IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S135 of 2016

BETWEEN:

Hua Wang Bank Berhad
Appellant

and

Commissioner of Taxation
Respondent

APPELLANT'S REPLY

Part I: This submission is in a form suitable for publication on the internet.

Part II:

1. The Appellant ('HWBB') submits it is only possible for Central Management and Control to be in Australia if a controlling aspect of the corporate form is present and active in Australia. If there is no corporate presence then a company is no more a resident than a natural person who lives overseas and never travels to Australia, but follows instructions from Australia. The analogy between a person and a company, for the purpose of determining corporate tax residency, is supported by extensive authority.[1] It has obvious application here.

2. By way of response the Respondent cites authorities which say corporate residence depends on *'solid facts'*,[2] on the place where a company is *'actually managed'*,[3] and that management of a company does not need to be regular, or authorized by its constitution, in order to constitute Central Management and Control. Strictly speaking these propositions are correct. These propositions are not an answer to HWBB's argument on appeal, and do not support a test that looks to the place where deliberation occurs rather than a test that looks to the place of corporate acts of management.

3. In relation to the Respondent's *'actual management'* point (at [25] and [39]), the authorities which say residence is located where a company is actually managed mean nothing more than what this court said in *North Australian Pastoral* (CLR at 631), which is that a company's organs of governance must function in order to be cognizable as Central Management and Control. The Respondent relies on *Unit Construction*, but in *Unit Construction* the court was considering an organ of governance that had ceased to function outright. *Unit Construction* is authority that a company must have a tangible presence in order to be resident in a particular jurisdiction, and a tangible presence is not established if a company's constitution requires the board of directors to meet in that jurisdiction, but meetings there do not actually occur. The ratio of *Unit Construction* goes not further than this.

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[1] *North Australian Pastoral v Commissioner of Taxation* (1946) 71 CLR 623 at 629 and 631, *Koitaki v Commissioner of Taxation* (1941) 64 CLR 241 per Rich ACJ at 244.7, Starke J at 245.8, Williams J at 248.7, with McTiernan J agreeing, *Wood v Holden* [2006] EWCA Civ at [48]
[2] Respondent submissions in S134 at [25], adopted by Respondent submission at [20]
[3] Respondent submissions in S134 at [35], adopted by Respondent submission at [20]

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4. *Unit Construction* did not purport to lay down a residency test based on the location of a company's deliberative decision-making. Instead the court endorsed the earlier authorities with the rider that, if a company is active in a jurisdiction, its presence can be taken into account even though the company's presence is *ultra vires* its articles of association.

5. In relation to the Respondent's point (at [25] of S134), which is that residency is a question of fact, the necessity to make factual findings in order to identify a place of Central Management and Control is a truism. It is also fully consistent with the test propounded by HWBB. The manifestations of corporate form, such as the place where the board of directors meet, are factual matters and questions of degree may arise about their relative importance. They are 'solid facts' that exist in the real world, and more concrete than incorporeal, non-binding, deliberations in Australia which result in corporate activity outside Australia.

6. The Respondent's suggested reason for adopting a test based on deliberative decision-making (at [25]) is that tax legislation does not look to legal form. This is not supported by any cases the Respondent has pointed to, and it is inconsistent with principle. The tax legislation recognizes companies as a type of taxable entity.[4] The conventional approach, where tax legislation imposes tax by reference to a general law concept, is to apply that concept unless it is modified by the legislation.[5] Questions such as whether a company has derived income, or has incurred expenditures on which it can claim a deduction, are all approached with an appreciation of the company as a legal person. A company's presence in Australia, and its liability for tax on the basis of residency, should be worked out in the same way. In the absence of an express legislative enactment nobody would ever assess a company to tax on income earned by a separate juristic entity, simply because that separate entity has a close relationship to the company (such as its managing director).[6] Nor would a court disregard a contract a company has entered because the company executed the contract on the instructions of a separate juristic person. Yet the Respondent's proposal is for companies to be liable to tax because of the cognitive processes of separate juristic persons who at no stage act *qua* company.

<u>The Respondent's proposed test for Central Management and Control</u>

7. The Respondent's submissions feature a duality. On the one hand the Respondent says Central Management and Control test is based on substance rather than form, but the Respondent also proposes a test under which an overseas company that follows directives from Australia does not necessarily have Central Management and Control in Australia. The Respondent's test is one where an Australian controller is only the Central Management and Control of an offshore company if the overseas directors fail to engage in a period of cogitation prior to implementing instructions from the Australian controller (at [31]).

8. Five observations seem pertinent. The first is the Respondent's test is only a small variation on the test propounded by HWBB. This is partially obscured by the Respondent's assertions that it is the actual place of management which fixes corporate residence. Yet, at bottom, the Respondent accepts that Central Management and Control remains with a company's directors, even when they implement

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[4] Section 960-100(1)(b), *Income Tax Assessment Act 1997*

[5] *Kiwi Brands v Commissioner of Taxation* (1998) 90 FCR 64 at 79, *Commissioner of Taxation v Ramsden* [2005] FCAFC 39 at [75]

[6] *Commissioner of Taxation v Raptis* (1989) 20 ATR 1262

instructions *'the substance and form of which have been conceived and prescribed by a party in a jurisdiction different from that where the directors meet'*[7] (emphasis added). The only requirement is for company directors to engage in deliberation. The length of the requisite cogitation has not been specified, and nor has the Respondent identified any utility in it, when both tests produce the same result: being a company controlled from Australia that is also a foreign tax resident.

9. Second, the Respondent has not essayed any response to [93] – [96] of the HWBB submissions, which outline the difficulty of applying the Respondent test outside of extreme cases where a company's directors engage in no deliberation at all about any of their decisions. In the real world the overseas subsidiaries of Australian parent companies implement numerous decisions without reflection, or dissent. The existence of this large undistributed middle means there will always be a question about how many decisions can be implemented in a mechanical fashion by an offshore company without the company becoming an Australian resident. Let it be assumed an offshore subsidiary pays dividends to its parent company, the size and frequency of which are determined by the parent and then implemented by the subsidiary without pause for reflection. Is the Central Management and Control in Australia? Assume that a parent company orders an offshore subsidiary to terminate the employment of a delinquent employee, and this directive is implemented by the subsidiary automatically. Is the Central Management and Control in Australia?

10. The Respondent does not deny it would be difficult to apply its proposed test. Instead the Respondent says two things. The first is that any difficulty and vexation will arise only for those who seek to manipulate residency (at [43]). This is not correct. In the real world when an ASX 200 company tells one of its offshore satellites to implement a course of action, as they routinely do, the offshore directors generally do not embark on an *'examination of the consequences, advantages and disadvantages'* (per Respondent at [31]) or raise *'a real prospect of dissent'*. To suggest otherwise, and to suggest that Australian business would not be inconvenienced by the Respondent's proposed test, is naive. The second thing the Respondent says (at [43]) is the difficulty of applying this test should not dissuade this court from adopting an appropriate criterion. This court is not compelled to accept the Respondent's test by clear statutory language or weight of previous authority. Indeed, the Respondent acknowledges it may be necessary for to overturn existing authority (at [46]), as well as conventional wisdom (at [44]), in order to adopt this test that the Respondent admits (or does not deny) will be difficult to apply. Yet the test has no demonstrated utility, apart from affording the Respondent a chance of success in the present litigation.

11. Third, the submission the HWBB directors needed to give informed consideration is inconsistent with what was put at first instance, where the Respondent submitted the nature of HWBB's business model meant the *'directors did not need to make judgments about whether the transactions they were directed to effect were financially prudent.'*[8] It was common ground, and court accepted (at [349]) HWBB's business was to perform back-to-back transactions whereby each liability was offset by an asset of equal size. As the Respondent correctly submitted, this meant HWBB had only minor risk exposure. So the Respondent is now suggesting HWBB was an Australian resident because its directors omitted to engage in prudential conduct that the Respondent originally said was unnecessary.

12. The fourth point is that the Respondent relies on findings by the primary judge to argue the HWBB directors did not give sufficient consideration to transactions. True it is, the

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[7] Respondent submission at [31]

[8] Respondent Closing Submission, Paragraph [289], p.100

primary judgment contains findings to the effect the HWBB directors *'were never placed in a position where they had to exercise the slightest judgment'* and *'simply implemented Mr Gould's will'*.[9] Those findings were made in a context where the issue presented was whether Vanda Gould was the 'controlling mind' of HWBB,[10] and the Respondent had told the court that HWBB's business model meant it was unnecessary for its directors to undertake prudential consideration.

13. Finally, the Respondent's revisions to the case it ran below cast doubt on the entirety of the first instance judgment. At first instance the Respondent submitted, and the judge accepted (at [346]), the rationale for the HWBB directors being resident in Samoa was essentially deceitful; to create the simulacrum of foreign tax residency by concealing the fact HWBB's decisions were made in Australia.[11] In this court the Respondent says the only vice about this arrangement is the HWBB directors did not spend enough time reflecting on whether to implement Vanda Gould's wishes. The Respondent also acknowledges that HWBB's position reflects a view about Central Management and Control that has been widely held for many years (at [44], and [43] of S134). If it is not suggested in this court that the operation of HWBB was a *'crooked pantomime'* or *'tax fraud of the most serious kind'* this sharpens the point made by HWBB, that the primary judge became diverted by misconceptions about what constitutes fraudulent conduct, being misconceptions encouraged by the Respondent.

The authorities: Central Management and Control

14. The cases say that to determine where a company is resident it is necessary to identify the location of the controlling part of the company. The management of the company does not need to be regular in all respects, but the directors are still the focal point of the inquiry. HWBB submissions (at [25] - [26]) trace this back to authorities, like *Cesena Sulphur*, which say the 'central point' of a company is the board of directors because the board provides authority for everything else done in the company's name.

15. The Respondent contends (at [23]) that *Cesena Sulphur* supports the existence of a test based on substantive commercial decision-making, but it does not. Of the two taxpayers in *Cesena Sulphur* it is the Calcutta Jute company that is presently relevant, and the court in *Cesena Suphur* accepted it was that company's appointed manager in India *'who directs and controls the whole conduct of the business.'*[12] A finding the Calcutta Jute company was resident in England was made because ultimate authority for what occurred in India was sourced in England. The court did not find Calcutta Jute was *'entirely under the actual control of ... the directors in England'*, as the Respondent suggests.[13]

16. More broadly the Respondent submits there is a dichotomy between cases where company directors implemented instructions after informed consideration and cases where directors acted in a purely ministerial capacity (at [29]). For the latter, the Respondent cites *Unit Construction*, which was a case where directors did not function in any capacity at all, and two fringe cases that purported to apply *Wood v Holden*.[14]

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[9] These findings are cited in Respondent submissions at [32]

[10] At [34] Respondent says the primary judge did not view his task as being to determine who was the 'controlling mind' of HWBB. However this is a fair characterisation of the first instance reasons.

[11] Transcript 55, lines 30 – 35; Transcript 1444, lines 5 – 15; Closing submissions, Paragraph [135]

[12] *Cesena Sulphur v Nicholson* (1876) 1 Ex D 428 at 444

[13] These words appear at 1 Ex D 428 at 444, but they are not a finding of fact by the court. They are the court's paraphrase of the articles of association of the Calcutta Jute company.

[14] *Unit Construction* was a case where directors had ceased to function outright; it did not involve inadequate consideration. *Smallwood* was a tribunal decision concerning the 'Place of Effective Management' concept. *Fundy Settlement* was a Canadian case about trust residency.

The Respondent then suggests *Esquire Nominees* and *Wood v Holden* were cases where informed consideration was given by company directors. Yet there was no curial finding in *Esquire Nominees* that the directors gave informed consideration.[15]

17. In *Wood v Holden* the findings of an administrative tribunal were that the relevant company directors did not constitute Central Management and Control because the directors *'did not give any, or at least sufficient, consideration to the issues involved'*.[16] An appeal lay from this decision on a question of law. A single judge allowed an appeal from the tribunal on the rationale it is not necessary for directors to give informed consideration prior to implementing instructions for directors to constitute Central Management and Control. This decision was affirmed by the UK Court of Appeal. The Respondent's suggestion that directors' decisions must be informed in order to constitute Central Management and Control is a paraphrase of a tribunal decision that was overturned in *Wood v Holden* for error of law.[17] The reliance on *Esquire Nominees* is equally inapposite. It is not a coincidence that the Respondent has only cited cases to support its proposition where these cases offer no real support at all. It is a matter of the Respondent's submissions being novel, and unsupported by serious authority.

Whether the appeal has utility: Respondent submissions, Paragraphs [4] – [9]

18. The Respondent contends (at [4]-[9]) the capital/revenue point was determined against HWBB. The true position is the Full Court declined to adjudicate HWBB's contention its shares were held on capital account. The stated reason was that HWBB did not also challenge the conclusion its shares were trading stock.

19. HWBB did challenge the conclusion concerning trading stock. HWBB's contention that its shares were capital assets, if successful, would have removed the only basis on which the shares could be trading stock. The statutory criterion under which assets become trading stock is posed by s.70-10(a): trading stock is *'anything ... held for purposes of manufacture, sale or exchange in the ordinary course of a business'*. HWBB's contention at all times was that its shares were not sold in the ordinary course of business and thus were capital assets.[18]

20. It was not incumbent on HWBB to separately articulate a challenge to the primary judge's characterization of the shares as trading stock. A challenge was implicit in HWBB's contention its shares were capital assets. There was no suggestion by HWBB the shares could be capital assets *at the same time as* being trading stock. It was only submitted in the alternative that the shares were trading stock. The Full Court decision in *Vincent v FCT* (2002) 124 FCR 350 at [50] says it is outlandish to suggest a capital asset can also be trading stock. The Respondent has not suggested it is possible for capital assets to be trading stock. If it is not possible for capital assets to be trading stock the court's reason for declining to deal with the point was incorrect and there is no valid objection to the remittal sought by HWBB.

Dated: 12 July 2016

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Noel Hutley
Signed by John Hyde Page

[15] The Respondent asserts the transcript from *Esquire* shows otherwise. If this court wishes to parse a first instance transcript (which is not suggested) it is plain from the transcript that no informed consideration was given. The directors executed an entire sheaf of documents at a single meeting (transcript p.109); they didn't know the trusts' beneficiaries (pp.130,161), and they didn't know what the trusts' investments were even though they implemented them (p.152).

[16] *Wood v Holden* [2005] EWHC 547 per Park J at [50].

[17] Ibid at [54]

[18] Primary judgment at [448]