RESIDENCE OF COMPANIES
ESQUIRE NOMINEES UNNECESSARILY DISTINGUISHED

This tax update concludes that the recent decision of Perram J in *Hua Wang Bank Berhad v FC of T* [2014] FCA 1392 (19 Dec 2014) unnecessarily distinguished the long standing decision of Gibbs J in the High Court decision in *Esquire Nominees Limited (as trustee of the Manolas Trust) v FC of T* 72 ATC 4076, in finding that a number of foreign incorporated companies were tax residents of Australia.

On the facts as found by Perram J, that Mr Vanda Gould (an Australian tax resident) was the beneficial owner of the companies, and had "usurped" the boards of the companies, there was no need to distinguish *Esquire Nominees*. His doing so potentially risks the *status quo*.

It has long been considered that the decision of Gibbs J in *Esquire Nominees* stands for the proposition that the "central management and control" of a foreign incorporated company, which is relevant to its residence, will be determined by the place of residence of the board of directors properly carrying out their duties, notwithstanding the directors receive suggestions from the company's shareholders or their advisers, as long as they act in the best interests of the company and would not do anything illegal or improper suggested to them. This position was accepted by the Commissioner in TR 2004/15 at [63]. What the Commissioner says in TR 2004/15 is not confined to companies acting as trustees.

However, Perram J in *Hua Wang Bank* has recently determined that a number of foreign companies were tax residents of Australia, and in doing so, said that *Esquire Nominees* effectively decided only that suggestions of shareholders or their advisers in relation to a particular trust, are not relevant to the place of residence of the trustee company (at [400]):

> *"Whilst the accountants could tell the trustee what to do qua trustee they could not tell the directors of the trustee company what to do qua company."*

Accordingly, he concluded that it was not surprising that Gibbs J found that the trustee company in *Esquire Nominees* was resident on Norfolk Island (as he concluded the influence was *only* in relation to the assessed trust)[1]. Put another way, Perram J appears to have been of the view that the outcome may have been different if the accountants had sought to influence the decisions of the board generally, and not just in relation to particular trusts.

As at the time of the transactions the subject of *Esquire Nominees* (1969) and when the case was decided in 1972, in Australia, the income of a Norfolk Island's resident from a Norfolk Island source was exempt: s7(1) ITAA 1936. To give effect to that section, Gibbs J found that it was necessary to make a finding of the residence of the trustee company. He found that it was resident in Norfolk Island. At that time, the place of the residence of a trustee was generally irrelevant as a result of the High Court decision in *Union-Fidelity Trustee Company of Australia v FC of T* (1969)[2]. There was no concept of residence of a trust estate as such under Div 6. As a result of *Union-Fidelity Trustee*, generally only Australian source income of a trustee was assessable under Div 6 before the amendments in 1979.

In 1979 the provisions were amended to fix the tax liability of a trustee under ss 99[3] & 99A with reference to the residence of the trust, to be determined alternatively by:

(a) the residence of the trustee; or
(b) the place of central management and control of the trust[4].

One reason why it was unnecessary to distinguish *Esquire Nominees* was that Perram J found in relation to Mr Borgas' activities as a director, at [98]:

> *"Mr Borgas' evidence about this persuaded me that he was a witness who was willing to lie on oath in a most discreditable way."*

And at [405] – [406]:

> *"The role of Mr Borgas was fake. He made no decision of any kind but simply implemented Mr Gould's instructions after which he generated a false document trail to make it appear otherwise….I reject entirely the*

[1] Curiously Perram J says there were 12 Manolas trusts, but that fact was not in the judgment of Gibbs J nor in the decision of the Full High Court on appeal, which was only on the source of income point. It is also worthy of note that Perram J says at [394], in the Full Court (73 ATC 4114) Barwick CJ referred to the decision of Gibbs J re residence "in passing". In fact, Barwick CJ and Menzies J both expressly said they agreed with Gibbs J on the question of residence at ATC 4116 and 4122, respectively.
[2] (1969) 119 CLR 177
[3] Esquire Nominees had been assessed under s99.
[4] Section 95(2) ITAA 1936. That alteration, and the alteration to s95(1) in the same Bill to refer to a trustee who was a resident, was to solve the problem revealed by *Union-Fidelity*. As far as we are aware, part (b) of the current definition of trust residence has not yet been considered by an Australian court. However, a recent Supreme Court of Canada case, *Fundy Settlement v Canada* 2012 SCC 14; [2012] 1 SCR 520 (commonly referred to as the *Garron* case), applied the concept. In that case, a Barbados trustee did not save the *inter vivos* trust formed in Barbados from being a resident of Canada, as the court held the central management and control of the trust was in Canada with the trust's settlor. *Garron* has not yet been considered in Australia.

> *idea that Mr Borgas might have declined a transaction which he believed or suspected to be improper. Such an approach would have put him out of business."*

In the English Court of Appeal in *Wood v Holden* (2006)[5] the taxpayer company was found to be a non-resident of the UK. The Court of Appeal made no adverse comment on the finding of Park J in the High Court in *Wood v Holden*[6], that *Esquire Nominees* was applied on the basis that there was no suggestion that the fact that the company was acting as a trustee[7], was relevant to the outcome in *Esquire Nominees*, and so, essentially, the principle set out above as to what the case stood for, was correct.

It is contended that what the Court of Appeal said in the principal judgement in *Wood v Holden* correctly states the position:

> *'27. In my view the judge [Park J] was correct in his analysis of the law. In seeking to determine where "central management and control" of a company incorporated outside the United Kingdom lies, it is essential to recognise the distinction between cases where management and control of the company is exercised through its own constitutional organs (the board of directors or the general meeting) and cases where the functions of those constitutional organs are "usurped" - in the sense that management and control is exercised independently of, or without regard to, those constitutional organs. And, in cases which fall within the former class, it is essential to recognise the distinction (in concept, at least) between the role of an "outsider" in proposing, advising and influencing the decisions which the constitutional organs take in fulfilling their functions and the role of an outsider who dictates the decisions which are to be taken. In that context an "outsider" is a person who is not, himself, a participant in the formal process (a board meeting or a general meeting) through which the relevant constitutional organ fulfils its function.'*

Esquire Nominees has been relied on at least two other occasions in the UK in recent years: *Untelrab Ltd v McGregor* (1996)[8]; *Laerstate BV v Revenue & Customs* (2009)[9], but the few cases in Australia since those UK cases were decided, including *Hua Wang Bank*, failed to mention the UK cases: *Crown Insurance Services Limited and Commissioner of Taxation* (2011)[10]; *Picton Finance Limited and Commissioner of Taxation* (2013)[11].

There is a disturbing trend in Australia not to refer to UK tax cases which are relevant and persuasive[12]. It is particularly disturbing in this case as the concept of central management and control is a UK common law concept, and there have been several cases in the UK in recent years dealing with the concept, including elucidation of the issue of whether and

[5] [2006] EWCA Civ 26
[6] [2005] EWHC 547 (Ch)
[7] At [26(ii)]
[8] [1996] STC (SCD) 1
[9] [2009] UKFTT 209 (TC)
[10] [2011] AATA 847 which taxpayer, at [74], was found to be resident only in Vanuatu, but which case itself did not mention *Esquire Nominees* either. The residence of the taxpayer was not the subject of the appeal reported at [2012] FCAFC 153.
[11] [2013] AATA 116
[12] Although perhaps not in other areas of the law: AM Gleeson, "The Influence of the Privy Council on Australia" (2007) 29 Australian Bar Review 123 at 133.

to what extent the directors participated in the decision making process[13], and whether they had sufficient information before them to make informed decisions[14].

Nor did Perram J refer to the English Court of Appeal decision in *HMRC v Smallwood & Anor* (2010)[15], which dealt with the question of the meaning of "effective management" in the corporate tie breakers of double tax agreements (DTAs), which Perram J instead dealt with from first principles[16].

Whilst on the facts, Perram J's understanding of the *ratio* of *Esquire Nominees* would not have affected the outcome in *Hua Wang Bank*, in one instance because the company held no directors meetings (e.g. Bywater Investments), and in others, as the directors did not know enough of the company's business to make any informed decision (e.g. Hua Wang Bank), the analysis of the *ratio* of *Esquire Nominees* in the *Hua Wang Bank* decision is at odds with TR 2004/15 and inconsistent with *Wood v Holden*.

In relation to the instances where Mr Borgas was a director of the foreign companies in the *Hua Wang Bank* case, as quoted above, Perram J said at [406]:

> *"I reject entirely the idea that Mr Borgas might have declined a transaction which he believed or suspected to be improper. Such an approach would have put him out of business."*

Based on his Honour's assessment of the evidence, with respect, that may be correct, but as a general proposition as to directors and boards of subsidiaries relationship with their foreign parents, DTAs are premised on the basis that merely because of the parent / subsidiary relationship, the subsidiary does not represent a permanent establishment of the parent in the country of the subsidiary, let alone make the subsidiary's place of central management and control the same as that of the parent. Invariably the parent's expectations in relation to the subsidiaries' activities will be made known. This will be so whether the local board is constituted by employees of the subsidiary or by independent directors (usually provided by service providers in the country of the subsidiary). The idea that generally an independent director provided by a service provider (that has many clients) is more likely to implement a plan which he believes or suspected to be improper, than would an employee of the subsidiary who may owe his whole living to the subsidiary, is not terribly logical.

In his judgment, Perram J proceeded to focus on the words "**real business**" in *De Beers Consolidated Mines Limited v Howe* [1906] AC 455 at 458, to the exclusion of more recent cases dealing with "central management and control", even though he provided the emphasis in his quote below:

> *"'The decision of Kelly C.B. and Huddleston B. in the Calcutta Jute Mills v. Nicholson (1876) 1 Ex. D. 428 and the Cesena Sulphur Co. v. Nicholson (1876) 1 Ex.D. 428, now thirty years ago, involved the principle that a company resides for purposes of income tax where its real business is carried on. Those decisions have been acted upon*

[13] *Untelrab*
[14] *Laerstate*
[15] [2010] EWCA Civ 778
[16] That differently constituted court, also quoted the same passage from *Wood v* Holden at [59] per Patten LJ and referred to the case at [68] per Hughes LJ.

> *ever since. I regard that as the true rule, and the real business is carried on where the* ***central management and control*** *actually abides."*

The principal judgment in the Court of Appeal in *Wood v Holden* was delivered by Chadwick LJ with Moore-Bick LJ and Sir Christopher Staughton agreeing. Importantly for present purposes, it is noted that Sir Christopher also said at [50]:

> *"There was discussion at the hearing as to what happened "in real life", where there were "real decisions", what happened in "a real sense", and whether all that happened was "a piece of paper". I decline to use such language so as to avoid the effect of what actually happened: the transaction was conducted by AA Trust [part of the ABN-AMRO Group] as the director of Eulalia and in the Netherlands. AA Trust might have had every incentive to carry it out; but it had the right to refuse if it wished, and had the power to do so. In my judgment Eulalia was and remained in the Netherlands, and was not resident in the United Kingdom. I would dismiss the appeal."*

As practically all ASX 200 companies have had many foreign subsidiaries for many years, traditionally which have never had their tax residence questioned, and with globalisation many SMEs now have foreign subsidiaries as well, there is a risk that an egregious[17] case such as *Hua Wang Bank* could upset the *status quo*. In any event, cautious Australian owned foreign subsidiaries should take particular care with the composition, knowledge and diligence of their boards in order to avoid catastrophic Australian tax outcomes.

Pointon Partners have special expertise in International Tax.

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[17] Perram J (at [485]) directed a copy of his judgement be given to the Commonwealth DPP, ASIC and the AFP, saying that the facts as found by him strongly suggested widespread money laundering, tax fraud of the most serious kind, and possibly in some cases, insider trading.