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"PLACE OF EFFECTIVE MANAGEMENT" – A SOUTH AFRICA PERSPECTIVE

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DECLARATION

I declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of LLM (Taxation) at the University of Pretoria. It has not been submitted before for any other degree or examination at any other university.

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31st day of October 2012

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ABSTRACT

The comments submitted by The South African Institute of Chartered Accountants (hereinafter referred to as "SAICA") to the Discussion Paper issued by the South African Revenue Service (hereinafter referred to as "SARS") in respect of Interpretation Note 6[1], included the following important introductory comments:

"We heartily welcome and endorse the revised approach, which brings the South African interpretation closer to international norm. South Africa is too small an economy in the world to be out of step with the general consensus view, including the views of our main treaty partners (who are mainly OECD members). It also reduces the prospect of having to resort to a mutual agreement procedure; not to mention reducing the likelihood of litigation in the South African courts."

South Africa's approach to the determination of a legal person's "place of effective management" (hereinafter referred to as "POEM") differs from the international approach and has resulted not only in adverse tax implications, but also in a lot of uncertainty for various taxpayers.

[1] 26 March 2002

CHAPTER 1: INTRODUCTION

Currently in South Africa a residence-based system of taxation is applied, i.e. South African residents are taxed in South Africa on their world-wide receipts. The residence-based system was introduced for years of assessment commencing on or after 1 January 2001. Prior to 1 January 2001 a source-based system of taxation was applied.

The residence-based taxation system does not, however, exclude any non-residents from being taxed within South Africa. Non-residents are taxed on all receipts from a source (or deemed source) within South Africa.

South Africa's residence-based system is embodied in section 1 of the Income Tax Act[2] (hereinafter referred to as "the Act") in terms of which "gross income" is defined as: "

(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic…"

Based on the "gross income" definition it is evident that one would need to distinguish between a resident and a non-resident for purposes of calculating taxable income, as a resident will be including its world-wide receipts (irrespective of source) into its gross income as opposed to a non-resident that will only have regard to South African sourced income.

Section 1 of the Act continues to define a "resident" to mean any: "

(a) …
(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

[2] Act 58 of 1962.

but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation."

South Africa therefore in essence applies two tests to determine whether a legal entity is resident in South Africa. The one test being whether an entity is formed, established or incorporated in South Africa and the other being whether the entity is effectively managed in South Africa.

Whether a legal entity is incorporated within South Africa is easy to determine. One would be able to confirm any incorporation information with the Companies and Intellectual Property Commission in South Africa. It is, however, the second test, i.e. the POEM test that is not one of simple application. This could mainly be ascribed to the fact that the term POEM is not defined in the Act.

To make matters worse, the POEM term also has no universal meaning and different countries, as well as members of the Organisation for Economic Co-operation and Development (hereinafter referred to as "the OECD") ascribe different meanings thereto. It is a test that if met, could result in significant tax consequences for any legal person.

The POEM term made one of its first appearances in the Fifth Interim Report[3], which dealt with the proposed changes in South Africa's tax base, i.e. moving from a source-based system to a residence-based system. This report notes inter alia the following:

"The current definition of a domestic (read 'resident') company is a company incorporated in South Africa, or a company 'managed and controlled' in South Africa. The main criticism of this definition is that it has proven subject to relatively simple, formalistic manipulation. This concept is also out of line with the commonly used, and much more substantial, tax treaty expression of 'effective management'. The Commission recommends that the concept of effective management as referred to in Article 4(3) of the OECD Model Tax Convention be used consistently to designate the tax residence of persons other than natural persons. This may perhaps be best achieved through an appropriate definition in Section 1 of the Income Tax Act. Again, the change will have the benefit of employing international and, therefore, commonly understood terminology."

[3] Report of the Commission of Inquiry into certain aspects of the tax structure of South Africa

It is clear from the above that the Katz Commission intended a different meaning to be ascribed to a company's POEM as to where the company is "managed and controlled". Even though it is advised to follow the tax treaty meaning of POEM "no clarity exists on the meaning of the term in a tax treaty context. If anything, the tax treaty meaning is probably much closer to 'managed and controlled' than the Katz Report seems to have intended. It is therefore regrettable that the recommendation of the Katz Report to define the term in the Act has not been followed." [4]

The legislation as it currently stands would therefore ensure that if a company is incorporated in Mauritius, but effectively managed in South Africa, it would constitute a tax resident for South African tax purposes. This will be irrespective of the company being incorporated in Mauritius. The company is effectively managed in South Africa, thereby complying with the requirements of South African residency and therefore taxed in South Africa on its world-wide receipts.

It is important to note though, as illustrated above, that when a legal entity is simultaneously tax resident in two countries based on each country's domestic legislation, the POEM test, usually acts as the "tie-breaker" rule as set out in the double taxation agreement entered into between these respective countries.

[4] Lynette Oliver *et al* (2011) *'International Tax: A South African Perspective*, at p27.

CHAPTER 2: INTERPRETATION NOTE 6

One will be unable to determine a legal person's POEM without having regard to Interpretation Note 6[5] (hereinafter referred to as "the Interpretation Note") issued by SARS. The Interpretation Note provides the necessary guidance as to the meaning of the term POEM and how it needs to be determined as a result of the term not being defined in the Act. The Interpretation Note highlights that the ordinary meaning of words, together with international precedent and interpretation needs to be used when determining the meaning of a legal entity's POEM.

It is important to note that even though the terms "effective management" and "effectively managed" are referred to by various countries and included in publications and documentation prepared by the OECD, these terms have no universal meaning. Countries ascribed different meanings thereto.

According to the Interpretation Note, effective management is not synonymous to shareholder-control or control by the board of directors. The management function deals with a company's purpose and business, and has no regard to the shareholder function of the company. The Interpretation Note further highlights that in order to establish the meaning of the term POEM "one should keep in mind that it is possible to distinguish between-

- the place where central management and control is carried out by a board of directors;
- the place where executive directors or senior management execute and implement the policy and strategic decisions made by the board of directors and make and implement day-to-day/regular/operational management and business activities;
- the place where the day-to-day business activities are carried out or conducted."[6]

The general approach adopted by SARS is that the POEM is the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company. The location where the overriding control of the company is exercised or where the board of directors meets is irrelevant in this regard.

The day-to-day management by the particular directors or senior managers pertains to the execution and implementation of the policy and strategic decisions that were determined by the board of

[5] 26 March 2002
[6] Interpretation Note 6, at para 3.1

directors. The Interpretation Note makes it clear that this can also be referred to as the place of implementation of the entity's overall group vision and objectives. It is important to note though that entities differ in their reporting lines and management structures and therefore it would be impossible to lay down set rules that could be blindly followed and applied in each scenario.

The following would be the steps to be followed to determine a legal person's POEM:

1. If the day-to-day management by senior managers takes place at a single location, that single location will constitute the legal person's POEM. Kindly note that this location might be different from the location where the day-to-day operations of the company are taking place;

2. If these management activities are executed from various locations, the location of the POEM will "best be reflected where the day-to-day operational management and commercial decisions taken by the senior managers are actually implemented, in other words, the place where the business operations/activities are actually carried out or conducted".[7]

3. If neither one of the two steps above provides an answer as to the company's POEM, one would need to determine "the place with the strongest economic nexus".[8]

Even though certain steps have been identified, it might be difficult to determine the POEM of an entity from a practical point of view. As highlighted, there is no set rule to determine the location of a legal entity's POEM. Each case needs to considered and reviewed on its own merits taking into account all relevant facts and circumstances. In order to achieve this, the following factors need to be taken into account when determining a legal entity's POEM:

- Where the centre of top level management is located
- Location of and functions performed at the headquarters
- Where the business operations are actually conducted
- Where controlling shareholders make key management and commercial decisions in relation to the company
- Legal factors such as the place of incorporation, formation or establishment, the location of the registered office and public officer;

[7] Interpretation Note 6, at para 3.3
[8] Interpretation Note 6, at para 3.3

- Where the directors or senior managers or the designated manager, who are responsible for the day-to-day management, reside;
- The frequency of the meetings of the entity's directors or senior managers and where they take place;
- The experience and skills of the directors, managers, trustees or designated managers who purport to manage the entity;
- The actual activities and physical location of senior employees;
- The scale of onshore as opposed to offshore operations;
- The nature of powers conferred upon representatives of the entity, the manner in which those powers are exercised by the representatives and the purpose of conferring the powers to the representatives.

The above factors are only guidelines that can be followed and not an exhaustive list. As set-out above, if the company conducts its operations from various locations, the place with the strongest economic nexus needs to be established.

CHAPTER 3: OECD MODEL TAX CONVENTION COMMENTARY VIEWPOINT

As highlighted in Chapter 1[9], the meaning South Africa ascribes to the term POEM differs from the approach followed by the OECD, i.e. the international norm. This could create uncertainty to the parties of a double tax agreement of which South Africa is a party.

The OECD commentary[10] to Article 4 of the OECD Model Tax Convention on Income and on Capital (hereinafter referred to as "the OECD Model") makes it clear that the reason why a country would have to consider the location of a legal person's POEM, is because a company might be incorporated in one country, but actually managed from another country.

Article 4 of the OECD Model reads as follows: "

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

    a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

    b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

[9] p.6
[10] Model Tax Convention on Income and on Capital – Condensed Version – July 2010 (hereinafter referred to as "OECD Commentary")

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated."

Article 4(3) is of importance to the current discussion in respect of the meaning ascribed to the term POEM. The OECD commentary thereto determines that the term POEM is defined as "the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made" (my emphasis).[11] It is further highlighted that all the necessary facts and circumstances need to be considered and reviewed in order to determine an entity's POEM.

It is interesting to compare the above meaning ascribe to the term POEM, to the meaning set out in the earlier OECD commentary[12], which reads as follows:

"The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given…" (my emphasis)

It is clear from the above comparison that the direct reference to the board of directors was moved away from towards a consideration of where in substance the decisions as a whole are made.

The view expressed by the OECD commentary, that even if a company has various places of management, it can only have one place of effective management at any given time, is also found in the Interpretation Note, as expressed by SARS.

[11] OECD Commentary, at para 24 at p.88
[12] 2000 OECD Commentary

Some countries believe, however, that a dual-residency for a legal person is very rare and therefore needs to be considered on a case-by-case basis. The case-by-case approach is further believed to be very efficient in the modern technology era we found ourselves to be in and could be useful where companies make use of new communication technologies. The countries in favour of such a case-by-case approach could allow the competent authorities of each State to determine the residence of a legal person by replacing Article 4(3) with the following provision:

"Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such a person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting State."[13]

It is noted that the competent authorities referred to above, in establishing a legal person's POEM, need to take into account the following factors:

- Location of board meetings (or equivalent body)
- Location of senior day-to-day management
- Place where the chief executive officer and other senior executives perform their services
- Location of the entity's headquarters
- Place where the accounting records are kept
- The domestic legislation of which country govern the legal status of the company

It is further advised that countries that do not follow the above approach could supplement their provision with some of the factors listed above, which they believe are relevant.

Observations to Article 4(3) include the following:

[13] OECD Commentary, at para 24.1 at p.89

- Hungary is of the opinion that in addition to the meaning ascribed to the term POEM as set out in the OECD commentary, one should also take into account the following two additional factors:

1. The place where the chief executive officer and other senior executives carry out their activities; and
2. Location of the senior day-to-day management of the company.

- France believes that the location of the POEM as defined by the OECD commentary, will in general correspond to "the place where the person or group of persons who exercises the most senior functions (for example a board of directors or management board) makes its decisions. It is the place where the organs of direction, management and control of the entity are, in fact, mainly located."[14]

- As with Hungary, Italy is of the opinion that an additional factor needs to be considered when determining the location of a company's POEM, i.e. the place where the "main and substantial activity of the entity is carried on…"[15]

Reservations to Article 4(3) include the following:

- Japan and Korea prefers to substitute any direct or indirect reference to the POEM term with the term "head or main office".

- Canada reserves the right to apply the "place of incorporation or organisation" as the test for paragraph 3. In the event that a company's residency cannot be determined by applying last mentioned test, dual resident companies are denied the benefits in terms of the Convention.

- The USA reserves the right to follow a similar approach as Canada, i.e. "place of incorporation" test. However, it still allows the dual resident companies certain benefits under the Convention.

- Turkey reserves the right to use both the POEM and "registered office" (legal head office) test in order to determine a company's residency.

[14] OECD Commentary, at para 26.3 at p.90
[15] OECD Commentary, at para 25 at p.90

CHAPTER 4: THE OCEANIC TRUST CASE[16]

4.1 INTRODUCTION

On 29 October 2009 the Oceanic Trust Co. Ltd N.O. (hereinafter referred to as "the Oceanic Trust"), in its capacity as trustee of the Specialised Insurance Solutions (Mauritius) Trust (hereinafter referred to as "the SISM Trust"), launched an urgent application in the Western Cape High Court requesting a declaratory order to confirm that the SISM Trust was inter alia not a 'resident' of South Africa as defined in terms of section 1 of the Act.

This case was of particular interest to tax specialists in the POEM arena. The court provided invaluable insight as to what needs to be considered in order to determine a legal entity's POEM. The concern was, however, that the court made no reference to the Interpretation Note in order to establish whether the SISM Trust's POEM was situated in South Africa or not.

4.2 FACTS

The SISM Trust was a trust established and registered in Mauritius by a Deed of Settlement (hereinafter referred to as "the Deed") dated 31 October 2000. The Deed was entered into between the Oceanic Trust and Monument Trust Company Limited and it determined that the validity, construction and administration thereof would be governed by Mauritian law.

The SISM Trust was a captive reinsurer and rendered its services to mCubed Life Limited from 2000 up until 2006. During 2006 the reinsurance agreement it had entered into with mCubed Life Limited was terminated, whereafter the SISM Trust transferred its reinsurance business to Emerald Insurance Company.

In terms of the reinsurance agreement, mCubed Life Limited transferred the premiums of the policies to the SISM Trust. These assets were invested by the SISM Trust in South Africa, as well as elsewhere in a variety of investments. In order to manage the investments it made in South Africa, the SISM Trust appointed an asset manager.

[16]Oceanic Trust Co. Ltd N.O. v The Commissioner for the South African Revenue Services (case number 22556/09) (hereinafter referred to as "the Oceanic Trust Case")

Upon termination of a policy, the SISM Trust was obliged to return the assets, together with any growth generated thereon to mCubed Life Limited. The fees the SISM Trust were entitled to, together with any expenses incurred in respect of the policy, were deducted from the amount paid to mCubed Life Limited.

The SISM Trust at all times prepared financial statements and submitted tax returns to the authorities in Mauritius. During the time in question the SISM Trust considered itself to have no tax obligations in South Africa.

The urgent application to the high court was preceded by the following events:

1. SARS issued a notice of audit in terms of section 74 of the Act, informing the SISM Trust that it intended to investigate the SISM Trust's financial affairs and also requested specific information in this regard.

2. The Oceanic Trust, as sole trustee, responded to SARS and provided it with certain of the information that had been requested.

3. SARS issued a letter to the SISM Trust informing it that it believed SARS had a tax claim against the SISM Trust and requested the SISM Trust to provide reasons as to why this was not the case.

4. The SISM Trust responded with detailed answers, but irrespective thereof, SARS continued to issue an assessment on 20 July 2009, levying additional tax for the tax years 2000 to 2007. Last mentioned assessment was based on the fact that SARS was of the view that the SISM Trust was a resident of South Africa and therefore liable for tax in South Africa. SARS believed the SISM Trust to be a South Africa tax resident because it had its POEM situated in South Africa. In the alternative, SARS based its argument on the fact that the SISM Trust carried on its business through a permanent establishment situated in South Africa.

5. The SISM Trust filed an objection on 28 August 2009 to the assessment issued by SARS.

6. On 23 July 2009 SARS appointed Standard Bank as the SISM Trust's agent and required Standard Bank to remit R1.5 billion to SARS, which constituted the SISM Trust's liability towards SARS. Standard Bank remitted an amount of approximately R20 million to SARS. Subsequent to this

transfer, SARS provided the SISM Trust with a written notice that it intended to proceed with legal action against it.

The Oceanic Trust, as the applicant in the matter, launched an urgent application in the high court and requested the court to determine that:

1. The SISM Trust was not a resident of South Africa.
2. The SISM Trust did not carry on its business through a permanent establishment situated in South Africa.
3. SARS, as the respondent, was liable to repay an amount of R20 million to the SISM Trust, which was transferred from its Standard Bank account.

The applicant argued that the high court had jurisdiction to adjudicate the matter as it was requested to adjudicate a question of law. The cases cited by the Oceanic Trust determined that the high court could have jurisdiction to adjudicate a matter if the facts were "fully found"[17] and "sufficiently clear"[18], i.e. it was a question of law posed to the court. The respondent's argument was, however, that there was clearly a dispute of facts, which could only be adjudicated by the tax court.

The court determined that before it could decide whether it had the required jurisdiction to adjudicate the matter, it had to consider the facts the respondent relied upon when it had assessed the SISM Trust for tax.

As set out above, the respondent issued a tax assessment against the SISM Trust based on it being of the opinion that the SISM Trust was a resident of South Africa as defined in section 1 of the Act. It further relied upon Article 4 of the double taxation agreement entered into between South Africa and Mauritius which determined that if a person is a resident of both countries, the person will be deemed to be resident where its POEM is situated. The responded considered this to be South Africa and highlighted that "In the end, the question as to where an entity's place of effective management is located is one of fact and of substance over legal form. It will depend upon a conspectus of all the facts regarding the management and operation of the business."[19] This was based on the following facts[20]:

[17] Farmer v Cotton's Trustee 1915 AC 922
[18] Commissioner of Inland Revenue v Stott 1928 AD 252
[19] The Oceanic Trust Case, at para 20
[20] The Oceanic Trust Case, at para 22

1. The SISM Trust was also registered as a trust in South Africa.

2. The main activity of the SISM Trust was to carry out captive re-insurance business.

3. The SISM Trust derived all its business income from mCubed Life Limited, a South African registered company.

4. mCubed Life Limited made decisions in accordance with the re-insurance agreement in respect of how all the premiums were to be handled by the SISM Trust.

5. The SISM Trust appointed Corporate Money Managers, then a wholly owned subsidiary of mCubed Life Limited, to be its asset manager and investment advisor for its South African investments. Corporate Money Managers received instructions regularly from mCubed Holdings Limited and its operating division, Asset Management Outsourcing, in respect of the SISM Trust's investments.

6. Both mCubed Life Limited and Corporate Money Managers were wholly owned subsidiaries of mCubed Holdings Limited, a company listed on the Johannesburg Stock Exchange.

7. All the SISM Trust's investments were made in South Africa.

8. During the period under review, the SISM Trust generated its entire income from business activities actually conducted in South Africa.

9. The SISM Trust held its bank account with Standard Bank in South Africa. A review of the SISM Trust's bank statements showed that it did not transfer any money to Mauritius from the bank account in South Africa, and vice versa, through the period that it was conducting business in South Africa.

10. The reason the SISM Trust was formed was as a result of mCubed Life Limited having a smaller balance sheet than most of its competitors. Many potential policyholders found mCubed Life policies to be attractive, but would not take up the policies for fear of mCubed Life not being able to discharge its obligations on maturity date. Furthermore, section 34 of the Long Term Insurance Act[21] prohibited mCubed Life from encumbering any of the assets it held.

[21] Act 52 of 1998.

11. mCubed Holdings Limited is a beneficiary of International Investment Trust, which is itself a beneficiary of the SISM Trust.

12. The SISM Trust did not provide SARS with any of the minutes of trustees' meetings that were held in Mauritius, or any other documentation to support that its business was run from Mauritius.

The applicant relied on the case of *Commissioner for Her Majesty's Revenue and Customs v Smallwood and Anor*[22] (hereinafter referred to as "the Smallwood case") to support its argument that the SISM Trust was not a resident of South Africa, in light of its POEM being situated in Mauritius.

The facts of this case are broadly the following:

A trust was potentially subject to capital gains tax in the United Kingdom upon the sale of shares it intended to enter into. Tax advice was obtained and it was decided to have the only trustee, a United Kingdom resident, resign and have her replaced with a company based in Mauritius, which was also a tax resident of Mauritius. The trust was then registered as an offshore trust in Mauritius.

In light of Mauritius not levying any capital gains tax, and the double taxation agreement entered into between the United Kingdom and Mauritius, providing Mauritius with the taxing right for capital gains tax, the sale of shares did not attract any capital gains tax for the trust. Subsequent to the sale of shares the Mauritian company resigned as trustee and was replaced by Mr and Mrs Smallwood, both United Kingdom residents.

The court held that the trust's POEM never moved from the United Kingdom to Mauritius and that it remained in the United Kingdom even during the period the sale of shares took place. This majority decision was based on the following:

"The taxpayer with whom we are concerned… are the trustee. Trustees are, by section 69(1) TCGA1992, treated as a continuing body: In relation to settled property the trustee of the settlement shall for the purpose of this Act be treated as being a single and continuing body of persons (distinct from the person who may from time to time be the trustees) and that body shall be treated as being resident and ordinarily resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on

[22] 2010 EWCA Civ 778

outside the United Kingdom and the trustees or the majority of them for the time being are not resident or not ordinarily resident in the United Kingdom."[23]

The majority judgment was further supported by the fact that the scheme to avoid capital gains tax was devised in the United Kingdom by Mr Smallwood, the steps taken was orchestrated from the United Kingdom and the ultimate aim was to only have the trust qualify as a Mauritian resident for the period the shares were sold. It was held that last mentioned reasons, and not the "snapshot" approach, provided the solution to determine the location of the trust's POEM.

4.3 CONCLUSION

In light of the Smallwood case, the court in the Oceanic Trust case held the following to be key features[24] to be taken into account, in respect of the current case before the court, when determining the POEM of an entity:

1. The POEM is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made.

2. The POEM will ordinarily be the place where the most senior group of persons (e.g. a board of directors) makes its decision, where the actions to be taken by the entity as a whole are determined.

3. However, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the POEM of an entity.

4. There may be more than one place of management, but only one POEM at any one time.

5. The decision was based not only on the general test for POEM but also on the specific section of the United Kingdom legislation which provided that the trustees be treated as a single and continuing body of persons who shall be treated as resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on outside the United Kingdom and the trustee or the majority of them for the time being are not resident or not ordinarily resident in the United Kingdom.

[23] The Oceanic Trust Case, at para 51
[24] The Oceanic Trust Case, at para 54

6. The court undertook a painstaking analysis of the facts and the way the scheme was set-up and implemented in order to come to the conclusion on where the POEM of the trust was located.

The court held that based on the test set out in the Smallwood case that the applicant did not prove the POEM of the SISM Trust to have been situated outside of South Africa. It was determined that "at least some key management decisions and at the very least, key commercial decisions necessary for the conduct of SISM's business were in substance made in South Africa."[25]

[25] The Oceanic Trust Case, at para 58

CHAPTER 5: THE TRADEHOLD CASE[26]

5.1 INTRODUCTION

The Supreme Court of Appeal was recently requested to determine whether a deemed disposal as envisaged in terms of paragraph 12 of the Eighth Schedule to the Act, fell within the ambit of Article 13(4) of the double taxation agreement entered into between South Africa and Luxembourg.

5.2 FACTS

Tradehold (hereinafter referred to as "the taxpayer" or "the respondent") was a South African incorporated investment holding company listed on the Johannesburg Stock Exchange. The taxpayer's only significant asset was its shareholding in a South African subsidiary which in turn (directly and indirectly) held shares in offshore based subsidiaries.

On 2 July 2002 at a meeting of the taxpayer's board of directors in Luxembourg, it was resolved that all future board meetings would be held in Luxembourg, although one of the taxpayer's executive directors remained in South Africa until 29 January 2003. Following the decision taken on 2 July 2002, the company became effectively managed in Luxembourg.

The taxpayer however, remained tax resident in South Africa due to the fact that the term "resident" as defined in the Act at that time, provided for incorporation in South Africa as a basis for tax residency. The definition of the term was however changed with effect from 26 February 2003. The change essentially provided that a taxpayer would not be deemed to be resident in South Africa if, due to the application of a tie-breaker clause to an income tax treaty concluded between South Africa and another country, the other country was allocated exclusive taxing rights with respect to that taxpayer.

Since the tax treaty entered into between South Africa and Luxembourg contained such a tie-breaker clause, the taxpayer ceased to be a resident in South Africa when the amended definition of the term "resident" came into effect.

[26] Commissioner for the South African Revenue Service v Tradehold Ltd (case number 132/11) (hereinafter referred to as ("the Tradehold case")

The Commissioner for SARS (hereinafter referred to as "the Commissioner"), relying on specific deemed disposition of assets provisions which, subject to certain exceptions, became operative on an exit of a taxpayer from the South African tax net, assessed the taxpayer for capital gains tax in the amount of R405 039 083.

The taxpayer essentially submitted two main arguments before the Tax Court against the Commissioner's contention:

- Firstly, based on the tie-breaker provisions of article 4(3) of the tax treaty discussed above, it claimed that it was tax resident in Luxembourg where it was effectively managed.

- Secondly, based on the provisions of Article 13(4) of the South Africa-Luxembourg tax treaty, it claimed that the capital gain should be taxed in Luxembourg. Article 13(4) deals with the alienation of shares and, subject to some exceptions, allocates sole taxing rights on capital gains to the country where the seller is tax resident.

The Commissioner contented that Article 13(4) applied to the "alienation" of property and not to a "deemed disposal" and consequently, that the gain that arose on a deemed disposal should not be protected by the tax treaty. In the alternative, the Commissioner argued that the taxpayer's investment could have been attributable to a permanent establishment and thus formed part of assets belonging to a non-resident which are earmarked for potential capital gains tax in South Africa upon disposal.

The Tax Court held in favour of the taxpayer and ruled that it was "unable to see any reason why a 'deemed disposal' of property should not be treated as an 'alienation' of property" for Article 13(4) purposes".

On appeal, the issue before the court was whether a deemed disposal as contemplated in paragraph 12 of the Eighth Schedule to the Act constitutes an "alienation" as contemplated under Article 13(4) of the particular tax treaty.

The acting judge of appeal (hereinafter referred to as "the judge") made a number of notable observations regarding tax treaties, among these being that they:

- are concluded under section 108 of the Act and once brought into operation, have the effect of law;

- allocate taxing rights between contracting states, modify the domestic law and apply in preference to domestic law to the extent that there is any conflict; and
- use wording of a wide nature and that they must be interpreted in a manner which gives effect to the purpose of the treaty and which is congruent with the words employed in it.

He stated that the first step in interpreting the provisions is to determine into which article of the treaty the particular tax falls. With respect to the South Africa-Luxembourg treaty, the judge observed that the treaty provisions apply to "the normal tax" in South Africa, which included capital gains.

He then highlighted that the question to be determined is whether the term "alienation" includes in its ambit gains arising from deemed disposal of assets. On this, the judge expressed the view that:

- the term "alienation" is not one of the defined terms and therefore Article 3(2) of the tax treaty (which refers the reader to the domestic legislation meaning of the word) found application;
- the term must be given a meaning that is congruent with the language of the tax treaty having regard to its object and purpose;
- Article 13 was widely cast and included within its ambit capital gains derived from the alienation of all property; and
- it was of significance that no distinction was drawn in Article 13(4) between capital gains that arise from actual or deemed alienation of property.

The acting judge of appeal concluded that the term "alienation" as used in the South Africa-Luxembourg tax treaty "is not restricted to actual alienation but that it was a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains".[27]

5.3 CONCLUSION

The court thus held that Article 13(4) applied to such capital gains and that when the taxpayer relocated its seat of effective management, the tax treaty provisions became applicable and Luxembourg had exclusive taxing rights in respect of all of the taxpayer's capital gains.

[27] The Tradehold case, at para 25

The importance of this case from a POEM perspective is whether this matter may have had a different outcome had the initial court, and then subsequently the Supreme Court, been called upon to examine more closely whether the taxpayer's seat of effective management had in fact moved to Luxembourg, in light of SARS' approach to effective management reflected in the Interpretation Note.

SARS, in the Interpretation Note, does not adopt the OECD "board-centric" approach to effective management, but rather takes the view that a company is effectively managed where its senior management execute and implement decisions taken by a company's board of directors.

CHAPTER 6: THE WOOD VERSUS HOLDEN CASE[28]

6.1 INTRODUCTION

On 26 January 2006 the Supreme Court of Appeal delivered its judgment in the Wood case[29] and held that "the judge was correct to hold that the only conclusion open to the special commissioners, on the facts which they have found, was that Eulalia was resident in the Netherlands."[30]

6.2 FACTS

The facts of the case are quite complex and therefore the following high level summary is provided:

Mr and Mrs Wood together held 96% of the shares in a company called Ron Wood Greetings Card Ltd (hereinafter referred to as "Greetings"). The minority shareholders included employees of Greetings, as well as a personal acquaintance of Mr Wood.

Price Waterhouse Corporate Finance was approached by Mr and Mrs Wood to locate a buyer for Greetings, as well as to facilitate the sale.

Subsequently Mr and Mrs Wood established a number of settlements (hereinafter referred to as "the family settlements"), which included a discretionary settlement. Barclaytrust was appointed as the trustee of the discretionary settlement, and Barclays Private Trust (BVI) Limited as the trustee of the remaining settlements. Barclaytrust was based in Geneva and the 100% shareholder of Barclays Private Trust (BVI) Limited.

Copsewood Investments Ltd (hereinafter referred to as "CIL"), a company registered in the British Virgin Islands, was incorporated by Barclays Private Trust (BVI) Limited and Barclaytrust.

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[28] 2006 EWCA Civ 26 (hereinafter referred to as "the Wood case")
[29] Supra
[30] The Wood case, at para 40

Mr and Mrs Wood purchased a shelf company, i.e. Ron Wood Greetings Card Holdings Ltd (hereinafter referred to as "Holdings"), of which they were the initial sole shareholders. A percentage of Holdings' shares were transferred to CIL and a percentage of Greetings' shares were transferred to Holdings.

CIL proceeded to purchase a dormant, Dutch incorporated, company, Eulalia Holding BV (hereinafter referred to as "Eulalia") and appointed ABN AMRO Trust Company (Netherlands resident) as the sole managing director. The shares held by CIL in Holdings were sold to Eulalia, after which Eulalia proceeded to sell the shares to a third party.

In terms of United Kingdom legislation any capital gains tax raised as a result of the sale of shares by CIL to Eulalia, would accrue to Mr and Mrs Wood, as settlors of the family settlements of which the trustees were non-residents. An exemption is, however, provided for in the event that both CIL and Eulalia were not UK resident and it was this exemption that brought the matter before the court, i.e. the court had to determine whether Eulalia was UK resident or not.

The special commissioners were of the opinion that Eulalia was resident in the UK and that Mr and Mrs Wood could not benefit from the capital gains tax exemption. They argued that ABN AMRO did not take any decisions by itself, but acted on the instructions of either Mr Wood, or Price Waterhouse Corporate Finance. Their argument was based on the following:

- Where a company is not incorporated in the UK, its residency is determined by applying the central management and control test as highlighted in the De Beers case[31]. "The basic principle established in De Beers (1906) AC 455 is 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', see per Lord Loreburn LC at page 458. The word 'actually' is crucial since it was decided in Unit Construction Co Ltd v Bullock that 'it is the actual place of management, not the place in which it ought to be managed, which fixes the residence of a company', see per Lord Simonds at 38 TC page 729."[32]

- They distinguished the current set of facts from the Unit Construction case[33] by highlighting that in the latter case the "parent company usurped the powers of the boards of the subsidiaries,

[31] De Beers Consolidated Mines Limited versus Howe (Surveyor of Taxes) (1905) 2 K.B. 612
[32] The Wood case, at para 15
[33] Bullock v Unit Construction Co Ltd 1960 AC 351

'which stood aside and did not meet at all."[34] In the current case "the directors of Eulalia and CIL were not by-passed nor did they stand aside since their representatives signed or executed the documents."[35]

- "The only acts of management and control of Eulalia were the making of the board resolutions and the signing or execution of documents in accordance with those resolutions. We do not consider that the mere physical acts of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical act. What is needed is an effective decision as to whether or not the resolution should be passed and the documents signed or executed and such decisions require some minimum level of information. The decisions must at least to some extent be informed decisions. Merely going through the motions of passing or making resolutions and signing documents does not suffice. Where the geographical location of the physical acts of signing and executing documents is different from the place where the actual effective decision that the documents be signed and executed is taken, we consider that the latter place is where the 'central management and control actually abides'".[36]

The Supreme Court of Appeal determined that the special commissioners' reasoning was based on the following three considerations:

1. As soon as CIL purchased Eulalia, ABN AMRO was appointed as Eulalia's managing director and was also responsible for the day-to-day management of Eulalia. When Eulalia entered into the sale agreement with its ultimate holding company, CIL, to purchase the shares in Holdings, no evidence was available to indicate that ABN AMRO ever reviewed and considered the sale in any detail. Last mentioned could be illustrated by the fact that no guidance could inter alia be obtained as to how the purchase price for the shares was determined, something you would expect a managing director to be well acquainted with.

   The special commissioners did, however, concede that "it would be a far-reaching proposition to state that any subsidiary entering into a contract to acquire property from its parent on such a basis without independent consideration of the terms is necessary ceding its central management and control to the parent".[37]

[34] The Wood case, at para 16
[35] The Wood case, at para 16
[36] The Wood case, at para 18
[37] The Wood case, at para 19

2. Eulalia had only one business interest and that was the acquisition of the Holdings shares from CIL and the ultimate sale thereof to a third party. There was nothing else that had to be managed by Eulalia.

3. No "real" or any detailed consideration was given by ABN AMRO to the terms of the sale agreement that was entered into between Eulalia and CIL. Last mentioned ensured that "the actual effective decision that the documents be signed and executed' was not taken by ABN AMRO in Amsterdam."[38] Ultimately ABN AMRO only complied with the wishes expressed by Mr Wood.

Upon determination that Eulalia was UK resident, the special commissioners continued to determine the POEM of Eulalia as set out in Article 4(3) of the double taxation agreement.

It was held that "in the present context there is no difference between central management and control and the place of effective management. In our judgment the place of effective management must be the place where effective management decisions are taken. There is no indication that any effective management decisions were taken in the Netherlands."[39]

The high court, however, held that Eulalia was resident in the Netherlands and not in the United Kingdom. In this regard the Supreme Court of Appeal found the following to be compelling:

- "The making of the board resolutions and the signing and execution of documents which the Commissioners say were the only acts of management and control of Eulalia all took place in the Netherlands. A company is resident where its central management and control are situated. How, therefore can Eulalia have been resident in the United Kingdom? How can it have been resident anywhere other than in the Netherlands?

- What the Commissioners seem really to be saying is that, although the only acts of control and management took place outside the United Kingdom, there was not much involved in them. But the test for a company's residence is still the central control and management test: it is not the

[38] The Wood case, at para 19
[39] The Wood case, at para 21

law that the test is superseded by some different test if the business of the company is such that not a great deal is required for central control and management of its business to be carried out."[40]

The High Court judge continued by highlighting that even though it could be argued that ABN AMRO was required to analyse in more detail the decisions taken pertaining to both sale agreements, these decisions were still taken by ABN AMRO. This leads to the conclusion that Eulalia was resident in the Netherlands. The judge further confirmed that if he was required to, he would also have concluded that Eulalia was resident in the Netherlands based on the POEM test as set out in Article 4(3) of the double taxation agreement.

6.3 CONCLUSION

The Supreme Court of Appeal concurred with the view adopted by the high court, i.e. Eulalia was resident in the Netherlands and not in the United Kingdom. The judge determined that the follow finding of facts by the special commissioners lead to this conclusion:

"The first (at paragraph 119 of their decision) was that 'the directors of Eulalia… were not by-passed nor did they stand aside since their representatives signed or executed the documents.' That finding takes this case outside the class exemplified by the facts in the Unit Construction Co td v Bullock. The second – implicit in the finding that 'their representatives signed or executed the documents', but made explicit in the observation (at paragraph 134 of the special commissioners' decision) that 'From the viewpoint of Eulalia we find nothing suprising in the fact that its directors accepted the agreement prepared by Price Waterhouse…' – was that ABN AMRO (the managing director of Eulalia), through Mr Fricot and Mr Schmitz, did sign and execute the documents (including the purchase agreement); and so must, in fact, have decided to do so."[41]

The judge determined that based on the above to facts there was no ground to argue that ABM AMRO did not take any decisions. Even though Price Waterhouse Corporate Finance expected ABM AMRO to execute the decisions to enter into both sale agreements, they never dictated ABM AMRO to do so. It was held that the special commissioners' approach had the following flaws:

[40] The Wood case, at para 35
[41] The Wood case, at para 40

- The argument that the decisions taken by ABM AMRO did not constitute "effective decisions" "by a constitutional organ exercising management and control"[42]. As was pointed out, Eulalia only had to make two decisions, which were the decisions to purchase the Holdings shares from CIL and to subsequently sell those shares to a third party. Both these decisions were taken by ABN AMRO as managing director of Eulalia.

- The argument that no "effective decisions" were taken by ABM AMRO in light of these decisions having been reached with due consideration. The judge held, however, that "a management decision does not cease to be a management decision because it might have been taken on fuller information; or even, as it seems to me, because it was taken in circumstances which might put the director at risk of an allegation of breach of duty. Ill-informed or ill-advised decisions taken in the management of a company remain management decisions."[43]

The Supreme Court of Appeal therefore upheld the decision taken by the high court and determined that Eulalia was resident in the Netherlands based on the central management and control test.

It is important to note that the remaining two judges agreed with the conclusion reached by Judge Chadwick. Judge Staughton interestingly noted the following:

"Whether Eulalia was resident in the United Kingdom was not a question of fact in this case. It was not a question which one witness might answer Yes, and another witness might answer No. The available facts were sufficient to enable the judge to decide whether, in law, Eulalia was resident in the United Kingdom. The only answer was that Eulalia was in the Netherlands. There might have been further facts; and if they had been proved, they might have contradicted the facts previously established. As it was, the facts that were proved showed that Eulalia was resident in the Netherlands."[44]

[42] The Wood case, at para 42
[43] The Wood case, at para 43
[44] The Wood case, at para 49

CHAPTER 7: THE MARK HIGGINS CASE[45]

7.1 FACTS

Mr Higgins and Mr Dixon entered into a partnership agreement during October 2001 and it was this particular partnership that the Commissioner for Her Majesty's Revenue and Customs (hereinafter referred to as "HMRC") argued to be controlled and managed in the United Kingdom by Mr Higgins. If this was indeed proven to be the case, Mr Higgins would be subject to tax on the non-UK sourced profits of the partnership. The partnership, however, opposed this argument by providing evidence that the partnership was managed and controlled from the Isle of Man. If the court accepted this argument, the remittance basis would be applied to Mr Higgins' share of the partnership's non-UK sourced income.

The following facts were brought into evidence by Mr Dixon and Mr Higgins:

Mr Dixon has been resident, for UK tax purposes, in the Isle of Man since 1991. He is a solicitor by profession and has gained extensive legal and commercial experience in the companies and partnerships arena. Mr Dixon, a rally driver enthusiast, met Mr Higgins, identified him as a future star in the rally world and subsequently became his mentor who provided him with the required support, both mentally and financially.

During October 1991 Mr Dixon and Mr Higgins entered into a partnership agreement. As partners, Mr Dixon contributed his business knowledge and Mr Higgins his rally driving skills to the partnership. In 1993 Mr Higgins relocated to the UK. This decision was based upon his family moving to Wales to take over a rally school. Up until this point the partnership was in a loss making position and the only tax matters that had to be taken care of by Mr Dixon was the Value-added Tax in the Isle of Man. The partnership was, however, to become profitable in the future and therefore Mr Dixon was concerned with the tax implications of the partnership going forward. In this regard he prepared an "Aide Memoir to Partnership Tax" to guide him in the future. His legal and commercial background provided him with the necessary skills to embark on such a task and "I knew that the partners had to control and manage the Partnership's trade from the Isle of Man, or otherwise outside the UK. I am a solicitor and was aware

[45] Mark Higgins Rallying v The Commissioner for Her Majesty's Revenue and Customs 2011 UKFTT 340 (TC) (hereinafter referred to as "the Mark Higgins case")

what was required of the partners, as to whether the acts, which the partners carried out, show that the trade was controlled and managed in the Isle of Man…"[46]

Even though no records of any of the partnership meetings were kept, Mr Dixon was at all relevant times aware that they had to ensure that the partnership was managed and controlled outside the UK. Even though Mr Higgins did not appreciate the rules that were laid down to ensure last mentioned status, he obeyed in light of Mr Dixon's personal knowledge in this regard.

The partnership generated profits by inter alia signing contracts with Volkswagen and Vauxhall, teaching rallying skills to other aspiring drivers and Mr Higgins appearing as a television presenter. At all times the partnership was managed on the assumption of Mr Higgins concentrating on his passion for driving and Mr Dixon providing his business experience. Mr Dixon highlighted that even though he could not provide Mr Higgins with any driving advice, which he could do only at the beginning of Mr Higgins career, he added value with financial support and his commercial experience.

It was further highlighted that all major contracts were executed by both partners in the Isle of Man, with the exception of the Volkswagen contract. This contract had to be signed urgently and without any delay. Apart from Mr Dixon's connections in the rally world which assisted in signing contracts with certain manufacturing teams, various business opportunities arose from personal contacts Mr Higgins had. Mr Higgins also did not discuss his professional career with his family, since his brother was also a rally driver who competed for the same driving opportunities.

Evidence was then provided by a Mr Roberts who conducted the enquiry into the partnership's management and control on behalf of the UK tax authorities. He determined that "the picture he had formed was of a trader who based himself in the UK, where he had extensive contact with manufacturers' teams, teaching, training, and other business opportunities."[47] He continued that "Mr Dixon could give legal advice and a view on whether the contract terms were fair but his activities were of a background nature and did not amount to control and management of the Partnership."[48]

The following submissions were made on behalf of the partnership:

[46] The Mark Higgins case, at para 13
[47] The Mark Higgins case, at para 25
[48] The Mark Higgins case, at para25

Council submitted that in order to determine where the control and management of a business is situated "one must look to the place where the highest level of decision making takes place. In the case of a partnership this will generally be where the partners hold their partnership meetings."[49]

In this regard the case of *Padmore v IRC*[50] was cited, where it was determined that the control and management of a Jersey partnership was situated outside the UK. The special commissioners in this case stated that "The business of CPA has, however, always been carried on from its offices in St Helier, Jersey; and its day-to-day business is dealt with by two managing partners who are Jersey residents. General meetings of the partners are held in Jersey or Guernsey (but nowhere else) four times a year, or more frequently as occasion demands. At those meetings policy matters are discussed and the decisions taken are thereafter implemented by the Jersey resident managing partners. It is common ground that the control and management of the business of CPA is situated abroad…"[51]

In addition to the above it was highlighted that not only did the HMRC accept the place of control and management of a partnership to be the place of the highest level of management in the Padmore case[52], but also in its own manual[53]. The taxpayers did submit that even though this manual did not constitute any authority, it provided the correct analysis of the law, which had to be adopted. The relevant paragraph reads as follows:

"What determines whether a partnership is within Section 112 Is the place of control and management of its business. We are concerned with statutory words but there is no judicial guidance on their meaning. This contrasts, somewhat paradoxically, with the control and management aspect of 'company residence' work where the words are not statutory but on which there is a good deal of somewhat ancient judicial guidance.

What then do we do? Generally speaking we follow the thinking on companies and look at the place of the highest level of management rather than the day-to-day management. Outside textbooks follow the same line.

[49] The Mark Higgins case, at para 30
[50] 1989 STC 493
[51] The Mark Higgins case, at para 31
[52] Supra
[53] International Tax Handbook para ITH1612

In deciding the location of the control and management of a firm with both United Kingdom and overseas partners, we would usually regard as significant such factors as the comparative seniority of the partners in age and experience (a simple head count will not do of course), the extent of their interests in the firm, the source and control of the finance, the place of decision on policy and major transactions, the places and locations of partners' meetings and what was done at those meetings. The place of meetings incidentally is not a conclusive factor any more that it is – or ought to be – for companies. So the nature of the business done at the meeting is important. Is it really about control and management or just part of a facade to mislead us about the place of actual control and management?"[54]

Council further stated the similarities between the De Beers case[55] and the current set of facts. In the De Beers case the company was held to be UK resident, even though the mining operations were conducted in South Africa. The board meetings were held in the UK and the high level decisions of the company were made at these meetings. Similarly, the rally driving and coaching took place in the UK, while all the high level decisions of the partnership were executed in the Isle of Man. It was argued that based on the case law referred to, the partnership could be controlled and managed from the Isle of Man, while activities were carried out in the UK. The activities carried out in the UK did not constitute "high level" business decisions and therefore did not impact on the partnership being controlled and managed from the Isle of Man.

It was further noted that even if some high level acts of management took place in the UK, these acts did not in itself affect the control and management of the partnership. In this regard the case of *Laerstate BV v HMRC*[56] was quoted: "…the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case"[57] as well as the case of *Untelrab Limited v McGregor*[58]: "…when deciding the issue of residence one should stand back from the detail and make up one's mind form the picture which the whole of the evidence presents."[59]

The following facts[60] were inter alia argued to be of importance in order to conclude that the partnership was controlled and managed from the Isle of Man:

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[54] International Tax Handbook, at para ITH1612
[55] Supra
[56] 2009 UKFTT 209 (TC) (hereinafter referred to as "the Laerstate case")
[57] The Mark Higgins case, at para 37
[58] 1996 STC (SCD) 1
[59] The Mark Higgins case, at para 37
[60] The Mark Higgins case, at para 38

- No partnership meetings were ever held in the UK.
- Nearly all major business contracts were executed outside the UK.
- Mr Dixon was the dominant partner with his business knowledge and experience.
- Mr Dixon was cautious at all times to ensure that the partnership was controlled and managed from the Isle of Man. This was illustrated by Mr Dixon's request to ensure that no major business decisions were taken over the phone, while Mr Higgins was in the UK.
- All activities performed by Mr Higgins related to the day-to-day matters of the partnership.
- The partnership's bank account was only in Mr Higgins name, purely because the driving and teaching activities were performed by him personally.
- Mr Higgins' family had no part in the business affairs of the partnership.

In its response to the above arguments, council for the HMRC stated that even though the partnership was initially controlled and managed from the Isle of Man, this changed when Mr Higgins relocated to the UK in 1993. Even though Mr Dixon provided Mr Higgins with the necessary guidance in the beginning of their partnership, this was no longer required. Mr Higgins "had become an established and successful professional, competing in numerous events and seeking out opportunities for sponsorship, testing and teaching."[61]

The partnership revolved around Mr Higgins' skills as a rally driver. He was the first person people made contact with. He constituted the "heartbeat of the business and it is his activities that generate all the profits."[62] The HMRC was of the opinion that Mr Dixon's contribution was limited to his legal experience as a solicitor, and that even though he might have had the responsibility to review the terms of proposed contracts, the decision to enter into any contract remained with Mr Higgins.

The emphasis on where the partnership executed its contracts was rejected as being determinative of where the partnership's control and management was located. It was argued that other factors played a more important role, i.e. the activities performed by Mr Higgins. The HRMC believed the partnership was a tax avoidance scheme, "the aim of Mr Dixon from the outset has been to create an artificial structure designed to achieve a tax advantage. The idea that the Isle of Man is the centre of control of the Partnership is just to create the required picture. It is not in fact the case. The Tribunal should ask itself how credible is the picture that the partners never discussed important matters on the telephone and that

[61] The Mark Higgins case, at para 40
[62] The Mark Higgins case, at para 41

Mr Higgins was summoned to fly to the Isle of Man for meetings that were never minuted. All taken together this smacks of artificiality."[63]

7.2 CONCLUSION

In delivering its judgment the court confirmed that the test to be applied to determine the location of control and management of the partnership was the test adopted by the courts in determining the said location in respect of companies. The court felt it important to refer to the views held in the following two cases:

In the case of *Untelrab Limited v McGregor*[64] the special commissioners stated that:

"From these authorities we have identified the following principles: that the residence of a company is where the directors meet and transact their business and exercise the powers conferred upon them; that if the directors meet in two places then the company's residence is where its real business is carried on and the real business is carried on where the central management and control actually abides; that a determination as to whether a case falls within that rule is a pure question of fact to be determined by a scrutiny of the course of business and trading; that the actual place of management, and not the place where a company ought to be managed, fixes the place of residence of a company;… and that when deciding the issue of residence one should stand back from the detail and make up one's mind from the picture which the whole of the evidence presents."[65]

In the case of *Laerstate BV v HMRC*[66] the Tribunal was of the view that:

"There is no assumption that (central control and management) must be found where the directors meet. It is entirely a question of fact where it is found. Where a company is managed by its directors in board meetings it will normally be where the board meetings are held. But if the management is carried out outside board meetings one needs to ask who was managing the company by making high level decisions and where, even where this is contrary to the company's constitution.

[63] The Mark Higgins case, at para 46 and 47
[64] Supra
[65] The Mark Higgins case, at para 52
[66] Supra

It is significant, we think, that Lord Loreburn (in De Beers) referred to the test as being where central management and control 'abides'. This is a test that does not confine itself to a consideration of particular actions of the company, such as the signing of documents or the making of certain board resolutions outside the UK if, in a given case, a more general overview of the course of business and trading demonstrates that as a matter of fact central management and control abides in the UK. As Lord Loreburn said (at 212-213), the factual question must be considered 'upon a scrutiny of the course of business and trading.'

This is consistent with the analogy with individual residence which was the basis on which Lord Loreburn propounded the central management and control test. Just as for an individual, for example, where a temporary departure from the UK would not in itself give rise to a change of residence, the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case."[67]

Based on the above the court made it clear that they were obliged to look at the partnership picture of Mr Higgins and Mr Dixon as a whole in order to determine who was managing the partnership by making high level decisions and at what location did this take place.

It reaching its conclusion the court held that:

1. The partnership was no "artificial structure motivated by tax planning concerns."[68] The evidence given by Mr Dixon made it clear that when the partnership was entered into, they were two business men doing business in the Isle of Man. Upon relocation of Mr Higgins to the UK, Mr Dixon took careful note of how the partnership had to be managed going forward in respect of potential UK tax implications in the event that the partnership became profitable. To support such a decision, Mr Dixon made it clear that no important decisions could be taken over the phone while Mr Higgins was in the UK. Mr Dixon also prepared his "Aide Memoir to Partnership Tax" to provide him with the necessary guidance in this regard.

   In support of this conclusion the court referred to Mr Higgins' evidence where he said that: "Roy made me aware of the importance of where the Partnership was controlled and managed. He made it clear that this had to be outside of the UK. His persistence in how I must not discuss with him or

[67] The Mark Higgins case, at para 53
[68] The Mark Higgins case, at para 61

make any decisions in the UK seemed strange to me, especially since very little money was made at that time other than from new car launches and teaching work. Nonetheless I followed his advice, and would travel back to the Isle of Man, when he requested, for meetings to discuss major decisions and to sign contracts. I often thought it was an unnecessary use of time and money but nevertheless I did so because Roy said it was crucial. Roy often stopped me discussing anything that might affect the future of the Partnership on the telephone unless I was in the Isle of Man, or otherwise outside of the UK. I have occasionally flown to the Island to deal with a partnership matter and then returned to the UK the same day."[69]

2. The emphasis on where certain contracts were signed, were not in itself a decisive factor. It was highlighted that the location where decision making took place, was more important as to where the contracts were signed.

3. The partnership was entered into to combine Mr Higgins' driving skills with Mr Dixon's business experience. It was clear from the evidence that Mr Higgins completely relied on Mr Dixon for the business aspect of the partnership. It was clear that Mr Higgins would not enter into any commercial commitment of a significant nature without Mr Dixon's consideration thereof.

4. It was determined that "the high level decisions of the Partnership were made outside the UK, because those were determined by the views of Mr Dixon, as the commercial brains of the Partnership…"[70]

The court ultimately held that by looking at the picture as a whole, Mr Dixon managed the partnership by making the high level decisions. These high level decisions were taken in the Isle of Man. In light of last mentioned the partnership was controlled and managed outside the UK.

[69] The Mark Higgins case, at para 61
[70] The Mark Higgins case, at para 64

CHAPTER 8: THE LAERSTATE CASE[71]

8.1 INTRODUCTION

In this matter the court was requested to determine whether the Appellant was at the material times in question resident in the UK.

8.2 FACTS

The facts of the matter brought before the court, were very detailed and could cause confusion if the case is not read it its entirety. It has therefore been decided to only set out the arguments of both parties, together with the court's finding in this regard. It is important to set out though, that a Mr Bock was the 100% shareholder of the Appellant and also a director of the company up to 1996. Upon resignation as director, a Mr Trapman was the only remaining director of the company.

The court highlighted that both parties were in agreement as to the test that had to be applied for corporate residency. It was how the test had to be applied to the current set of facts that caused the disagreement.

Council for the Appellant raised arguments to support the fact that central management and control were executed outside the UK. Mr Baker in this regard "treats as the act of central management and control the resolution where this precedes the signing of a document, or the signing of the document itself where there is no resolution."[72]

In opposing the above argument, the HMRC noted that if a company is run at board meetings, the location of central management and control is likely to be where the board meets. What is argued though, is that the HMRC is of the opinion that the Appellant was not run in this way.

In support of this argument, the HMRC highlighted the following important facts:

1. Decisions regarding the Appellant were not taken at board meetings at all. As was evidenced by Mr Bock "the 'meetings' were not really meetings and no discussion took place"[73] at these meetings.

[71] Supra
[72] The Laerstate case, at para 25
[73] The Laerstate case, at para 26

The HMRC was of the opinion that based on the facts, whatever happened to Mr Brock's company was not dealt with at board meetings, and especially not dealt with by Mr Trapman.

2. The current case needs to be distinguished from a case of "usurpation". In the current instance the board of directors at no stage acted in a management capacity. All business decisions were taken by Mr Brock, as dominant director, and 100% shareholder of the Appellant. It is also noted that this decision making did not cease upon his resignation as director.

3. "There is a difference between, on the one hand exhortation or persuasion by a UK resident of a non-resident director, or board of directors, and, on the other hand, the abdication of responsibility by the non-resident board or usurpation by the UK."[74] In the current case it therefore needs to be determined whether Mr Brock persuaded Mr Trapman to make certain decisions, or whether Mr Brock made the decisions himself.

4. In the event that it is determined that the central management and control of the Appellant did take place in the UK, it would be easy to conclude that the place of effective management location would also be in the UK. Any effective management that took place in the Netherlands was of a minimal nature.

8.3 CONCLUSION

In reaching its conclusion, the court first set out the law that in its opinion had to be applied to the current set of facts. In determining what question had to be answered, it was held that "There is no assumption that central management and control must be found where the directors meet. It is entirely a question of fact where it is found. Where a company is managed by its directors in board meetings it will normally be where the board meetings are held. But if the management is carried out outside board meetings one needs to ask who was managing the company by making high level decisions and where, even where this is contrary to the company's constitution."[75]

It was made clear that based on the test set out in the De Beers case[76], that when determining a company's central management and control location, one should not be limited to specific actions that have taken

[74] The Laerstate case, at para 26
[75] The Laerstate case, at para 27
[76] Supra

place outside the UK, for example the signing of documents and passing of resolutions. This would be the case where a more general overview of the business indicates that in fact the central management and control of the company does abide in the UK.

The court also referred to the analogy of individual residence upon which Lord Loreburn proposed the central management and control test. Even though an individual may temporarily leave the UK, this would not result in a change of residency for the individual. This is similar to the scenario of a company, "the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case."[77]

The case of *Wood v Holden*[78] and *Bullock v The Unit Construction Co Ltd*[79] were also referred to in respect of the period during which Mr Bock was still a director of the Appellant. In the Bullock case[80] the court had to determine whether the central management and control of the East African operations took place in England. If last mentioned was answered affirmative it had to be determined whether these subsidiaries could be UK resident irrespective of the fact that the persons who performed the acts did not have the required authority and the meetings held were deemed invalid in terms of the subsidiaries' constitution. In this case the court noted that "it would be exceptional for a parent company to usurp control of its subsidiary, as a parent company usually operates through the boards of its subsidiaries."[81]

The above mentioned was also referred to in the Wood v Holden case[82], where it was held that "all decisions had been made at meetings in the Netherlands by the managing director of the company. Those meetings could not be dismissed as immaterial legal formalities. Without the decisions of the managing director in the Netherlands the relevant agreements would not have been made."[83]

The court continued to also highlight the following different scenarios:

- The directors sign an agreement, without them knowing what they have signed, i.e. "mindless signing"[84]. The agreement is opened at the signature page and the directors sign it regardless.

[77] The Laerstate case, at para 29
[78] Supra
[79] Supra
[80] Supra
[81] The Laerstate case, at para 31
[82] Supra
[83] The Laerstate case, at para 32
[84] The Laerstate case, at para 34

- The directors know what they are signing, but do not consider whether it would be better to sign it or not.

- The directors follow the view adopted by the shareholders, but only after they have considered whether to follow the set view or not. In this scenario the directors have substantial information on which their decision is based, but "less information than a reasonable director would require in order sensibly to decide whether or not to follow the shareholder's wishes."[85]

- The directors have all the necessary information to make an informed decision.

When the court applied the above legislation and relevant case law to the set of facts before it, it concluded that the Appellant was resident in the UK during the time periods in question.

[85] The Laerstate case, at para 36

CHAPTER 9: DISCUSSION PAPER ON INTERPRETATION NOTE 6

9.1 INTRODUCTION

During 2011 SARS issued a Discussion Paper on the Interpretation Note[86] in order to address the concerns raised by tax practitioners in respect of the new headquarter company regime being launched as part of the "Gateway into Africa" initiative.

The Headquarter company regime was introduced to attract foreign investment into South Africa and to make South Africa an attractive location as a holding company gateway for foreign multinationals into Africa.

In order for a South African company to qualify as a headquarter company (hereinafter referred to as "HQC") it must satisfy the following criteria[87]:

- Each shareholder (whether alone or together with any other company forming part of the same group of companies as the shareholder) of the HQC must hold at least 10% of the HQC's equity shares and voting rights for that year of assessment and all previous years of assessment;

- At the end of that year of assessment and of all previous years of assessment of that company, 80% or more of the cost of the total assets (excluding cash or a bank deposit payable on demand) of the company (in the form of equity shares, amounts loaned or advanced or intellectual property) should represent investments in foreign subsidiaries in which the HQC holds (whether alone or together with any other company forming part of the same group of companies as the shareholder) at least 10% of the equity shares and voting rights; and

- Where the gross income of the HQC exceeds R5 million for that year of assessment, 50% or more of that gross income for that year of assessment must consist of any rental, dividend, interest, royalty, or service fee paid or payable by any qualifying foreign company or any proceeds from the disposal of any interest in equity shares in a foreign company or intellectual property licensed to a qualifying foreign company. In determining the gross income set out above, any exchange difference in terms of section 24I should be excluded.

[86] South African Revenue Service, *Discussion Paper on Interpretation Note 6 Place of Effective Management* (hereinafter referred to as the "Discussion Paper")
[87] Section 9I of the Income Tax Act, 1962

The concerns raised pertain to the risk of the foreign subsidiaries held by a headquarter company qualifying as South Africa tax residents based on South Africa's current interpretation of the term POEM. This would nullify the benefits the new headquarter company regime aims to provide and would have a negative impact on the idea to promote South Africa as an attractive country for investment into the rest of Africa. This is highlighted as the "problem statement"[88] by SARS in its discussion document.

It is confirmed that if such a foreign subsidiary of a HQC indeed qualifies as a South Africa tax resident, the foreign subsidiary would be taxable in South Africa on its world-wide receipts and subject to tax at 28%. This will result in the foreign subsidiary being able to only claim a rebate on the foreign taxes proved to be payable in the country it operates in.

It is made clear that the purpose of the discussion document is to obtain comments and suggestions from tax practitioners in respect of the above concerns raised. The aim would be to obtain a framework that could be applied in order to amend the Interpretation Note accordingly.

For ease of reference, the rest of this chapter will mirror the lay-out of the Discussion Paper.

9.2 GENERAL

The Discussion Paper continues to explain the two residence-based tests that are currently being applied by South Africa in respect of a legal person. The one being the place where it is incorporated, established or formed, and the other being the place whether the legal person's POEM is situated. It is highlighted that the first test, i.e. the place of incorporation, is easy to identify, but just as easy to manipulate in the current modern environment we live in. A company could be incorporated in Mauritius, but all its operations and management may be taking place in South Africa. It is therefore clear that the place of incorporation may have "little or no connection with the entity's actual economic and business links."[89]

The second test on the other hand, i.e. POEM, is not as easy to manipulate, but has proven to be difficult in its interpretation as well as in its application. This test purports the "substance over form" test. Even

[88] Discussion Paper, at para 3
[89] BA van der Merwe, *The Phrase 'place of effective management': Effectively Explained?*, 18 SA Merc LJ, 121 at p.124-125 (2006) (hereinafter referred to as "Van der Merwe")

though a company might be incorporated in Mauritius, one would need to determine where it is actually managed from.

9.3 SARS'S CURRENT APPROACH TO THE TERM POEM

South Africa's current interpretation of POEM is further expanded upon by referring to the guidelines provided by the Interpretation Note. As set-out in Chapter 1 above, the test applied by South Africa is "the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets."[90] It is clear therefore that one needs to determine where a company's decisions are executed and implemented by senior management and not where the directors meet to exercise their control.

In order to determine a legal person's POEM from a practical point of view, the three steps set out in the Interpretation Note needs to be followed, i.e.:[91]

1. If these management functions are executed at a single location, that single location will constitute the legal person's POEM;

2. If all these management functions are executed from different locations, one would determine the location where the day-to-day management and commercial decisions taken by senior management are actually implemented. This will be the location where the actual business operations of the company are carried out; and

3. If both steps above can't provide a definite answer, one would determine the "place with the strongest economic nexus".

In addition to the three steps set-out above, SARS provides certain factors that need to be considered when determining a legal person's POEM. These factors include inter alia where the business operations are actually conducted and where the centre of top level management is located[92]. It is reiterated that these factors do not constitute an exhaustive list, but only acts as guidelines to be followed.

[90] Interpretation Note 6
[91] Interpretation Note 6
[92] Interpretation Note 6

9.4 CRITICISM OF INTERPRETATION NOTE 6

The Interpretation Note has been subject to widespread criticism which mainly includes the following:

1. The approach followed by SARS as set out in the Interpretation Note, is one where the strategic decisions of a company is implemented and executed. This is different from the approach followed by the OECD, which is where these strategic and policy decisions are taken, i.e. where the board of directors meets. The reason for concern would be the interpretation of POEM in a double taxation agreement context which is modelled on the Model Tax Convention. The approach followed by South Africa would therefore be the complete opposite from the approach followed by the OECD.

2. The terminology used in the general approach is inconsistent with the terminology used in the practical application. In addition to this terminology inconsistency, the statutory basis to make use of the "economic nexus" to determine a company's POEM is questioned in circumstances where the primary locus of "second level" management cannot be determined.

3. Inconsistencies have been identified between the facts and circumstances of the general approach and the guideline. In this regard the following two factors[93] have been very controversial:

    a) where controlling shareholders make key management and commercial decisions in relation to the company; and

    b) legal factors such as the place of incorporation, formation or establishment, the location of the registered office and public officer.

4. No guidance or information is provided to determine the POEM of a passive or intermediate holding company.

9.5 INTERNATIONAL BENCHMARKING

As highlighted previously, the term POEM has no universal meaning. There are, however, mainly two tests that are applied when determining the location of an entity's POEM, i.e. the place where the board of

[93] Interpretation Note 6

directors meets, or the place where the senior management of the company operate. Last mentioned two tests are referred to as the "Anglo-American" and "Continental" approach respectively, of which South Africa follows the Continental approach.

9.5.1 CRITICISM OF A "BOARD-CENTRIC" APPROACH

The main concern raised in respect of the board-centric, i.e. the Anglo-American approach, is the fact that this approach has not kept up to date with the ever evolving technology of our modern era. This is highlighted by two United Kingdom authorities[94] whom questions whether historic concepts developed and applied prior to the current technological world of today is still appropriate. They continue to contrast these historic concepts to the international communications channels of inter alia email and video-conferencing available to companies today.

The same concern was raised by the author BA van der Merwe[95], which held that:

"The adequacy of effective management as a tie-breaker rule based upon the location of superior management decision making has been questioned. This interpretation of the phrase was coined when companies were generally organised in a hierarchical structure and management could be located at a specific point within a certain period of time. However, modern companies are increasingly run and managed divisionally rather than through the legal entities in which the divisions are formed. This has resulted in an organisational network spread across different countries. Also, due to modern technology, management has become much more mobile and traditional place of effective management may rotate. Technology has furthermore made it possible to manage without the need for a group of persons to be physically located or to meet in one place, for instance at the company's headquarters. Because of these changed management structures and technology, effective management based on where the directors meet becomes a matter of choice and manipulation. Even when based on a wider interpretation of key management and decision making, it is evident that technology makes it difficult to pin effective management down to one constant location, and double or multiple residences or even non-residences may be the result."

9.5.2 THE OECD AND THE COMMENTARY ON ARTICLE 4 OF THE MODEL TAX CONVENTION

[94] Anglehard Miller & Lynne Oates, *Principles of International Taxation*, para 4.16 (2006)
[95] Van der Merwe at p.124 - 125

In an attempt to address the concerns raised in this regard, the OECD's Technical Advisory Group issued a draft discussion paper[96] which highlighted that it was previously quite easy to determine the place where the key management and commercial decisions were made. This would have been as a result of top management operating from and meeting at a single location, usually the head office. This location also usually coincided with inter alia a company's registered office, where the actual operations were conducted and where the directors and senior managers of the company resided. Based on the traditional way businesses were managed, there was rarely a scenario where a company was potentially resident in two different countries.

However, in light of technology constantly evolving, it is not a requirement anymore for people to meet at any single location to operate a business from. This would have an impact on companies with potential dual-residency statuses and the application of the POEM test as a tie-breaker rule.

The draft discussion paper noted that "the application of the (traditional) factors may not result in a clear determination of which State should be given preference as the State of residence, or may result in an outcome which does not appear to accord with the policy intentions of the (tie-breaker) provision. Given that the "place of effective management" is one of substance over form, in theory, it should always produce results which reflect the true policy intention of the tie-breaker rule.[97]

Different alternatives were provided, as well as refinements to the existing OECD commentary on the POEM, which included a determination being made on the basis of predominant factors or a weighting being ascribed to each factor.

By applying the 2000 OECD commentary it is clear that the POEM should be determined by taking into account the following predominant factors[98]:

1. Where the key management and commercial decisions are made in substance.
2. Where the most senior person or group of persons makes its decisions.
3. Where the actions to be taken by the enterprise as a whole are determined.

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[96] *The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie Breaker Rule* (hereinafter referred to as the "Draft Discussion Paper")
[97] Draft Discussion Paper, at para 35 and 36
[98] Draft Discussion Paper, at para 63

It is further noted that when the tie-breaker rule is applied, the above factors will in most instances provide an answer which reflects the underlying policy intent. If, however, the POEM cannot be determined based on these three factors, additional factors[99] need to be considered which include:

- Location of and functions performed at the headquarters.
- Information on where central management and control of the company is to be located contained within company formation documents (articles of association etc.).
- Place of incorporation or registration.
- Relative importance of the functions performed within the two States.
- Where the majority of directors reside.

Subsequent to the Technical Advisory Group's draft discussion paper, a follow-up discussion paper[100] was issued which focused inter alia on an expanded explanation of the term POEM. In this regard additional factors were identified that had to be taken into account where key management decisions were in substance made by a certain group of people at a specific location, but these decisions were finalised by a different group of people at a different location.

These additional factors include:[101]

- "Where a board of directors formally finalises key management and commercial decisions necessary for the conduct of the entity's business at meetings held in one State but these decisions are in substance made in another State, the place of management will be in the other State.

- If there is a person such as a controlling interest holder (e.g. a parent company or associated enterprise) that effectively makes the key management and commercial decisions that are necessary for the conduct of the entity's business, the place of effective management will be where that person makes these key decisions. For that to be the case, however, the key decisions must go beyond decisions related to the normal management and policy formulation of a group's activities (e.g. the type of decisions that a parent company of a multinational group would be expected to take as regards the direction, co-ordination and supervision of the activities of each part of the group).

[99] Draft Discussion Paper, at para 64
[100] *Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention* (hereinafter referred to as the "2003 Discussion Paper")
[101] 2003 Discussion Paper, at para 7

- Where a board of directors routinely approves the commercial and strategic decisions made by the executive officers, the place where the executive officers perform their functions would be important in determining the place of effective management of the entity. In distinguishing between a place where a decision is made as opposed to where it is merely approved, one should consider the place where advice on recommendations or options relating to the decisions were considered and where the decisions were ultimately developed."

9.5.3 RECENT DEVELOPMENTS IN THE UK

In this regard reference is made to the Smallwood case[102] and the Laerstate case[103]. Both these cases were discussed in detail in Chapter 4 and Chapter 8 respectively.

9.6 TENTATIVE PROPOSALS

SARS notes that any refinements made to the Interpretation Note:

- "…must help to ensure that the place of effective management provision fulfils its purpose as a substantive test that is not open to 'simple, formalistic manipulation'".[104]

- "…should seek to reduce uncertainty wherever possible."[105]

The Interpretation Note has resulted in at least the following three uncertainties:

1. The approach adopted by South Africa differs from international practice applied, i.e. the place where strategic decisions are implemented and executed as opposed to where these decisions are taken.
2. No clear distinction was made between "second" and "third" level of management referred to.
3. Certain of the factors for consideration included in the guidance of the Interpretation Note are in conflict with the general approach adopted by SARS.

[102] Supra
[103] Supra
[104] Discussion Paper, at para 8
[105] Discussion Paper, at para 8

- "…need to accommodate the broad variety of factual situations that may arise."[106] SARS illustrates the potential broad variety of facts by noting that in certain instances the board of directors may retain control in the event of extra-ordinary decisions having to be taken, such as acquisition procedures, while providing its senior management with the complete authority to manage the day-to-day running of the business as a whole. Also, in certain instances senior management is not only responsible for the day-to-day management of the company, but also to formulate commercial strategies and policies, while the board of directors' role is limited to ratifying the strategies and policies so formulated.

  In light of the facts of each scenario differing from the next, SARS reiterates that each case needs to be reviewed individually, while taking into account all relevant facts and circumstances. No definitive rule can be provided to suit each potential scenario.

- "…should provide sufficient guidance to address the legitimate concerns in this area that have been expressed by potential investors in headquarter companies."[107] In this regard SARS highlights that "the revisions should seek to relieve needless anxiety over situations involving foreign operating subsidiaries with bona fide foreign operations and 'on the ground' top level managers responsible for the high level day-to-day running of those operations."[108]

As a response to last mentioned SAICA notes[109] that it believes the shift from where strategic decisions are executed and implemented to where decisions are in substance made, will increase anxiety in the Southern Africa context. It is not only costly, but also difficult to relocate the appropriate level of management in relation to foreign subsidiaries in Africa. Last mentioned is illustrated by way of the following example:

"Say a division of a South African holding company incorporates companies in Swaziland, Lesotho, Mozambique and Malawi to sell its products to customers in these countries and to provide vital after sales support and parts to the customers located in these countries. These companies are established as subsidiaries of the South Africa holding company. The establishment of these companies is driven exclusively by commercial considerations and there is no tax avoidance motive. Each company rents or buys premises from which it conducts its operations, staffed by sales personnel, finance and

[106] Discussion Paper, at para 8
[107] Discussion Paper, at para 8
[108] Discussion Paper, at para 8
[109] SAICA's response to the Discussion Paper

administrative personnel, a parts manager and workshop staff. In addition, two managers at senior level (namely a general manager and a project manager) are appointed in each company to oversee its business operations and reside in each of these territories. These companies are therefore "foreign operating subsidiaries with bona fide foreign operations."

To establish the most efficient management structure and overcome the problem caused by a shortage of suitably trained and experienced senior management, the holding company establishes a regional management team that is dedicated to managing the operations of the division in these three countries. The team consists of a chief operating officer, a chief finance executive and a risk executive. While the members of this team visit the territories on a regular basis, they are based mainly in South Africa. The holding company charges the three subsidiaries an arm's length fee for the services rendered by the South African regional management team.

Each of the operations in Africa is therefore arguably managed jointly by senior managers of the local subsidiary in the country of incorporation and by the regional management team in South Africa."[110]

If the POEM of each of the above African subsidiaries had to be determined and the strategic function performed by the regional management team in South Africa played a role, it could lead to practical difficulties. One would have to distinguish between what the role of the senior managers in each Africa jurisdiction is, the role of the regional management team, including their time spent in each jurisdiction and ultimately a call would have to be made as to what constitutes "top level" management and "operational" management.

This could ensure that "despite the fact that the foreign subsidiaries have well established foreign operations and have been incorporated in each respective country for commercial reasons, it could turn out that these companies are effective managed in South Africa and therefore South African residents."[111]

9.6.1 REFINEMENT OF THE GENERAL FOCUS

Based on the review done in terms of the discussion document, SARS proposed to have the general approach of the Interpretation Note refined. It is, however, reiterated that the general approach "would continue to focus on the 'second level of management'. In this regard, however, it would be clarified that

[110] SAICA's response to the Discussion Paper
[111] SAICA's response to the Discussion Paper

the primary emphasis is upon those 'top' personnel who 'call the shots' and exercise 'realistic positive management"[112]. SARS identifies these personnel to be the senior officers or executives of a company who are responsible for:[113]

a. Actually developing or formulating key operational or commercial strategies and policies for, or taking decisions on key operational or commercial actions by the company (regardless of whether those strategies, policies and decisions are subject to formal approval by a board or similar body); and

b. Ensuring that those strategies and policies are carried out.

It is further noted that "Areas of decision-making involving extra-ordinary matters (such as major acquisitions, disposals, mergers or new borrowing) that are commonly reserved to a company's board or its shareholders generally would not be considered part of this 'second level of management' for a foreign operating subsidiary and therefore generally would not affect the determination of a foreign operating subsidiary's place of effective management. Similarly, day-to-day operational decision-making by junior and middle management would also generally fall outside of the second level of management, as would the performance of routine administrative or support functions."[114]

It is interesting to note that a Google search was performed by SAICA which indicated that the functions set out above, for example the development of strategic plans, were performed by "top level" management which is synonymous to a company's board of directors. SAICA notes that last mentioned would appear to contradict SARS's view set-out in its discussion paper, which is the rejection of the "board-centric" approach.[115]

In addition to the above refinement to the general approach, all references to the "implementation" of strategies and policies will be deleted. This will be done in order to align South Africa's approach to that of international practice and also to avoid any confusion caused between second and third levels of management. Last mentioned is illustrated by the following:

"Thus, for example, a manufacturing company may have a head office in Johannesburg, where all of its senior management is based (including the managing director, finance director, sales director, and human

[112] Discussion Paper, at para 8.1
[113] Discussion Paper, at para 8.1
[114] Discussion Paper, at para 8.1
[115] SAICA's response to the Discussion Paper

resources director, as well as their immediate subordinates) and a main plant in Botswana, where the manufacturing takes place under the supervision of local management. In this situation, the company's place of effective management would be its head office in Johannesburg. The result would be the same if the company's board of directors met in Gaborone, where it routinely approved proposals formulated by senior management or, if and when necessary, took decisions on extraordinary matters."[116]

Based on the commentary submitted by SAICA, it is noted that the discussion paper seems to move away from the place where the strategic decisions are executed and implemented towards the place where decisions in substance are made. A very important concern raised by SAICA in this regard, is that this change in interpretation could result in certain companies now suddenly becoming South Africa tax resident, and others ceasing to be tax residents of South Africa.[117] It is therefore important to have guidelines issued by SARS as to how these commencement or cessation of residency is to be treated.

SAICA requests SARS to further expand on the manufacturing example set out above, to "include a group situation and guidance be provided in circumstances where the senior management of the group is employed by a holding company, whilst the operational functions/manufacturing is performed by subsidiary companies located in various jurisdictions. Guidance should be provided in respect of the place of effective management of the operating/manufacturing subsidiaries, where the management of the subsidiaries is required to report to the higher level of management of the holding company or where the management of the subsidiaries is required to adhere to the group strategy as formulated by the holding company."[118]

The above is of paramount importance as it reflects a situation often stumbled upon in practice.

9.6.2 TERMINOLOGY

As highlighted above, one of the areas of criticism the Interpretation Note was subject to, was the inconsistency of terminology used. The Discussion Paper addresses this concern by suggesting that certain terms used in the Interpretation Note be defined. These terms include the following:

- senior management

[116] Discussion Paper, at para 8.1
[117] SAICA's response to the Discussion Paper
[118] SAICA's response to the Discussion Paper

- operational management
- executive/inside directors
- non-executive/outside directors
- head office
- base of operations
- passive holding company

SAICA in its commentary submitted to SARS highlights that even though these definitions would be welcomed, each of these terms might, however, have different meanings ascribe to it in different companies. In addition to the above-mentioned terms, SAICA is of the opinion that the following terms would also have to be defined:[119]

- Day-to-day operational decisions
- Junior management
- Middle management
- Top management
- Administrative functions
- Support functions
- First, second and third levels of management
- Key management and commercial decisions
- High level decisions
- Policy and strategic decisions

9.6.3 RELEVANT FACTS AND CIRCUMSTANCES

The Discussion Paper proposes the following amendments and additions to the current Interpretation Note:[120]

1. The deletion of the reference to legal factors, such as the place of incorporation, formation or establishment, the location of registered office and public officer.

[119] SAICA's response to the Discussion Paper
[120] Discussion Paper, at para 8.3

2. A clarification of the reference to where controlling shareholders make key management and commercial decisions in relation to the company. In particular, the application of this factor would generally be limited to situations in which controlling shareholders in fact "call the shots" and/or the board of directors or similar body is not the true decision maker. In particular, this factor would be relevant in determining the place of effective management of passive holding companies.

3. The addition of the following factors:

    - Delegations of authority by the board of directors or similar body, for example, to an executive committee.

    - Consideration of differing board structure, for example, distinctions between commercial and non-commercial or supervisory boards.

    - The identification of various factors that will generally be given little weight, for example the place where administrative activities, such as the opening of a bank account, take place.

    - Refinement of the distinctions between various levels of management. (For example, in companies operating on divisional basis, individual divisions are often run by an executive vice president or operational manager who reports to a higher level of management that is responsible for the company as a whole. In such a situation, the place of effective management would be the place where that top level of management is primarily or predominantly based).

    - Criteria for determining the base of operations for senior management in situations where senior management travels frequently or operates from multiple locations (with meetings held, for example, via video conferencing).

9.6.4 MUTUAL AGREEMENT PROCEDURE

The Discussion Paper concludes that even if the proposed refinements to the Interpretation Note were to be effected, certain situations might still arise where the interpretation adopted by a treaty partner differs from the interpretation adopted by SARS. In these instances, the Interpretation Note will explicitly state that the problem needs to be resolved in terms of the mutual agreement procedures provided for in the applicable tax treaty.

CHAPTER 10: COMPARISSON WITH AUSTRALIA

10.1 INTRODUCTION

Section 6(1) of the Australian Income Tax Assessment Act provides the definition of a resident and determines that where a company is not incorporated in Australia, it would be tax resident in Australia if:

a) It carries on business in Australia; and
b) Its central management and control is located in Australia; or
c) Its shareholders, who control the voting power, are Australian residents.

A ruling[121] (hereinafter referred to as the "Taxation Ruling") was issued to provide guidelines when trying to determine whether a company was an Australian tax resident, in the event that it was not incorporated within Australia. It is important to note that this particular ruling only dealt with the requirements of carrying on a business, and having a company's central management and control situated in Australia.

10.2 TWO REQUIREMENTS

It is clear from the definition of a resident that in order for a company to qualify as an Australian tax resident it does not only require a company to carry on business in Australia, but also to have its central management and control situated in Australia. Therefore, if a company is not carrying on any business in Australia, there is no need to determine the location of its central management and control as it will already fall outside the definition of a resident by falling foul of the first requirement.

The nature of a company's business might also result in the location of its central management and control being the same as the location where its business is carried on. This could for instance be in the case of an investment company, where the operational activities are limited. The company in essence only makes decisions in respect of managing its assets and in last mentioned scenario the same factors would be considered in order to determine both the company's location of central management and control and the location where it is carrying on its business.

[121] Taxation Ruling – *Income Tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control*, TR2004/15

It is important to note that if a company carries on business in Australia, it does not automatically mean that its central management and control is also located in Australia.

10.3 CARRIES ON BUSINESS IN AUSTRALIA

In order to determine the location of where a company's business is carried on, one needs to examine the facts and circumstances of each case. It is a question of fact. A person is required to determine where the activities of the particular company are carried on.

The ruling clearly highlights that in order to determine this factual question, the Australian Government draws a distinction between a company with activities of an operational nature and a company with activities of a passive nature. It is, however, recognised that these activities might in certain instances overlap. Examples of operational activities include inter alia major trading, manufacturing and mining activities.

Where a company's overall business largely consists of operational activities executed at a single location, this location will most likely constitute the jurisdiction where its business is carried on. This determination will be made irrespective of the location where its central management and control is carried on. Last mentioned could be contrasted against an investment company, who's only activities consist of decisions made in respect of its assets and this investment company will carry on business at the location where these decisions are made.

The meaning of the phrase "carrying on business" needs to be given a wider meaning when applying the test provided in terms of section 6(1). Even if a company's only activity consists of the management of its investment assets, this will qualify as carrying on business for purposes of determining the tax residency of the particular company.

10.4 CENTRAL MANAGEMENT AND CONTROL

As set out above, the second requirement to determine Australian tax residency, would be to determine the location of a company's central management and control. In this regard one would need to focus on the "management and control decisions that guide and control the company's business activities."[122] It is highlighted that this level of management and control refers to the "high level decision making processes,

[122] Taxation Ruling, at para 13

including activities involving high level company matters such as general policies and strategic directions, major agreements and significant financial matters. It also includes activities such as the monitoring of the company's overall corporate performance and the review of strategic recommendations made in light of the company's performance."[123]

It is important to ensure that central management and control of a company is not confused with the mere legal right to exercise the central management and control of a particular company. Possession of this legal right will not in itself constitute the location of the company's central management and control. However, a person in possession of such a right might still participate in a company's central management and control even if it delegates its powers to someone else in this regard. It is important though that the person in possession of such a right still reviews and considers the decisions taken by the person to whom the powers were delegated. The person in possession of the right to exercise the central management and control of the company needs to ultimately decide whether the proposed action should be proceeded with, or whether an alternative action is required.

10.5 LOCATION OF CENTRAL MANAGEMENT AND CONTROL

As with the determination of whether a company is carrying on business in Australia, the determination of a company's central management and control location is also a question of fact. This question needs to be answered by taking into account the specific facts and circumstances of each individual case.
Where a company's central management and control is exercised by its board of directors at its board meetings, the Australian Government will accept the location of the majority of such board meetings to be the location of the company's central management and control. Last mentioned method of determination is adopted to reduce any uncertainty taxpayers might experience. An exception to this rule is, however, where the particular location is artificial in nature. Where there is no commercial reason to convene the board meeting at the specific location in question, or the decisions of the company are made by someone else other than the board of directors, this location will not constitute the location of the company's central management and control.

In terms of the Taxation Ruling a board meeting is deemed to be held within Australia if the majority of the board of directors meet in Australia. In the event of the directors being evenly split outside and inside of Australia when convening the meeting, the directors having special powers may be decisive in this

[123] Taxation Ruling, at para 13

regard. Once again it is highlighted that where these activities reflect an artificial creation of the company's central management and control location, this deemed provision will not apply.

In addition to the above, the opposite is also true. Where the majority of the board meetings are convened outside of Australia, the company's central management and control location will be situated outside of Australia. This deeming provision will apply irrespective of the board members constituting Australian tax residents.

It is reassuring to know that if the major decisions of the company are taken at board meetings, the fact that round robin resolutions are executed in respect of less important decisions, it will have no impact on the company's central management and control location.

Where a parent company has the authority to remove the board of directors of its subsidiary, but does not participate in the central management and control of the subsidiary, the ultimate removal power will not result in the parent company exercising the central management and control of its subsidiary. Last mentioned is in line with the view adopted in treaties Australia has entered into, i.e. parents and subsidiaries are seen as separate entities and highlights that a parent and its subsidiary companies could be situated in different jurisdictions.

However, if the parent company exercised the central management and control of its particular subsidiary, the subsidiary had to have been carrying on business in Australia before it could be seen to constitute an Australian tax resident.

10.6 LOCATION OF CENTRAL MANAGEMENT AND CONTROL IN MORE THAN ONE COUNTRY

It is clear from the above that it is possible that a company might have its central management and control executed within two separate jurisdictions. The Taxation Ruling highlights that a company's central management and control "can be located where there is some part of the superior or directing authority by means of which the relevant affairs of the company are controlled. However, it is necessary that the exercise of that power and authority is to some substantial degree found in a place for the central management and control to be located there (and elsewhere)."[124]

[124] Taxation Ruling, at para 21

10.7 STATUTROY CONSTRUCTION

As set out above, it is not enough for a company to only have its central management and control situated in Australia. The company also needs to carry on business in Australia. The fact that last mentioned is a requirement in addition to the central management and control test could be found by applying a basic rule of statutory interpretation, i.e. "plain words of an Act must be given full meaning and effect."[125] In addition to last mentioned it is highlighted that "Courts should not easily consider any word or sentence used in an Act as superfluous or of limited meaning."[126] In case law cited it was also held that "as a general rule a court will adopt that construction of a statute which will give some effect to all the words it contains."[127] In light of last mentioned it could be argued that when giving effect to all the words of the secondary residency test, the requirement of carrying on business in Australia, is superfluous and unnecessary.

With reference to the case of Malayan Shipping, certain writers have expressed the view that the comments made by Judge Williams, lays down a general principle in respect of Australia's secondary residency test, i.e. where a company's central management and control is situated in Australia, will also mean that the company is carrying on business within Australia.

The facts of the Malayan Shipping case[128] were briefly the following:

The company was incorporated in Singapore and also had its registered office located there. The managing director was an Australian resident and had the right to appoint any members and to remove any of the remaining members of the board. He also had the right to veto any decision taken by the board and had the sole authority to affix the company seal.

The nature of the business involved the charter of a tanker from shipping agents and the sub-charter of the tanker to its managing director. The managing director provided the shipping agents with instructions, provided instructions in respect of signing a charter party and also prepared the necessary documentation. In addition to last mentioned the managing director also paid the charter out of his personal funds and never remitted any of the remaining funds to the company in respect of the voyage charters.

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[125] Taxation Ruling, at para 28
[126] Taxation Ruling, at para 28
[127] Taxation Ruling, at para 28
[128] FCT (1946) 71 CLR 156

The court determined that the managing director was managing and controlling both the business operations and internal administration of the company. It was further held that last mentioned constituted central management and control of the company as well as carrying on of the charting business. The source of the income was also held to be from an Australian source, in light of the activities that was executed by the managing director in Australia.

Based on the above it is clear that both requirements of the secondary test were met by considering and applying the same set of facts. The managing director was not only executing the central management and control of the company, but also carrying on the business of the company based on the powers he had and the activities he executed. The court reconfirmed that it is a question of fact when determining the location where a company's business is carried on.

In this case the court also concluded on whether the requirement of carrying on business only refers to the actual operations or to the control of operations from which the company's profits arose. The former argument was rejected by the court and in support hereof the case of *Mitchell v Egyptian Hotels*[129] was quoted:

"Where the brain which control the operations from which the profits and gains arise is in this country the trade or business is, at any rate partly, carried on in this country. The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business or the controlling shareholders must be situate or resident 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."

The above supports the view that Australia's secondary residency test consists of two requirements. The mere carrying on of a business in Australia is not sufficient in itself to establish Australian residency. It is further required that the company's central management and control is situated in Australia. However, it should be remembered that if a company's central management and control is situated in Australia, it does not automatically meant that it is carrying on a business in Australia as well. These two locations could be different from one another.

[129] 1915 AC 1022 at 1037

In respect of the statutory interpretation as discussed above, the Taxation Ruling highlights that it has made clear that "the construction of an Act must never supplant or supersede the actual words of the statute itself and that ultimately, each case must be governed by the Act, and not judicial formulae."[130]

It is important to reiterate that the facts of the Malayan Shipping case[131] ensured that both requirements were simultaneously met. This should be distinguished from the Mitchell case[132] where the company's central management and control was located within the United Kingdom, while it was carrying on its business completely outside of the United Kingdom.

It could be possible to argue that a wide application of the comments provided by the court in the Malayan case is supported by the court's comments in the De Beers case[133], i.e. "a company resides where its 'real' business is carried on and that the real business is carried on where the central management and control actually abides." It is important, however, to keep in mind that both the De Beers and Mitchell cases was dealt with by interpreting and applying tax legislation to the question of a company's tax residency, where this particular legislation did not include a statutory definition of the concept.

The ruling reaffirms that trading in itself is not sufficient to constitute Australian tax residency, but that the location of a company's central management and control could be a factor to consider in this regard. It is considered, however, "that major operational activities which are the essence of a company's income earning activities and which are carried out with a high degree of autonomy would be sufficient to constitute the carrying on of business in Australia where those activities occur in Australia."[134]

10.8 CARRIES ON BUSINESS

As set out above, the requirement of carrying on business in Australia is given a wide meaning. In light of last mentioned a company will be carrying on business even if its business activity is limited to the management of its investments. The profits a company like this could potentially realise would include for example rent, dividends, royalties and interest. It is therefore clear that a company carrying on trading

[130] Taxation Ruling, at para 38
[131] Supra
[132] Supra
[133] Supra
[134] Taxation Ruling, at para 41

activities and a company of a passive nature could both comply with the requirement of carrying on a business.

There is, however, an alternative view to the above interpretation. This alternative view refers to a narrow application of the meaning which results in companies that realise profits from investments made do not carry on a business. It is made clear, however, that "the statutory context seems to assume that all companies (other than dormant companies) are carrying on a business."[135]

10.9 CENTRAL MANAGEMENT AND CONTROL

This term was established as a common law principle in order to determine a company's residency. In this regard the Taxation Ruling quotes the well-known section of the De Beers case[136] where Lord Loreburn stated that:

"In applying the concept of residence to a company, we ought, I think, to proceed as nearly as we can upon an analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Kelly C.B. and Huddleston B. in the Calcutta Jute Mills and Cesna Sulphur cases, involved the principle that a company resides for purposes of income tax where its real business is carried on. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

It remains to be considered whether the present case falls within that rule. This is a pure question of fact to be determined, not according to the construction of this or that regulation or ruling, but on a scrutiny of the course of business and trading."[137]

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[135] Taxation Ruling, at para 45
[136] Supra
[137] Supra, at 458

The above two analogies, i.e. where a company keeps house and does business, is reflected in the two requirements of the secondary residency test, which is carrying on of business and central management and control. As highlighted above, it does not mean that if a company's central management and control is situated in Australia, that it is also automatically carrying on business in Australia.

The authors of the Guidebook to Australian International Taxation state that "Although the statutory definition prescribes a two-part test (that is, carrying on business and central management and control), as a result of the decision in Malayan Shipping Co Ltd v FCT (1946) 71 CLR 156 effectively all that must be shown is that central management and control of the company is situated in Australia. Once this is established, it will usually be inferred that the company is carrying on business, since acts of control and management are acts for carrying on business.

However, this may now be viewed as a somewhat simplistic conclusion and it may be true to say that to be a resident it must be positively shown that the acts of management and control are genuinely accompanied by acts of carrying on business."[138]

10.10 NATURE OF CENTRAL MANAGEMENT AND CONTROL

In order to determine a company's central management and control a review of the who, when and where in respect of the strategic decision making of the company is required. The ruling determines that included in the term "central management and control" are the setting of company goals as well as the "evaluation of the company's performance measured against these benchmarks and emerging market risks and opportunities."[139] The second requirement is therefore determined by focusing on the "management and control decisions made at the highest level in the company."[140]

10.11 LOCATION OF CENTRAL MANAGEMENT AND CONTROL

In most instances the highest level of decision making by a company takes place with its board of directors. It is therefore clear that where the board meets would be prima facie indicative of the company's central management and control, although not the only factor to be taken into account. As was

[138] Taxation Ruling, at para 48
[139] Taxation Ruling, at para 48
[140] Taxation Ruling, at para 48

illustrated by the Malayan Shipping case[141], the highest level of decision making is not always reserved to the board of directors.

In the event that electronic facilities are utilised to conduct board meetings, one would rather focus on the members contributing to the high level decisions of the company, than to the location of the electronic facilities. If the contribution to the majority of the high level decision makers of the company takes place from a location outside of Australia, it would support the argument that the central management and control of the particular company is not situated in Australia. This will further be strengthened if the majority of the decision makers execute their company duties from a location outside of Australia.

Where the use of electronic facilities and the variety of jurisdictions make it difficult to determine a company's central management and control additional factors need to be considered, which include:[142]

- Location of the key functions of the board
- Location where the decision makers usually perform their company duties and participate in the high level decision making of the company
- Residency of the high level decision makers (this is not a factor to consider by itself, but could be indicative of the central management and control of a company)
- Location of the secretary

10.12 THIRD PARTY CONTROL

In respect of third party control reference is made to even if a subsidiary's board of directors does not meet in Australia, its central management and control could still be executed in Australia. This would be the case where a third party, for example the parent company's board of directors, exercises the subsidiary's central management and control in Australia. Last mentioned will usually arise in instances where the high-level decision making people of the parent company, resident in Australia, make decisions in Australia, in respect of its subsidiary's general policy and strategic framework, financial affairs and major contracts.

It is highlighted, however, that in order for the functions performed by the parent company to constitute exercise of the subsidiary's central management and control, a certain degree of actual participation is

[141] Supra
[142] Taxation Ruling, at para 50

required in respect of the high level decision making process of the subsidiary. Examples provided in this regard include decisions in respect of trading activities, key personnel, capital allocation, funding and major expenditure.

Even though an active step of participation, i.e. a positive action by the third party, is required, the Taxation Ruling mentions that "participation in the management and control of the company can be conducted through the 'passive oversight and tacit control' of the affairs of the company." [143]As an example the case of *BW Noble Ltd v Mitchell*[144] is referred to where it was held that "the central management and control was held to reside with a board that had delegated full power to carry on the company's business in France to a resident of France, but monitored progress reports and gave agreement to a number of proposals."

It is highlighted that the BW Noble case[145] could be contrasted with *Egyptian Delta Land and Investments Company Ltd v Todd*[146] where it was determined that "the mere existence of the capacity for ultimate control was not sufficient to constitute central management and control where the control was not exercised in practice". Last mentioned view is supported by the Mitchell case[147] where it was held that the mere legal right to interfere with the high level decision making of the company did not in itself constitute central management and control.

The following circumstances are highlighted to not constitute central management and control in itself:

- The power to exercise the rights generally held by a majority shareholder
- The power to remove a high level decision maker(s) of the company
- The grating of a power of attorney to a person to enable them to manage the company's affairs

10.13 BOARD OF DIRECTORS STANDING ASIDE

In this regard it is highlighted that the central management and control will not automatically be situated in Australia, if the board meetings are held in Australia. The board needs to undertake high level decision making at these meetings, and not merely be rubber stamping decisions taken elsewhere by someone else.

[143] Taxation Ruling, at para 56
[144] (1926) 11 TC 372
[145] Supra
[146] 1929 AC 1
[147] Supra

The Taxation Ruling provides various examples in illustrating the principles discussed above. In this regard the following example[148] is highlighted:

Facts

Yellozz Co is a small company incorporated in Hong Kong. It carries on business in Australia and other parts of the world. The directors of Yellozz Co reside, hold board meetings and undertake their other duties as high level decision makers, in Hong Kong. The majority of Yellozz Co's shareholders reside outside of Australia.

The board appoints one of the company's employees as the Australian manager of the business. The Australian manager has a power of attorney to conduct business in Australia on the company's behalf, including the power to make decisions regarding major contracts in Australia, sources of loans and general policies and strategies for the Australian business.

The Australian manager has the power to implement these decisions without reference to the board and often does so. However, the board retains the power to override any decision before Yellozz Co is bound by that decision. The board can also remove the Australian manager as a decision maker of the company. During board meetings the board makes high level decisions regarding Yellozz Co. In addition, during the board meetings the board monitors and evaluates the Australian manager's performance. The board finds that the Australian manager is performing competently and decides that there is no need to take any action in respect of the decisions made by the manager.

Yellozz is not an Australian resident under the second statutory test. The high level decision making of Yellozz Co is ultimately exercised by its board of directors in Hong Kong (that is, outside Australia) as the board oversees the decisions made by the Australian manager (an employee of Yellozz Co), actively makes other decisions regarding Yellozz Co (particularly decisions regarding its business operations outside Australia) and undertakes other high level functions in country of incorporation.

Conclusion

[148] Taxation Ruling, at para 90

Although the Australian manager makes some high level decisions regarding Yellozz Co's Australian operations, this does not of itself mean that the central management and control of Yellozz Co also lies with the manager in Australia. Other factors indicate that the central management and control of the company is exercised by the board of directors outside Australia and not by the company's manager in Australia, in particular:

a) The board continues to participate in the high level decision making of Yellozz Co by monitoring and evaluating the performance of the Australian manager in the manager's exercise of the power of attorney;

b) The board actively makes other high level decisions regarding Yellozz Co including decisions that impact upon its Australian business. The Australian manager makes no decisions regarding the overseas business operations of Yellozz Co – these decisions remain with the board of directors. Therefore the board deals with a range of high level issues outside of Australia; and

c) The board can revoke the Australian manager's power of attorney and make all decisions itself in relation to the Australian operations (that is, has both the power to remove the decision maker and the power to make the decision itself.)

Consequently the central management and control of Yellozz Co is with its board outside Australia.

CHAPTER 11: CONCLUSION

It is clear from the detailed discussion set out above, that the interpretation and meaning of the POEM term still has a far way to go in South Africa. Not only does the term remain open to manipulation, but no definitive interpretation thereof is given by SARS. It is even more alarming to conclude that the Discussion Paper on Interpretation Note 6 released by SARS created more uncertainty in respect of the meaning that needs to be ascribed to a legal person's POEM than the intended guidance and certainty. Something that would almost indicate that not even SARS is clear and confident as to the meaning that needs to be ascribed to a legal person's POEM.

The location of a legal person's POEM has various tax implications and is accompanied with an additional administrative burden if located in a different location as the country of incorporation. It would only be fair to conclude that if SARS wants to put a stop to the manipulation of a legal person's POEM and protect its tax base, clear guidance needs to be given as to how this very important and influential terms need to be interpreted and applied.

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