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28 July 2023

Ms Sarah Hassen & Ms Lara Cavanough
PGIPAG Unit
The Australian Taxation Office

Dear Sir/Madam,

DRAFT PCG 2018/9DC1 – CENTRAL MANAGEMENT AND CONTROL TEST OF RESIDENCY: IDENTIFYING WHERE A COMPANY'S CENTRAL MANAGEMENT AND CONTROL IS LOCATED

BDO refers to the invitation by the Australian Taxation Office ("ATO") to provide comments on the revised Draft PCG 2018/9DC1("the revised Draft PCG") regarding the ATO's compliance approach when applying the central management and control ("CMC") test in determining the residency status applicable to foreign incorporated companies.

BDO is pleased to provide the following comments on the revised Draft PCG.

Similarity of treatment of Section 23AH ITAA 1936 compared to, subdivisions 768-A and 768-G ITAA 1997 and Part X of ITAA 1936

BDO commends the ATO's comments at paragraph 5B of the Draft PCG in relation to permanent establishment / branch exemption rules and the similarity of treatment for a controlled foreign company under the CFC rules. The similarity of treatment of these provisions is crucial for any analysis of the effect of deeming Australian residency via CMC being in Australia. BDO suggests, when the revised draft PCG is finalised, it refers to the relevant provisions (section 23AH ITAA 1936, subdivisions 768-A and 768-G ITAA 1997 and Part X of ITAA 1936) and provides a more detailed explanation and examples of how they give a similar treatment. This may allay some unfounded concerns about the tax effect of subsidiaries being deemed to be an Australian tax resident under the CMC test.

Paragraph 5B of the revised Draft PCG states:

'…..it is acknowledged that the residency of a company will often be a low-risk issue for the ATO. This is because, where a company has its operating business wholly offshore but is also resident in Australia, permanent establishment or branch exemption rules will generally apply in determining the taxation treatment of the profits and losses of the offshore operation business. This means that the company's tax position is similar to what it would be if the company were not resident – for example, where the company is a subsidiary of an Australian company, the resulting taxation position is sufficiently similar to the position that would arise if the offshore operations formed part of a controlled foreign company (CFC) with attribution under the CFC regime. Accordingly, it is unlikely the Commissioner would apply

resources to review the residence of such companies (other than where there are integrity concerns such as those discussed in paragraph 107 of this Guidance).'

These comments appear to be referring to the similar effect of section 23AH of the ITAA 1936 on a foreign registered company deemed to be an Australian resident because of CMC in Australia, and that has operations in a foreign country; compared to the application of subdivisions 768-A and 768-G of the ITAA 1997 and Part X of ITAA 1936 on a foreign registered company that is not deemed to be an Australian resident because its CMC is outside Australia. However, we note there is no specific reference to these provisions in the revised Draft PCG.

Section 23AH of the ITAA 1936 contains provisions that treat as non-assessable non-exempt (NANE) income branch profits earned by Australian companies subject to satisfying certain conditions. These conditions include the active income test and asset tainting requirements in a similar way to the CFC rules applying to a controlled foreign company. Section 23AH would clearly apply to many foreign subsidiaries that carry on business in a foreign country and have deemed Australian tax residence through the CMC test.

When this is compared to the treatment of a foreign registered company that is not deemed to be an Australian tax resident, it is apparent there is a similar tax outcome under the applications of the CFC rules in Part X ITAA 1936 and the NANE income treatment under subdivisions 768-A and 768-G ITAA 1997 in relation to distributions made on equity interests held by active companies in foreign jurisdictions and reductions in capital gains and losses in relation to these equity interests.

There has been some commentary made in the media about the problems that can be caused by the deeming of Australian tax residency of foreign registered companies via the CMC being in Australia, however the similarity of tax treatment compared to a controlled foreign company is rarely mentioned in these commentaries. We suggest, when the Revised Draft PCG is finalised, it provides a more detailed explanation and examples of how these situations can result in a similar tax treatment.

Double Tax Agreements

We note that there may be some differences in treatment between these two situations if the relevant foreign country has a double tax treaty with Australia. We also suggest, when the revised Draft PCG is finalised, it comments that, in such cases the relevant treaty requirements would have to be considered.

Should you have any questions or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

Lance Cunningham

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