which Australia is a party.

4.2.1 Risks of changing residency

Stakeholders have highlighted that changes in corporate residency rules could have adverse tax implications for foreign incorporated resident companies under the CGT and tax consolidation regimes. For example, cessation of residency would give rise to CGT event I1, and any unrealised gains on the CGT assets owned by the affected company, which are not taxable Australian property, will need to be crystallised at the time of the event. Similarly, a foreign incorporated company currently in an Australian tax consolidated group will cease to be a member of the group, triggering further CGT consequences.

The Board notes that the adoption of an incorporation-only test will necessitate the implementation of transitional arrangements to deal with existing companies incorporated outside Australia that treat themselves as Australian residents, and file tax returns accordingly.

4.2.2 Residency manipulation and revenue cost

Some stakeholders were concerned that adopting an incorporation-only test may encourage the manipulation of a company's residency status. The test can presumably be abused as the place of incorporation is not always where profits are earned or where decisions are made, and there may be particular concerns about Australian taxpayers using foreign incorporated companies in this regard, particularly in light of Australia's relatively high corporate tax rate.

A number of stakeholders have suggested that there may be a need to introduce integrity rules to supplement an incorporation-only test in order to prevent manipulation of residency and other unpalatable outcomes, such as the prospect of stateless companies and double non-taxation of income. A possible example the Board has become aware of arises from Singapore corporate tax residency being determined solely on where the "control and management" of a company is exercised. A company incorporated in Singapore but controlled and managed in Australia would hence not be a resident in either jurisdiction. If the company then, for example, derives a capital gain from the disposal of property located in New Zealand it will, *prima facie*, not be subject to tax anywhere.

The need (if any) for amendments to existing integrity rules would also have to be explored,[10] as well as understanding potential revenue losses for the government if all foreign incorporated companies are to be treated as non-residents and subject to tax only on income and gains sourced from Australia.[11]

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[10] Section 385 of the ITAA1936 may be relevant in this context. This section, which is found in Part X, provides for the making of regulations that specify types of income that are to be included in the notional assessable income of a controlled foreign company that is a resident of a listed country.

[11] There is also a possibility of revenue gains under an incorporation-only test such as, for example, in a consolidation scenario where payments from a foreign incorporated company will be assessable in the hands of the head company of the consolidated group.

4.2.3 *Interaction with tax treaties*

Concerns have been expressed to the Board that making significant changes to the company residency rules could prompt re-negotiations of Australia's international tax agreements. The basis of these concerns is that a company must be an Australian resident under Australia's domestic laws in order for the relevant tax treaty to apply, and that Australia's tax treaties have been entered into on the basis of arguably more expansive domestic company residency rules.

Other stakeholders have, however, questioned whether such an outcome would arise. Changing the domestic criteria for residency to an incorporation-only basis will ensure that a foreign incorporated company will not be a resident for the purposes of the applicable tax treaty. That being the case, these stakeholders then point out that instances of dual residency involving Australian incorporated companies will still need to be resolved under the pre-existing tie-breaker mechanisms in Australia's tax treaties, regardless as to whether (for example) such mechanisms exclusively involve place of effective management or Competent Authority involvement under the terms of the Multilateral Instrument. There would, therefore, be no consequent need to amend any tax treaty to which Australia is a party.

Some stakeholders have even argued that a change to an incorporation-only test will prove beneficial in this regard, given that it will presumably reduce the incidence of dual residency and hence the need for Competent Authority involvement in those cases where the tax treaty in question has been modified by the Multilateral Instrument.

Consultation question 3

The Board seeks stakeholder comment on whether the adoption of an incorporation-only test will be more effective at reducing taxpayer uncertainty and better aligned with modern corporate governance practices, as compared with the retention of a modified version of the CMAC test.

Consultation question 4

The Board seeks stakeholder feedback on whether there are any technical or compliance considerations of concern that may arise if corporate residency is determined by an incorporation-only test.

Consultation question 5

The Board anticipates that some forms of corporate restructuring will take place in the event that an incorporation-only test is adopted. The Board seeks stakeholders' experience with, and views on, how corporate structures may change in response to such a significant amendment to the residency rules. How could the effects on Australia's corporate tax base be evaluated?

Consultation question 6

The Board seeks stakeholder feedback on whether an integrity rule (or rules) would be required to supplement an incorporation-only test, and if so in what form? The Board is particularly interested in any observations that stakeholders may have on whether changes would need to be made to the controlled foreign companies rules in the event that an incorporation-only test is adopted, and if so what those changes would be. For example, should a new stateless income rule be introduced? Or should new measures similar to the "transferor trust" approach be introduced to apply to a transferor who has transferred property or services to a non-resident company?

5 Transitional arrangements (both options)

The Board is aware that the reform options under consideration may have substantial implications for the corporate taxpayer population, such as companies that may cease to be Australian tax residents because they were incorporated outside Australia. Accordingly, due consideration will need to be given to the design of suitable transitional measures to facilitate an orderly transition.

Consultation question 7
The Board seeks stakeholder feedback on whether it is necessary to introduce a transitional rule when implementing a change to the company residence rules. It has been put to the Board that a transitional rule is only required if place of incorporation is the sole test for residence. Is this correct? In thinking about this question, if you consider that a transitional rule is required what should it be? The Board seeks stakeholder feedback on an appropriate commencement date for either reform option.