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Abstract
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Keywords
residency tests, income tax assessment, company

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Dr Michael Dirkis is Senior Tax Counsel, Taxation Institute of Australia. The views expressed are those of the author and do not necessarily reflect the views of the Taxation Institute of Australia. This paper is drawn from Chapter 4 of his PhD Thesis published as Is it Australia's?: Residency and source analysed, Research Study No 44, Australian Tax Research Foundation (2005).

STILL A PROBLEM CHILD: CENTRAL MANAGEMENT AND CONTROL AFTER RITA

*Michael Dirkis**

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Introduction

The central management and control test is the second of three statutory residency tests applicable to companies contained in s 6(1)(b) of the *Income Tax Assessment Act 1936* (Cth) (the 1936 Act). This key test deems a company to be a resident where the company, 'not being incorporated in Australia, carries on business in Australia and has . . . its central management and control in Australia'.[1] The test is intended to apply 'to companies . . . whose central management and control is in Australia' thereby ensuring that a 'number of companies incorporated outside Australia whose sole or principal business is located in Australia' were taxable as residents.[2]

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1 The central management and control test has been adopted from the common law of the United Kingdom (see Taxation Review Committee, Commonwealth, *Full Report* (1975) (the *Asprey Report*) 255) and is the same company test adopted in the 1930s when the Commonwealth and some states introduced the residency basis of taxation.

2 Note on Clause 2 in Explanatory Notes, Bill to Amend the Income Tax Assessment Act 1922-1929 (Cth) 11.

However, concerns about the potential width of the test was one of the major reasons for the Treasury issuing the Review of International Taxation Arrangements consultative paper (the RITA Consultation Paper) on 22 August 2002, which explored options for reforming the company residency test.[3] Following a consultation process conducted by the Board of Taxation, the Board recommended the adoption of 'incorporation in Australia' as the sole test for corporate residency.[4] Despite the recommendation, the Government deferred consideration of any changes pending the release of a Ruling by the Australian Taxation Office (ATO) to clarify the operation of the central management and control test.[5]

This article explores the extent to which Taxation Ruling TR 2004/15: Income Tax: Residence of Companies Not Incorporated in Australia – Carrying on Business in Australia and Central Management and Control has clarified the operation of the test.[6]

The impact of TR 2004/15

To evaluate whether TR 2004/15 has clarified the operation of the central management and control test, the article explores whether the Ruling:

> clarifies whether the first element of the test (ie the company must be carrying on business in Australia) has an independent role in terms of the test;
>
> assists in determining whether a business is being carried on; and
>
> deals with the existing complexity (compliance costs) and avoidance risk problems.

3 Treasury, Commonwealth, *Review of International Taxation Arrangements: Consultation Paper* (2002) (RITA Consultation Paper), after examining the incorporation test, proposed consideration of options to clarify the test of company residency so that exercising central management and control alone does not constitute the carrying on of a business (Option 3.12). See generally Michael Dirkis, 'Reviewing an International Tax Review' (2002) 6 *Tax Specialist* 68.

4 Board of Taxation, Commonwealth, *International Taxation: A Report to the Treasurer* (2003) 109 (Recommendation 3.12).

5 Treasurer, 'Review of International Tax Arrangements' (Press Release No 32, 13 May 2003).

6 A pre-issue draft ruling was confidentially circulated by the ATO in June 2003, with Draft Taxation Ruling TR 2004/D7, *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control* being released on 23 June 2004 for public comment, with public comment required by 6 August 2004.

Relevance of 'carries on business in Australia'

The Problem

The High Court in *Malayan Shipping Co v Federal Commissioner of Taxation*[7] found that once central management and control was established, it would be inferred that a business is being carried on. As Williams J noted:

> The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business . . . must be . . . in Australia is, in my opinion, to make it clear that the mere trading in Australia by a Company not incorporated in Australia will not of itself be sufficient to cause the company to become a resident of Australia. *But if the business of the company carried on in Australia consists of or includes its central management and control, then the company is carrying on business in Australia* and its central management and control is in Australia.[8] [Emphasis added][9]

Therefore, if the element has no independent role, the central management and control test in s 6(1) has the potential of deeming resident companies, not carrying on business in Australia, to be a resident on the basis that central management and control is found to lie in Australia.

Although there is a broadly accepted view that the 'carries on business' element of the test is otiose,[10] there are those who believed that 'to be resident it must be positively

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7 (1946) 71 CLR 156; 8 ATD 75; 3 AITR 258.

8 (1946) 71 CLR 156, 159; 8 ATD 75, 77; 3 AITR 258, 261.

9 Justice Dixon also expressed a similar view in *North Australian Pastoral Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 623, 629; 8 ATD 121, 125; 3 AITR 314, 319. Also see *San Paulo (Brazilian) Railway Company v Carter* (1895) 3 Tax 407, 410 (Lord Halsbury LC) who noted that the phrase 'where trade is carried on' has two meanings: one being where the day to day business is conducted ('where things corporeally exist or are dealt with', the other the place where 'the conduct and management, the head and brain of the trading adventure' is located which may be different.

10 *Asprey Report*, above 1, 5, 255; NE Challoner and JM Greenwood *Income Tax Law and Practice (Commonwealth)* (2nd ed, 1962), 42; Uta Kohl, 'The Horror-Scope for the Taxation Office: The Internet and its Impact on "Residence"' (1998) 21 *University of New South Wales Law Journal* 436, n 45; Tom Magney, 'Australia-Singapore Taxation Aspects of Carrying on Business in Singapore – Part II' (1975) 4 *Australian Tax Review* 67, 69; Kerrie Sadiq, 'Jurisdiction to tax and the case for threshold reform' (Paper presented at the 16th Australasian Tax Teachers Association Conference, Adelaide, 30 January 2004), 9 and; Richard Vann and Ross Parsons, 'The foreign tax credit and reform of international taxation' (1986) 3 *Australian Tax Forum* 131, 148.

shown that the acts of management and control are genuinely accompanied by acts of carrying on business'.[11] The RITA Consultation Paper notes that the case law is not entirely clear and it further illustrates the uncertainty by revealing that the Commissioner applies the test so that the carries on business element is separate to the central management and control element.[12] Clarification of this uncertainty was the key issue for the Government requesting TR 2004/15.

Does TR 2004/15 clarify the issue?

The existence of a 'two tier' test is confirmed by the Commissioner in TR 2004/15. The Ruling argues that, on both precedent and statutory interpretative grounds, the two elements of the test are in fact distinct elements which must both be satisfied for the residency to be found.

The statutory interpretation arguments are that the two elements of the test are separate requirements under the basic rules of statutory interpretation as:

- the plain words of an Act must be given full meaning and effect;[13]
- courts should not easily consider any word or sentence used in an Act as superfluous or of limited meaning;[14] and

11 See, eg, Roger Hamilton, Robert Deutsch and John Raneri, *Australian International Taxation* (October 2002) para 2.190. Similarly, AJ Baldwin and JAL Gunn, in *Income Tax Laws of Australia* (1937) 168, note that a company is a resident "if the business of the company carried on in Australia consists of or includes its cental management and control". Although John Vincent Ratcliffe, John York McGrath and JWR Hughes, *The Law of Income Tax (The Commonwealth)* (1938), 105-6 recognises that the words "carries on business" could be redundant, the authors suggest that the phrase could be used ". . . in the sense of 'carries on its trade or other operations in Australia' as distinct from the management and control of those operations."

12 RITA Consultation Paper, above n 3, 54.

13 Taxation Ruling TR 2004/15: *Income Tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*, para 28 citing *Broken Hill South Ltd (Public Officer) v Commissioner of Taxation (NSW)* (1937) 56 CLR 337, 371; 1 AITR 106, 126; 4 ATD 163, 180 (Dixon J) and *Jackson v Secretary, Department of Health* (1987) 75 ALR 561, 571 (Northrop J).

14 TR 2004/15, ibid, para 28 citing *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 and *Beckwith v R* (1976) 135 CLR 569. In *Beckwith* at 574, Gibbs J stated that, '[a]s a general rule a court will adopt that construction of a statute which will give some effect to all the words which it contains'. Also see *Chaudhri v Federal Commission of Taxation* (2001) 47 ATR 126, 128; 2001 ATC 4214, 4216.

- that judicial statements regarding the construction of an Act must never supplant or supersede the actual words of the statute itself. Ultimately, each case must be governed by the Act and not judicial formulae.[15]

The second line of argument is based upon distinguishing the precedent value of *Malayan Shipping* and other cases. The Ruling initially seeks to argue, by implication, that *Malayan Shipping* should be limited to its facts. It argues that Williams J's comments (cited above) are explicable in the context of *Malayan Shipping* as in the case there was no need to examine the carries on business requirement due to the fact that the two separate requirements in the second statutory test were met by the same set of facts and activities.[16]

Also, it is argued that the extract from *Mitchell v Egyptian Hotels Ltd*, cited in *Malayan Shipping* by Williams J (see above), only indicates that mere trading is not sufficient to establish residency (ie, there must also be central management and control). This does not support the further proposition that if you have central management and control you are also invariably carrying on a business in that jurisdiction.[17]

As a result, the Ruling concludes that only where a company's business is management of its investment assets, and it undertakes only minor operational activities (as in *Malayan Shipping*), will the factors that determine where a company is carrying on a business be similar to those determining where it is exercising central management and control. It is only in that situation that the location of central management and control may be indicative of where the company carries on business.[18]

The Ruling then seeks to limit the precedential value of other decisions by arguing that:

- the Australian cases on central management and control, apart from *Malayan Shipping*, do not turn on the residence of the company under the second statutory test (including North Australian Pastoral Co Ltd), rather

15 TR 2004/15, ibid para 38, citing *Paisner v Goodrich* [1955] 2 QB 353, 358, *John v Federal Commissioner of Taxation* (1989) 166 CLR 417; 20 ATR 1; 89 ATC 4101, *Ogden Industries Pty Ltd v Lucas* [1970] AC 113, 127 (Lord Upjohn) and *Brennan v Comcare* (1994) 50 FCR 555; (1994) 122 ALR 615, 634.

16 Ibid para 34.

17 Ibid para 37.

18 Ibid para 6.

they considered provisions requiring a person to be a 'resident' in a particular place;[19]

- although the statement by Lord Loreburn in *De Beers Consolidated Mines Ltd v Howe* ' that a company resides where its real business is carried on . . . and the real business is carried on where the central management and control actually abides'[20] seems to support one element view, the *De Beers* case involved the question of the residence of a company under taxation laws that did not include a statutory definition of that concept; [21] and
- in *Mitchell* the company was held to be carrying on a business wholly outside the United Kingdom notwithstanding that its central management and control was in the United Kingdom.[22]

In light of these arguments, the Ruling concludes that for a company to be a resident under the second statutory test the two separate requirements must be met. This interpretation will give effect to all the words of the second statutory test, which is a preferable interpretation to one which makes the words 'carries on business in Australia' superfluous and unnecessary.

However, despite the Commissioner's attempt to restrict the impact of *Malayan Shipping* to cases where the business is the management of investments, the

19 Ibid footnote 5. *Esquire Nominees Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 177; 73 ATC 4114; 4 ATR 75, considered the former s 7(1) of the 1936 Act, *Waterloo Pastoral Co Ltd v Federal Commissioner of Taxation* [1946] 72 CLR 262; 3 AITR 329; 8 ATD 165 and *North Australian Pastoral Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156; 8 ATD 75; 3 AITR 258 considered the former s 23(m) of 1936 Act, and *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1940) 64 CLR 15; 2 AITR 136; 6 ATD 42 (High Court); *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241; 2 AITR 167; 6 ATD 82 (Full High Court) considered the former s 23(n) of the 1936 Act. Support for the Commissioner's view is found in Baldwin (above n 11, 171) who notes in 1937 that the definition in s 6(1) is only conclusive of residence elsewhere and residence under these provisions must be determined in accordance with the common law.

20 *De Beers Consolidated Mines v Howe* [1906] AC 455, 458; (1906) 5 TC 211, 213 (Lord Lorebum LC). The principle has been subsequently adopted in *Koitaki Para Rubber Estates v Federal Commissioner of Taxation* (1941) 64 CLR 241; 2 AITR 167; 6 ATD 82, *North Australian Pastoral Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156; 8 ATD 75; 3 AITR 258, *Unit Construction Co Ltd v Bullock* [1960] AC 351, *Esquire Nominees Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 177; 73 ATC 4114; (1973) 4 ATR 75, and many other cases (TR 2004/15, above n 13, footnotes 6).

21 TR 2004/15, above n 13, para 40.

22 Ibid para 36.

Commissioner's arguments struggle in light of the overwhelming weight of precedent endorsing the statements of Williams J in *Malayan Shipping*.[23]

Determining whether a business is being carried on

Having argued the test is a two tier test, the Commissioner states in TR 2004/15 that in the statutory context it is assumed that all companies (other than dormant companies) are carrying on a business.[24] However, this view is also not supported in the case law. In both *Southern Estates Pty Ltd v Federal Commissioner of Taxation* and *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation the Courts* held that the companies were not carrying on a business as the activities undertaken were preliminary to commencing a business.[25] Thus, if a business is not being conducted or is no longer being conducted then the test is not satisfied, and to this extent the Ruling appears again to be wrong.

Dealing with complexity

Overview

To illustrate the complexity underlying the operation of the central management and control test, it is important to provide the following overview of its operation.

Under the second element of the test the focus is on the 'management and control' exercised by the directors, not the 'control' of the company by shareholders through the general meeting, which is the focus of the 'voting power control' test. Therefore, while the words 'management' and 'control' are distinct terms, in this context they are often interpreted together. The word 'central' in the formulation qualifies the words 'management and control' in order to indicate that the test is focused on the people

23 See, eg, *Esquire Nominees Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 177; 73 ATC 4114; (1973) 4 ATR 75, *Waterloo Pastoral Co Ltd v Federal Commissioner of Taxation* [1946] 72 CLR 262; 3 AITR 329; 8 ATD 165, *North Australian Pastoral Co Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 156; 8 ATD 75; 3 AITR 258, and *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241; 2 AITR 167; 6 ATD 82. In July 2000, as part of consultation on the proposed entity tax measures (see Review of Business Taxation, Parliament of Australia, *A Tax System Redesigned* (1999)) the residency test recommended for an 'entity' was a central management and control test without the carries on business element.

24 TR 2004/15, above n 13, para 45.

25 *Southern Estates Pty Ltd v Federal Commissioner of Taxation* (1966) 117 CLR 481; 10 AITR 525; 14 ATD 543; and *Softwood Pulp and Paper Ltd v Federal Commissioner of Taxation* (1976) 7 ATR 101; 76 ATC 4439.

who occupy the pinnacle of power, the directors, not the minor day to day managers.[26] This approach differs from modern corporate regulation adopted under the *Corporations Act 2001* (Cth), which acknowledges that day-to-day managers can have de facto control of a company and that this practical control can circumvent, in some circumstances, the legal control exercised by the board.

Ascertaining a company's residence under this test is mainly a question of fact.[27] However, the cases yield a number of factors that will assist in determining with whom the central management and control lays, in particular that:

Although the company's constitution (memorandum and article of association) will normally provide that the power to control the company is vested in a board of directors,[28] these documents are not conclusive as the application of the test is determined by 'scrutiny of the course of business and trading';[29]

Control may be from the course of business and trading which may reveal that a single person alone may exercise central management and control (eg, where a chairman or managing director exercised powers conferred by the articles) or the

26 The importance of the word 'central' was stressed as long ago as 1930 by the then Leader of the Opposition, Sir John Greig Latham, who in the House of Representatives noted that the removal of the word 'central' could result in a company being 'held to be a resident in Australia, although there was no real and genuine control of it in the Commonwealth'. He also warned that the words could be interpreted as 'whole management and control should be in Australia' which would facilitate tax avoidance (see Commonwealth, *Parliamentary Debates*, House of Representatives, 29 July 1930, 4859 (Sir John Greig Latham, Opposition Leader)). Peter Gillies agrees, observing that in order to indicate that he was concerned to identify the people who occupy the pinnacle of power Lord Loreburn LC in *De Beers Consolidated Mines v Howe* [1906] AC 455 inserted the adjective 'central' to his test – 'Understanding Company Residence: Central Management and Control' (1989) 1(4) *CCH Journal of Australian Taxation* 52, 54.

27 *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241, 246; 2 AITR 167, 170; 6 ATD 82, 85. Robert Couzin, *Corporate Residence and International Taxation* (2002), 44 notes that '[w]hile the test for residence is a question of law, its application is a pure question of fact. Corporate residence is found not where central management and control should abide but where it actually does abide'.

28 A replaceable rule in the Company Constitution requires that 'the business of the company is to be managed by or under the direction of directors' – *Corporations Act* 2001 (Cth) s 198A(1).

29 *De Beers Consolidated Mines v Howe* [1906] AC 455, 458 (Lord Loreburm LC) and *Unit Construction Co Ltd v Bullock* (1959) 38 TC 712, 741; [1960] AC 351, 370-1.

board is merely a 'cypher' for a controlling shareholder as in *Malayan Shipping*;[30] and 'control' has to be actual control, not implied.[31] For example, in the *Unit Constructions* case the directors stood aside completely, while in *Esquire Nominees* the directors continued to meet, make decisions exercising independent discretion, and did not solely act on instruction.[32] Thus, control must be 'actual' control.[33]

Similarly, once central management and control has been established, to ascertain where it is exercised is again 'a question of fact to be determined in light of all the relevant facts and circumstances.'[34] There are a number of factors that determine the place where central management and control is exercised:

- the place where the board of directors meet;[35]
- generally, physical locations, such as the place of incorporation and the location of the registered office, are usually not indicative of where 'central management and control' is exercised;[36]
- although the place of meeting may, in some circumstances, be where central management and control is found, in other situations 'central management

30 Richard Shaddick, 'International Tax and structures' (Paper presented at the 1996 Taxation Institute of Australia's Queensland Convention, Brisbane, 24-25 May 1996) 112, 116.

31 See Gibbs J in *Esquire Nominees Ltd v Federal Commissioner of Taxation* ((1972) 129 CLR 177, 190-1; 72 ATC 4076; 4086; 3 ATR 105, 115.

32 The crucial determinant is that Gibbs J did 'not believe that they would have acted on instruction'. The *Esquire Nominee* approach has been followed in more recent cases such as *Re Little Olympian Each Ways Ltd* [1994] 4 All ER 561 and *New Zealand Forest Products Finance NV v Commissioner of Inland Revenue* (1995) 17 NZTC 12073 – see J David B Oliver, 'Company Residence – Four Cases' [1996] *British Tax Review* 505.

33 TR 2004/15 (above n 13, paras 19 and 20) notes that 'where a parent company exercises central management and control in Australia over a subsidiary . . . the subsidiary would need to also be carrying on business in Australia for it to be a resident under the second statutory test.' Also see *BW Noble Ltd v Mitchell* (1926) 11 TC 372.

34 TR 2004/15, ibid, para 15.

35 *De Beers Consolidated Mines v Howe* [1906] AC 455, *The Calcutta Jute Mills Company Limited v Nicholson* (1876) 1 TC 82, and *Cesena Sulphur Co Ltd v Nicholson* (1876) 1 TC 88. The RITA Consultation Paper, above n 3, 54, takes a simplistic view that central management and control will, in practice be found where the board of directors meet as the test is focused on the persons who have the ultimate power, the directors, not the managers responsible for the day to day operations.

36 However, they may be relevant factors in the ultimate conclusion – see Gillies, above n 26, 59.

and control' is located at the place of principal business activity (as that is where the important decisions are undertaken);[37]

- The place of business can also determine the place where central management and control is exercised, even where the board meets away from the place of business.[38]

However, according to TR 2004/15, the Commissioner will, as a matter of practical compliance, accept that central management and control is in Australia, if the majority of the board meetings are held in Australia (ie, when the majority of directors of the company meet in Australia) and will be outside Australia if the majority of the board meetings are held in a single jurisdiction outside Australia. This position is conditional upon the central management and control being exercised by a board of directors at the board meetings and that there are no circumstances to indicate the central management and control outcome is artificial or contrived.[39]

As the outcome can turn on a single fact, the outcome in many circumstances is difficult to predict, resulting in tax administration and high compliance costs, which are key indicators of a lack of simplicity. [40]

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37 In *North Australian Pastoral Company Ltd v Federal Commissioner of Taxation* (1944) 71 CLR 623; 3 AITR 314; 8 ATD 121, Dixon J concluded that a pastoral company does not carry on ". . . a financial or trading business the control and management of which might be considered to depend on decisions of policy and upon the judgement and capacity of the general manager independently of the locality. It was essentially localised. There has not been a case so far in which . . . the company has been held not to reside there." (634; 322; 129). Also see Shaddick, above n 30, who notes that ". . . the place of directors' meeting is significant only in so far as those meetings constitute the medium through which central management and control is exercised."

38 Similarly, in *The Waterloo Pastoral Company Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 262; 3 AITR 329; 8 ATD 165 Williams J noted that the 'board of the appellant had power under the articles of association to require that all important decisions should be subject to its confirmation, and it could have met regularly and exercised this control instead of leaving these decisions to Messrs Bowater and Bingle. But to exercise this control effectively it would have been necessary for the directors to visit the stations and meet there because so many of these decisions could only be made on the spot.' (267; 332; 168).

39 TR 2004/15, above n 10, paras 15-18.

40 See Graeme S Cooper, 'Themes and issues in tax simplification' (1993) 10 *Australian Tax Forum* 417, 424. Cooper, after reviewing the literature, suggests that the many and varied concepts discussed by writers can be distilled down to seven concepts that are embodied in the notion of simplicity, being predictability (ease of understanding) of a rule's intended scope; proportionality (complexity proportional to the policy); consistency (avoids arbitrary

Compliance costs

This 'fact and circumstance' nature imposes a high level of cost upon the company in complying with the law. A company, in a self assessment environment, must determine, in light of its individual factual circumstances, whether it is a resident under the various tests contained in the 1936 Act. However, this process is complicated as the origins of the non-incorporation tests lie in the common law and their scope has been defined by a long line of often conflicting United Kingdom and Australian judicial decisions. The uncertainty is magnified with factual application and technology changes that allow remote management.

Thus, the determination of residency under the central management and control test is an expensive exercise as offshore subsidiaries of Australian companies, multinationals, regional holding companies and dual listed companies can be treated as resident companies. The RITA Consultation Paper notes this cost and the costs associated in avoiding the application of the rules. The paper suggests that this planning can be costly and inconvenient and is unnecessary on policy grounds.[41]

Similarly, there are administrative difficulties arising from the fact and circumstance basis of the central management and control test. As a company's residency depends upon its circumstances, the ATO is required to make individual, subjective determinations in respect of issues such as whether the company has the requisite central management and control. This uncertainty and the case by case nature of the test mean that the ATO is unable to give simple broad pronouncements on how the law operates.

As the self assessment system is dependent on taxpayers having the necessary information to determine their tax position, the inability to provide that information impacts adversely on the ability to self assess and the extent to which the ATO can treat as reliable self-assessed residency determinations.[42] If reliability is low, risk is high and the ATO under its compliance model is required to devote additional

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distinctions); low compliance burdens; easy administration; co-ordination with other tax rules; or clear expression.

41 RITA Consultation Paper, above n 3, 53.

42 A search of the word 'resident' on the ATOIDs section of the ATO website (<http://www.ato.gov.au> at 28 April 2004) reveals that only 19 of the over 500 ATOIDS issued between 2002 and 2004 related to companies and only one ATOID rules on a company's residency.

resources to areas of risk.[43] Thus, it is obvious that the uncertain and subjective central management and control test would have difficulty satisfying any simplicity criterion.

This difficulty is compounded where the trading activities are conducted by mail order or electronic means (Internet). As a result it is impossible for the ATO to give simple broad pronouncements on how the law operates and it is equally difficult for taxpayers to determine their residency status. Again, this test becomes impossible to effectively administer in the self-assessment environment.

In summary, given the fact and circumstance nature of the test, TR 2004/15 was never going to do anything other than restate the law. Operational clarity was never going to be achievable.

Dealing with avoidance

Concerns about the effectiveness of the central management and control test were also raised as early as 1930 when the residency definitions were first introduced.[44] The then Leader of the Opposition, Sir John Greig Latham, in the House of Representatives noted that the central management and control test would be avoided by 'encouraging companies to remove their central management and control from Australia and arrange to be controlled by persons abroad.'[45] The place of management style test is easily exploited 'because a change in the place of management generally can be accomplished without triggering any tax'.[46]

In its first report on the Internet, however, the ATO concludes that there is sufficient authority to indicate that the courts are open to modifying the application of the central management and control test to the electronic communication environment (eg, internet, videoconferences, etc).[47] Despite this optimistic view, the ATO concedes that applying a factual test will prove difficult.[48]

43 Australian Taxation Office, Commonwealth, *Compliance Program 2005-6* (2005).

44 Commonwealth, *Parliamentary Debates*, House of Representatives, 29 July 1930, 4859 (Sir John Greig Latham, Opposition Leader).

45 Ibid.

46 Brian Arnold and Michael McIntyre, *International Tax Primer* (1995) 23.

47 Australian Taxation Office, Commonwealth, *Tax and the Internet: Discussion Report* (1997) para 7.2.20 (ATO's first Internet Report).

48 Ibid para 7.2.21.

This is not a new problem, as in the past the courts have struggled to determine the place of management and control where directors live in different parts of the world.[49] Although, it is now accepted that dual residency can exist where central management and control of a company is divided,[50] it will be often difficult to establish this on the facts.[51]

This problem is compounded by the instantaneous and global facilities, available currently, which render physical meeting otiose.[52] The *Corporations Act* permits directors' meetings to use any technology consented to by all the directors, but there must be some evidence of participation by the directors.[53] Even where physical meetings take place, its location may be determined by taxpayer manipulation.[54] This view is confirmed by the Business Council of Australia who noted the:

test causes Australian companies with foreign subsidiaries or joint venture companies to ensure that the subsidiary's management is out of Australia, and thereby minimises

49 Kohl, above n 10, 446. The slow acceptance of the 'dual residence' concept is highlighted by comparing A Farnsworth's 1939 published doctoral thesis (*The Residence and Domicil of Corporations* (1939)) with the 1975 work of Tom Magney (above n 10). While Farnsworth (at 196) concluded that *Swedish Central Railway Co v Thompson* [1925] AC 495 (the case that first mooted dual residency) was an exception to a long series of court decisions, Magney is able to conclude (at 106) that dual residency occurs where there is a division of central management and control due to Lord Radcliffe's qualification of the *Swedish Central Railway* case's principle in *Bullock (Inspector of Taxes) v The Unit Construction Co Ltd* (1959) 38 TC 712; [1960] AC 351 and other post-1939 cases such as *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241; 2 AITR 167; 6 ATD 42 and *Union Corporation Ltd v Inland Revenue Commissioner* (1952) 34 TC 207.

50 Ian Gzell, 'Concepts of Residence and Source into the 21st Century' (1996) *Taxation Institute of Australia's International Tax into the 21st Century Red Series Intensive Retreat*, 10-12.

51 Lord Radcliffe in *Bullock (Inspector of Taxes) v The Unit Construction Co Ltd* (1959) 38 TC 712, 739; [1960] AC 351, 366 noted that 'individual cases have not always so arranged themselves as to make it possible to identify any one country as the seat of central management and control at all. Though such instances must be rare, the management and control may be divided or even, at any rate in theory, peripatetic'.

52 Jinyan Li, 'E-commerce Policy in Australia, Canada and the United States' (2000) 6 *University of New South Wales Law Journal* 40, 41; Kohl, above n 10, 445 and OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayer* (November 1997) para 114.

53 *Corporations Act 2001* (Cth) s 248D.

54 Li, above n 52, 41. The problem is compounded by the fact that internet business transactions are unverifiable making evidentiary collection impossible - see Gary Sprague and Michael Boyle, 'General Report' in International Fiscal Association, LXXXVIa *Cahiers de Droit Fiscal International – Taxation of Income Derived from Electronic Commerce* (2001) 21.

Australian involvement. To do otherwise would expose the foreign subsidiary's earnings (as well as actual or deemed capital gains) to tax in Australia. [55]

The RITA Consultation Paper also confirms that the test is avoidable by careful planning.[56] However, the paper concedes that the planning can be costly, inconvenient and unnecessary (on policy grounds). The RITA Consultation Paper also acknowledges that more uncertainty arises in a technological age (eg video conferencing, internet, etc) as the ascertainment of the residence under both non-incorporation tests is broadly based upon geographic ties determined as a question of fact.[57]

Again, given the fact and circumstance nature of the test, TR 2004/15 was never going to do anything other than restate the law. Operational clarity was never going to be achievable.

Conclusion

The central management and control test remains a problem child, as Taxation Ruling TR 2004/15 has done little to clarify its operation. To ensure that the central management and control test does operate more effectively, it is clear that legislative reform is the only option.

55 Michael Wachtel and Alf Capito (Andersen), *Removing Tax Barriers to International Growth* (Business Council of Australia Discussion Paper, 11 December 2001), para 2.8.5.

56 RITA Consultation paper, above n 3, 54-5.

57 Ibid 54.