The purpose of this new comparative survey is to provide country reports on the concept of substance in international taxation. Although the substance requirement has since long been an important part of the functioning of different taxation rules, the focus on this concept has recently increased. The BEPS initiative, launched by the G20 and led by the OECD, may result in changes to the substance requirement as it is expressed in different kinds of norms such as domestic laws, tax treaties and soft law. The European Union is interested in these developments and adheres to the work of the OECD on BEPS, while conducting certain initiatives on its own.

Given these recent developments, the International Transfer Pricing Journal wishes to present an overview of certain issues related to the substance requirement in several jurisdictions. The purpose of this study is to show the complexity, the diversity, but also the similarities between some of the requirements of different countries. At this point, the substance requirements in transfer pricing is deliberately not included in the questionnaire so as to limit the scope of this study. The outline has been prepared in cooperation with Jérôme Monsenego (Associate Professor of tax law, Uppsala University).

### Comparative Survey

#### The Concept of Substance in International Taxation

1. **General Principle of Economic Substance**
   Australia does not have a general doctrine of economic substance in its domestic tax law. The Commissioner may challenge arrangements lacking economic substance by applying the general anti-avoidance rule in Part IVA of the Income Tax Assessment Act 1936 (ITAA 1936) or relying on a concept of sham (for example Jaques v. Federal Commissioner of Taxation [1], or Raftland Pty Ltd as Trustee of the Raftland Trust v. Commissioner of Taxation [2]).

   Economic substance will have relevance to those provisions in the tax law that are specifically worded to be based on the economic substance of an arrangement (e.g. debt/equity rules in Division 974 of the Income Tax Assessment Act 1997 (ITAA 1997) that treat an instrument as debt or equity for tax purposes based on its economic substance). On the other hand, some provisions operate based on the legal form of the arrangement (e.g. the participation exemption in section 23AJ of the ITAA 1936 that applies to "shares" and does not apply to non-share equity interests).

2. **Substance and Corporate Residence**
   2.1. **Criteria for corporate residence**
   Subsection 6(1) of the ITAA 1936 states that a company is a resident in Australia if it:
   - is incorporated in Australia, or
   - carries on a business in Australia and either (i) has its central management and control in Australia; or (ii) has its voting power controlled by shareholders who are resident in Australia.

2.2. **Judicial interpretation of “place of effective management”**
   The “place of effective management” is substituted by a “place of central management and control.” A place of central management and control is the place where high-level decision-making processes take place, including decisions on general policies, strategic decisions, major agreements and significant financial matters.

   While the place of the central management and control is a question of fact, it is generally accepted that if the majority of directors are in Australia when board meetings are held, the central management and control of that company will also be located in Australia. If the location of directors at board meetings is split evenly between within and outside Australia, the analysis may be more complex and the location of the directors with special powers is likely to be decisive.

   It is particularly important to determine the location of the directors when high-level strategic and major decisions are made. The physical location is important, regardless of the location of electronic facilities used at the meetings. The place where board meetings are held may not be a single determinative factor for the location of the central management and control in all cases, and other relevant factors may need to be considered.

   Further, if the judgment based on the location of directors is difficult to make, other factors may be considered instead of the location of board meetings, such as the loca-

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* Tom Toryanik, Singapore.

5. AU: 1959, Unit Construction v. Bullock, 3 All ER 831.
tion of the key functions of the board, the residence of the directors or the location of the secretariat.

The place of meetings during which low-level decisions are made (e.g. by way of a circular resolution) are generally less relevant for determining the location of the central management and control. The location of day-to-day management of the company is normally not relevant in determining the central management and control.

It is important that “central management and control” be interpreted as a reference to a location where the actual central management takes place and not merely a location where the decision making process may take place. Further, the actual decision makers are considered to be the persons exercising the central management and control of a company and not, for example, nominee board members.

While not common, it is not impossible for a company to have the central management and control in Australia and in another country.  

For further details, see Taxation Ruling TR 2004/15.

3. Substance and Permanent Establishments

3.1. Place of management

The “place of management” criterion is not included in the domestic tax law definition of a permanent establishment.  

The “place of management” criterion is included in treaty definitions. There is no specific guidance on the interpretation of the “place of management” criterion in determining whether specific activities give rise to a permanent establishment in Australia. As such, it is expected that this criterion would be interpreted under general principles of law interpretation with regard to the relevant documents, such as the Commentary on the OECD Model Convention (OECD Model).

For completeness, one should bear in mind that “management” is expected to be interpreted as activities falling short of central management and control.  

3.2. Characteristics of a “place” for permanent establishment purposes

There are no particular expectations with regard to the characteristics that a “place” should have, other than that it should be a place at or through which a business is carried on. See the discussion under section 3.3. for specific expectations with regard to the permanency of the “place”.

3.3. Permanency criterion

The domestic definition of a permanent establishment in section 6(1) of the ITAA 1936 does not include a requirement that a place at or through which a business is carried on, be fixed or permanent. In contrast, all Australian income tax treaties define a permanent establishment as a “fixed place of business”. The Australian Taxation Office has been administering tax law on the basis that it is not significant that the word “fixed” does not appear in the domestic definition.  

Both the courts and the ATO have been interpreting the requirement for a fixed place of business as that of a permanent place of business, in terms of both geographic and temporal permanence.

Geographic permanence usually refers to specific business premises, but may also refer to any area that is commercially viewed as a whole, for example a market where a trader operates a stall, even if the exact location of the stall within the market may be different on each occasion.

Temporal permanence requires that the business presence not be of a purely temporary nature. While this is a question of fact and degree, permanent presence does not need to be everlasting.  

As a practical guide, the ATO asserts that normally if a business operates at or through a place continuously for 6 months or more, the place would be expected to be permanent (Taxation Ruling TR 2002/5).  

Lastly, in interpreting the definition of a permanent establishment, references to the Commentary on the OECD Model are expected to be acceptable, to the extent that the provisions of the relevant treaty are the same as those of the OECD Model.

3.4. Service permanent establishment

While the provision of services is not specifically included in the activities that give rise to a permanent establishment under domestic tax law, where such activities amount to carrying on a business, they are able to give rise to a permanent establishment as any other business activities.

Some Australian income tax treaties specifically include the provision of services in the list of activities that give rise to a permanent establishment. The required duration of the provision of services ranges from 90 days (treaty with India) or 120 days (treaty with Taipei) to 183 days (treaty with Thailand) or 6 months (e.g. treaty with the Philippines), in any 12-month period (treaty with India) or during an income year (treaty with Papua New Guinea).

There are no other specific requirements for service permanent establishments under Australian income tax treaties.

3.5. Activities of a preparatory or auxiliary character

All Australia income tax treaties include provisions similar to article 5(4)(e) (and some, similar to article 5(4)(f)) of the OECD Model. Australian tax law does not include specific guidance on the interpretation of these articles.

It has been accepted that the Commentary on the OECD Model is relevant to the interpretation of Australian income tax treaties (to the extent that the applicable article

6. AU: TC, 1918, John Hood and Company Ltd. v. Magee, 7 TC 327.  
7. AU: TC, 1925, The Swedish Central Railway Company Ltd. v. Thompson, 9 TC 342.  
8. AU: ITAA 1936 sec. 6(1).  
9. AU: 1955, Case 110, 3 CTBR (NS) 656.  
12. Unisys, supra n. 11.
of the OECD Model is the same as that in the Australian income tax treaty under consideration). As such, the definition of activities of a preparatory or auxiliary character is expected to follow that in the OECD Commentary.

For example in ATO Interpretative Decision ATO ID 2006/263, the ATO considered whether activities in Australia of an employee of a non-resident company amounted to the company carrying on business through a permanent establishment in Australia. The ATO concluded that the activities had a preparatory or auxiliary character solely based on the Commentary on Article 5 of the OECD Model.

3.6. Significant people functions
The concept of "significant people functions" has not been specifically interpreted in Australia in reference to the existence of a permanent establishment.

4. Substance and Abuse of Tax Treaties

4.1. Substance requirements for residence certification
A company incorporated in Australia is not required to satisfy specific substance requirements in order to apply for a residence certificate from the Australian Taxation Office. The Australian Taxation Office may request additional information from the taxpayer in some cases.

4.2. Beneficial ownership
The tax treaty concept of beneficial ownership is not specifically defined and has not been tested in court. Instead of targeting beneficial ownership, the Commissioner may consider the arrangement to be treaty shopping and apply the general anti-avoidance rule on this basis.

4.3. Limitation-on-benefits provisions
Australia has not concluded any tax treaties that include a limitation-on-benefits provision referring to a company’s place of management and control.

5. Substance and Obtaining Certainty with Regard to Tax Treatment

5.1. Criteria for advance certainty from tax authorities
There are a number of ways for a taxpayer to obtain certainty about the tax treatment of its planned activities. A taxpayer may apply for a private ruling (a binding ruling that applies to the taxpayer) or a class ruling (a binding ruling that applies to a class of taxpayers) in respect of a specific arrangement. Both private and class rulings are advice setting out how a tax law applies to the taxpayer or a class of taxpayers in relation to a specific arrangement or circumstance.

A taxpayer may also rely on public rulings or tax determinations issued by the Australian Taxation Office, if the facts on which the ruling or determination is based are the same as those of the taxpayer.

Interpretative decisions give an indication as to how the Australian Taxation Office may apply a tax law provision, but are not binding on the Australian Taxation Office.

5.2. Substance requirements for various activities
There are no such specific requirements.
