INTERNATIONAL TAX PLANNING:
THE CONCEPT OF
PLACE OF EFFECTIVE MANAGEMENT

CHANTELLE GOOSEN
Student Number: KLPCHA001
Tel Nr: (021) 403 7557
E-Mail: chag@chevron.com
Post Graduate Diploma in Income Tax Law
CML636W
University of Cape Town
Trevor S Emslie
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I hereby declare that I have read and understood the regulations governing the submission of the Post Graduate Diploma in Income Tax Law (CML636W) dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.
# TABLE OF CONTENTS

1. Introduction .................................................. 2

2. Falling within the ambit of the South African Tax Law ........... 3

3. Resident versus source basis of taxation .......................... 4

4. Defining a resident ............................................. 6

5. Place of effective management .................................. 8
   5.1 Ordinary meaning of the words ............................... 9
   5.2 Local interpretation .........................................
      5.2.1 South African Revenue Service ......................... 11
      5.2.2 Controlled foreign entity .............................. 15
      5.2.3 Meyerowitz ........................................... 15
   5.3 International interpretation .................................
      5.3.1 OECD Model ........................................... 16
      5.3.2 OECD Discussion Draft on effective management concept 21
      5.3.3 United Kingdom ....................................... 25
      5.3.4 Netherlands ........................................... 29
      5.3.5 Klaus Vogel ........................................... 30
   5.4 Guidance from “Place of Management” ....................... 31
   5.5 Guidance from “Central Management and Control” .......... 32
   5.6 Multiple places of effective management ................... 34
   5.7 Summary .................................................. 36
   5.8 Example .................................................. 39

6. Dual residence ................................................
   6.1 Double Taxation Agreements ................................ 42
   6.2 The consequences of dual residence: Example ............... 43

7. Conclusion ..................................................... 47

8. Bibliography ...................................................
   8.1 Table of Statutes ........................................... 51
   8.2 Table of Cases ............................................. 51
   8.3 Articles, books, journals and other references ............ 51
   8.4 The Internet .............................................. 52
1. **Introduction**

It was once said that taxation is the price we pay for civilization\(^1\). This observation rings true, taxation of income having evolved with the emergence of commerce and specifically trading across borders. South Africa has rapidly re-integrated into the world economy. This caused the position of companies in relation to local as well as foreign taxes to assume increased importance and complexity in nature. As a result, tax planning has become the essence of many a Multinational company with offshore business operations or interests.

In principle, international tax planning is quite simple; the details are what drive one mad. International tax planning is based on the fact that the revenue laws of any state are largely restricted to its domestic economy. The tax authorities have a hard time crossing borders but people and wealth can do so easily.

The legislature is very enthusiastic in churning out a plethora of provisions to close all possible loopholes and attempt to “cross borders”. Today, the taxpayer is under a constant apprehension of falling foul to the law. This combination of circumstances leaves the taxpayer somewhere between a rock and a hard place.

But what are these provisions that place the taxpayer in that difficult position when conducting business across borders? There are three basic elements that govern the tax situation of a company. These are 1) the residence, 2) the geographic source of income and 3) effective tax planning by the entity.

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\(^1\) Oliver Wendel Homes
This dissertation will study certain aspects of the South African Income Tax Act\(^2\) such as residence-based concepts, with specific reference to place of effective management, which brings a taxpayer within the ambit of the South African Tax Law. It will also address issues regarding Double taxation agreements and the impact of all these issues on companies trading internationally. This paper is intended to raise an awareness of the current issues, general principles and practices to be taken into account when organizing a company’s affairs to limit the tax liability in South Africa.

2. **Falling within the ambit of the South African Tax Law**

For an amount to be taxed under the South African Tax Law it must adhere to the requirements of Gross income as defined in the Act.

Section 1 of the Act defines “Gross Income” 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....’

Two of the main requirements without which no amount can be considered to be gross income for South African tax purposes is 1) to be a resident or 2) for non-residents, income from a source within or deemed to be within the Republic. Either

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\(^2\) Income Tax Act No. 58 of 1962, hereinafter referred to as the Act.
one of the two of these requirements must be met for an amount to be taxed under the ambit of the South African tax law.

It is clear that both residence and source are important principles that must be understood when applying the provisions of gross income and therefore the South African Income Tax Act.

I will concentrate on the application of resident provisions and discuss these in depth. The source provisions, applicable to any non-resident, will not be analyzed for purposes of this paper.

3. **Resident versus source basis of taxation**

A residence basis of taxation replaced the source basis of taxation with effect from the 2001 tax year. As apposed to source based tax systems, residence based systems tax residents of particular countries on their worldwide income. Therefore, if a company is considered to be a South African resident, it will be taxed on the income wherever in the world such income was earned. South Africa adopted a “residence minus” system however. This means that certain categories of income and activities undertaken outside South Africa will be exempt from South African tax. It still remains imperative though, for a company to avoid being a resident of South Africa in order to avoid being taxed under the South African tax laws.

It is held that the change to residence basis of taxation was due to the following reasons and resulting benefits:
a) It protects the South African tax base from exploitation by placing the income tax system on a sounder footing

b) It brings the South African tax system more in line with international tax principles

c) To relax exchange control and thereby ensuring greater offshore involvement of South African companies

d) The effective catering for taxation of e-commerce products, services and initiatives.\(^3\)

The justification for residence tax may also rest on the need to finance its public goods and social infrastructure, and the nexus between the consumption of such public goods and infrastructure by persons and companies who are residents having an over-all capacity to pay.

It still remains a difficult administrative burden for SARS to identify and subsequently tax all companies qualifying as residents under the ambit of South African tax law as some companies are situated offshore and have various international activities. However, the residence basis eases this burden as apposed to source basis which was far more difficult to catch within the net of our local tax system. With the residence basis of taxation, Revenue Authorities are not obliged to investigate every transaction to determine the source of the income derived therefrom, but merely the residence of the company as a whole.

\(^3\) http://www.sars.gov.za
The source basis of taxation however, still remains relevant in the context of South African tax law as it stands at the moment. Non-residents are taxed under the Act on all income received by them or accruing to them from a South African source or deemed South African source.

An entity can therefore also be brought into the ambit of the Act when either the actual source of income or the deemed source of income is in South Africa.

4. **Defining a resident**

Section 1 of the Act defines “Resident” as any 

\[(b) \text{ person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation.}\]

An international headquarter company is, however, excluded. The exclusion of companies who are deemed to be a resident in another country in terms of a double taxation agreement was brought into the act on 26 February 2003.

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4 A company is an international headquarter company if 90% of the value of assets represent shares in, and loans to non-resident subsidiaries (this must be determined at the end of the tax year). The entire equity share capital must be held directly by non-residents, which are not SA residents or trusts. SA residents and trusts may not hold an indirect interest in aggregate of more than 5% in the Headquarter Company. These conditions apply for the entire year of assessment. If the above requirements are met, the company will not be regarded as a resident.
A company will therefore have its place of residence in South Africa if it meets either one of the following 2 criteria, with the exception of companies falling in the exclusion clauses as described above:

1) If the company or trust is incorporated, established or formed in South Africa

2) Companies with its place of effective management in South Africa

As can be seen, the definition of a resident in the case of companies, closed corporations and trusts is very wide as all the requirements are alternatives. A company incorporated in South Africa is a resident irrespective of where its place of effective management is and conversely a company that has its place of effective management in South Africa is a resident irrespective of where it is incorporated or established.

The question of place of incorporation or establishment in South Africa is a simple question of fact, not creating any grey areas for dispute. Once a company is incorporated, established or formed in South Africa, that company will be regarded as being a South African resident until the termination of its corporate personality, even if it has long since left South African shores.\(^5\) Although the place of incorporation test provides simplicity and certainty to both tax authorities and taxpayers, it is easy to manipulate. However, if a company is incorporated outside South Africa, its South African residence can change from year to year, depending where the place of effective management resides.

One aspect that raises some uncertainty though is the question of what constitutes “place of effective management”.

5. Place of effective management

As discussed previously, one of the alternatives for a company to be considered as a resident for South African tax purposes is to have its place of effective management in South Africa.

The term place of effective management raises many questions and creates great uncertainty amongst taxpayers. The Katz Commission recommended in their Fifth Interim Report in 1977 that the term “effective management” be introduced into the South African domestic tax legislation. The Revenue Laws Amendment Act 59 of 2000 introduced the definition of “resident” into s1 of the Act, including the term “place of effective management” in this definition. The Income Tax Act however, does not define the term place of effective management. To date there are no South African Case law precedents to act as authority in deciding where the place of effective management of a company is, making it a rather grey area which is open for discussion and personal interpretation.

Reliance must therefore be placed on secondary sources to debate and substantiate such decisions. The ordinary meaning of the words, taking into account international precedent and interpretation must therefore assist in ascribing a meaning to the term.

The term is used by various countries throughout the world, as well as by the Organisation for Economic Co-operation and Development (OECD). This term
however does not have a universal meaning. The various countries and the members of the OECD have attached different meanings to it, making its precise meaning all but clear. These differences in interpretation can have a huge impact on the tax liabilities of an international company, with specific reference to double taxation. A closer look will now be taken at the various views of parties from all over the world.

5.1. Ordinary meaning of the words

The Income Tax Act is probably the most complex legislation on the statute book. This is largely due to the fact that many words or phrases in the Act can be interpreted in more than one way. Language is inherently ambiguous and many a reader of the tax laws grapple daily with the complex text of fiscal legislation and tries to attach the correct interpretation to a word or phrase, which is in line with what the legislature had in mind amidst a maze of meanings and constant amendments.

Therefore, when determining and interpreting the ordinary meaning of the words “place of effective management” it might be helpful to look at the definitions attached to the various words in the dictionary.

The Concise Oxford Dictionary defines the terms as follow:

Effective : Having a definite or desired effect;

Powerful in effect; impressive;

Actual; existing in fact rather than officially or theoretically\(^6\)

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Manage : Organise; regulate
Take or have charge or control of;
To be in charge of

Management : The process or an instance of managing or being managed;
The professional administration of business concerns;
A governing body; a board of directors or the people in
charge of running a business, regarded collectively

The word “effective” in the phrase has a rather subjective meaning and its interpretation can differ depending on the particular circumstances of a specific case. It is also open for personal interpretation as each person can have his or her own idea of “having the desired effect”.

Valuable guidance is given on the meaning of effective however by the words “actual, existing in fact rather than officially or theoretically”. The use of the adjective effective in the phrase “place of effective management” implies realistic, positive management. Being a director or manager in name rather than reality will not constitute effective management. This will merely constitute theoretical management, but not prove actual or official management. It was held that it is not sufficient that some sort of management was carried on in a specific country such as operating a bank account in the name of the enterprise. The place of

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effective management is where the shots are called, to adopt a vivid transatlantic colloquialism.  

Even when looking at the dictionary definition of the words, the term management is somehow viewed as ambiguous, describing either the nature of management or the level of management and management decisions.

5.2. **Local interpretation**

5.2.1. **South African Revenue Service**

The South African Revenue Service\(^9\) issued Interpretation Note 6 on 26 March 2002, setting out SARS’ view of the meaning of “place of effective management”. This was done to form a more uniform approach followed in the Act for inconsistent use of concepts such as “managed and controlled” and “effectively managed”.

The Interpretation Note notes that one should keep in mind that it is possible to distinguish between the following three important places:

- Where the 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 do day-to-day/regular or operational management and business decisions;
- Where the day-to-day business activities are carried out.

\(^9\) *Wensleydale’s Settlement Trustees v Inland Revenue Commissioners*

\(^10\) South African Revenue Service, hereinafter referred to as SARS
In SARS’ view effective management is the day-to-day or regular management of a company by the directors or senior managers.

The concept of effective management relates to management’s focus on the company’s purpose and business. It does not relate to shareholder-control or control by the board of directors. Effective management is therefore where the implementation of strategy and policy decisions, made by the board of directors, is executed and implemented. It can also be referred to as the place of implementation of the company’s overall group vision and objectives. It is not where the overriding control is exercised, where the board of directors meets or where the strategy decisions are taken. The location of these management functions could be different from the place where the day-to-day business activities are conducted.

SARS’ view that the implementation of decisions is that which is important raises a further question as to what constitutes “implementation”. In most cases it will be obvious, but in other circumstances it might be less so. What happens for example in the case of a director that locally decides to raise finance from a foreign bank? The South African resident director through a phone call made from South Africa arranges for the finance. He then flies overseas to sign all the relevant finance agreements. The question arises as to whether the decision was implemented locally or offshore. To determine this one has to look at all the decisions taken and implemented by the relevant company. The easiest way to avert doubt in this regard would be for all the decisions and actions to be taken and implemented at one location, e.g.
offshore during signing of the finance agreement. It is of utmost importance, though, that all the relevant documentation such as board resolutions consistently reflects this view.11

As no definite set of rules can be laid down, each case must be examined on its own merits and relevant set of facts. It is acknowledged that management structures, reporting lines and responsibilities vary from company to company. The following is a set of guidelines, and by no means an exhaustive list, which can be used to determine the place of effective management of a company based on its own circumstances.

- Where the center 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;
- 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 apposed 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.\textsuperscript{12}

Considering these points gives valuable guidance in terms of South
African tax law in the absence of any local case law. It is difficult to
understand however, why SARS attaches importance to the location of board
meetings, when determining the place of effective management, if the Note
regards the place where decisions are implemented as important, irrespective
of where meetings are held. It is clear that the place where the board meetings
are convened is only one of the factors that will be taken into account and
would definitely not be the deciding factor.\textsuperscript{13} Consideration must also be
given to the powers and authority of these directors. The question arises as to
whether they are in fact the decision makers and implementers of these
decisions or whether they are in fact merely men of straw or only the persons
who rubber-stamp the decisions of the real decision makers, such as the
shareholders.\textsuperscript{14}

\textsuperscript{12} Interpretation Note: No. 6 of March 2002: Resident – Place of effective management (persons other
than natural persons)
\textsuperscript{13} Brincker, Honiball & Olivier: \textit{International Tax A South African Perspective}, 2004 at p19
\textsuperscript{14} Brincker, Honiball & Olivier: \textit{Supra} at p19
A further point to consider is what happens in a situation where there is no
day-to-day management? The Interpretation Note does not deal with such a situation or set of circumstances. In my opinion the day-to-day management will then shift to “management and control”. This phrase basically refers to the place where the board of directors convenes meetings and takes important decisions, which is not necessarily the place where the decisions are implemented.

SARS’ Interpretation Note therefore does not clarify all questions and gray areas around the term place of effective management. In some instances it might even create more uncertainty and give scope for various interpretations and even manipulations.

5.2.2. Controlled foreign entity

A company that has its place of effective management in South Africa is a resident in terms of the Act and therefore subject to tax on its world-wide income. A company of this nature will not be regarded to be a controlled foreign entity as defined in s 9D(1) of the Act in relation to another resident.15

5.2.3. Meyerowitz

Meyerowitz comments;

‘It is submitted that the place of effective management is normally the place where the directors meet on the company business, which may differ from the place where a company carries on business or is managed by staff and

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15 Income Tax Reporter, Volume 41 Part 5 2002
directors individually and not as a board. Where the company has executive directors, the facts may reveal that the company is effectively managed where such directors, in contrast to the board of directors as a whole, conduct the company business.’

Meyerowitz therefore does not agree with the interpretation of SARS, but rather with that of international parties. More emphasis is placed on the place where the decisions are taken than on the place where they are implemented.

5.3. **International interpretation**

5.3.1. **OECD Model**

The OECD\textsuperscript{16} model treaty is used as a base for the drawing up of many double taxation agreements, including those entered into by South Africa. It is therefore useful to look at the provisions of the OECD Model to get an indication of their interpretation of the term place of effective management.

Article 4(1) of the OECD model tax treaty defines the term ‘resident of a contracting state’ as ‘any person who, under the laws of that state, is liable to tax in it by reason of his domicile, residence, place of management or any other criterion of a similar nature.’\textsuperscript{17}

\textsuperscript{16} Organization for Economic Co-operation and Development hereinafter referred to as the OECD

\textsuperscript{17} Article 4(1) of the ‘Articles of the model convention with respect to taxes on income and on capital (OECD)’
The provisions of article 4(3) set out so-called tiebreak rules. These rules come into operation when there are residence-residence conflicts. Residence-residence conflicts arise because a company is a resident of more than one state by virtue of the application of different tests of what is a resident in terms of the domestic laws. For example, if a company

- is incorporated in a state that regards the test for residence as being place of incorporation, and
- is managed and controlled in a state which provides that a company is resident where it is managed and controlled,

then both states may tax its entire income. This double tax conflict arises because of the differing tests used to determine a resident. The provisions of article 4(3) then endeavor to fix residence in one or the other of the states.

For a person other than an individual that is resident in both states, article 4(3) deems it to be a resident only of the state in which its place of effective management is situated.

The meaning of the term “place of effective management” is not defined in Article 4 of the OECD Model tax convention. However, paragraph 24 in the Commentary offers some guidance in the meaning of the term. The commentary reinforces the point that the determination of a place of effective management is a question of fact.

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18 Article 4(3) of the ‘Articles of the model convention with respect to taxes on income and on capital (OECD)’
Paragraph 24 of the OECD Model Commentary states that the place of effective management is the place ‘where key management and commercial decisions that are necessary for the conduct of the enterprise’s business are in substance made’. This will usually be located where the actions to be taken by the entity as a whole are, in fact, determined. This is normally where the most senior person or group of people (such as the board of directors) makes its decisions. It therefore argues, but not prescribes, that the superior management of a company as a unit is indicative of effective management rather than the daily hands-on management thereof. This view correlates with that of Klaus Vogel (refer below). The Commentary indicates, however, that no specific rule can be given and it is therefore important that all the relevant facts and circumstances must be examined to determine the actual or real place of effective management.

In certain circumstances other parties and not the board of directors may exercise the strategic decisions and controlling powers. In such an instance the commentary makes it clear that the relevant consideration is where the high-level decision-making occurs. If persons other than the board of directors perform this function, then the relevant consideration is the place where those other people make their decisions.

It is important to distinguish between the actual making of decisions and the formal approval thereof. There could be situations where key management makes decisions regarding the conduct of the company’s business in one place

19 The OECD commentary on Article 4 of the Model Tax convention, Article 4, para 24
but these decisions are formally finalized and approved elsewhere by another person or group of people. It will then be necessary to consider other factors such as the following:

- Where a board of directors formally finalizes 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 effective management will be in the latter State.

- If there is a person such as a controlling interest holder (e.g. a parent company or associated company) 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 made by that person must go beyond decisions related to the normal management and policy formulation of a group’s activities. For example, the type of decisions that a parent company of a multinational group would be expected to take as regards direction, coordination and supervision of the activities of each part of the group.

- 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.\(^\text{20}\)

Therefore, in contrast to the South African view, the OECD looks more at the senior/top management and their decisions. These deviations from SARS’ interpretation could cause some difficulty when the meaning of the phrase must be determined in a Double Taxation Agreement context. Most of the Double Taxation Agreements entered into by South Africa are based on the OECD model. Courts might even lean towards the OECD interpretation, rather than placing reliance on the SARS Interpretation Note when deciding such a case.

In a treaty context South African local courts are bound to take cognizance of the guidelines for interpretation issued by the OECD in its commentaries on the concepts utilized in the OECD Model Double Taxation Convention, as South Africa had adopted the Model for its double tax agreements.\(^\text{21}\) Local courts, furthermore, are bound to apply customary international-law rules and practice in terms of section 232 of the Constitution. Therefore, even if our courts would accept the meaning of the concept as interpreted by SARS in their Interpretation Note, they would be reluctant to apply this meaning in the context of a Double Taxation Agreement.\(^\text{22}\) This anomaly could cause a company to have its place of effective management in one country when determining it for local tax purposes and in another for treaty purposes.

\(^\text{20}\) OECD Place of Effective management concept: Suggestions for changes to the OECD model tax convention
\(^\text{21}\) CIR v Downing 37 SATC 249
\(^\text{22}\) Brincker, Honiball & Olivier: Supra at p24
5.3.2. **OECD Discussion Draft on effective management concept**

Inconsistent and/or overlapping interpretations by countries on the meaning of effective management, as well as the absence of a defined term in the double taxation agreements themselves, may result in double taxation or in some instances, no taxation at all.

In an attempt to address the abovementioned problem the OECD released a discussion draft for public comment on 27 May 2003 entitled ‘Place of Effective management concept: Suggestions for changes to the OECD Model Tax Convention’. The draft sets forth two alternative proposals as developed by the Technical Advisory Group (TAG). The first proposal focuses on refining the current concept of “place of effective management” and the second proposal puts forward the “Hierarchy of tests”, including commentary thereon, which is an alternative version of paragraph 3 of Article 4 of the Model Tax Convention. The second proposal itself includes three different options as regards a possible second tiebreaker test.

**1) Refinement of the place of effective management concept**

The proposal emphasizes the fact that an essential distinction is the one between the actual making of decisions and the formal approval of these decisions. The place of effective management remains an essential determinant of this distinction, which can be described as the predominant factor.

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23 OECD Discussion Draft: “Place of effective management concept: Suggestions for changes to the OECD Model Tax Convention”
Although the predominant factors can be considered to be the norm, it might happen in some cases that these factors do not produce a single place of effective management. This could necessitate the consideration of additional factors including for example:

- The location of and functions performed at the headquarters.
- Legal factors such as the place of incorporation, the location of the registered office and the public officer.
- Information on where central management and control of the company is to be located contained within company formation documents.
- Where the majority of the directors reside.

One might even consider attaching a weighting to each of the additional considerations in order to arrive at a reasonable interpretation and location of the place of effective management.

(2) Hierarchy of tests

The second proposal follows the approach currently used as the tiebreaker rule for individuals. This entails the utilization of four different rules in succession to resolve dual-residence in the case of individuals. Three different options have been offered as regards the second rule for companies that would apply if the situation could not be solved through the place of effective management test. The order of the hierarchy in which these options would be applied as tiebreaker is still to be discussed and open to comment and suggestions.
The place of effective management test will still remain the first test to
determine the residency of a company. Though, in some instances it is
impossible to determine the country in which the place of effective
management is situated. This could be due to various technicalities such as
the senior group of persons responsible for making the key decisions for the
entity meeting regularly in different countries. In some situations the
company utilizes modern technology such as the Internet and conference call
facilities. In such a case, the second proposal, containing three options as
regards to a second tiebreaker test, will be used.

Option A deems the residence of a company to be in the State with which
its economic relations are closer. This refers to the State in which the
company is making greater use of the economic resources as well as the legal,
financial, physical and social infrastructures. In order to apply this test one
would have to examine various factors, including but not limited to, where the
company derives most of its revenue, where most of the employees and assets
are situated or where most the company’s activities are carried on. This test is
very wide and little guidance is given as to how it should be applied.

Option B deems the residence of a company to be in the State in which its
business activities are primarily carried on. A functional analysis of the
activities performed by the company in both States will have to be examined.
One will then have to determine in which of the two States the functions
performed are clearly the most important. This option is a narrower test than
Option A and one that is capable of objective determination. Little guidance is
given however as to the method of measurement of the relative value of business functions carried out in different countries. The question arises whether the measure should be quantitative or qualitative in nature or whether it should be based on a mixture of these and other determinants/values. Even though this option still requires some refinement, is it probably the best of the options given.

Option C deems the residence of a company to be in the State in which its senior executive decisions are primarily taken. This will usually be the State in which the headquarters of the company is located. This test appears to overlap and be similar in nature to the place of effective management test. Clarification regarding the concept of “senior executive decisions” will be required should this option be adopted. Senior executive decisions would typically include decisions regarding policy and strategy, but exclude day-to-day management decisions, even if senior executives make them.

If the State of residency cannot be determined by utilizing either one of the above options or tests, the company shall be deemed to be a resident of the State from the laws of which it derives its legal status.

If it cannot be determined from which State the entity derives its legal status, then the competent authorities of the Contracting States shall settle the question by mutual agreement.24

24 OECD Discussion Draft: “Place of effective management concept: Suggestions for changes to the OECD Model Tax Convention”
As this draft has given rise to many questions and objections by the OECD members, the OECD has decided to shelve the guideline for the time being. Unfortunately it is therefore not expected that a common definition of effective management for the OECD treaties will enter into force in the near future. This just emphasizes the fact that the place of effective management is a difficult term to interpret and various people attach different meanings to the term.

5.3.3. United Kingdom

The High Court of the United Kingdom was recently called upon to interpret the meaning of place of effective management in relation to a company and place a precedent for interpretation of this difficult phrase.

The case centered on the residence of a company incorporated in the Netherlands. Mr. and Mrs. Wood entered into a complex scheme designed to avoid Capital Gains Tax on part of the gain referable to a sale of a group of trading companies, which Mr. Wood had built up over the years. The scheme involved a number of quite intricate transactions, and the participation of three companies that were incorporated outside the United Kingdom.

The success or failure of the scheme hinged on one of the basic concepts of United Kingdom tax law, the concept of the “residence” of a company. One of the steps in the scheme involved a British Virgin Islands company,

25 Mr. R. J. Wood & Mrs. R.J. Wood v HM Inspector of Taxes
CIL\textsuperscript{26}, selling a United Kingdom company, Holdings\textsuperscript{27}, to a Netherlands company, Eulalia\textsuperscript{28}. The scheme assumed that CIL and Eulalia were not merely incorporated outside the United Kingdom but also resident outside the United Kingdom. The Revenue, however, after examining in detail the events that had taken place in the course of the scheme, took the view that, although CIL was resident outside the United Kingdom, Eulalia was resident in the United Kingdom. As a result the UK revenue assessed the Netherlands Company to pay tax on the gain that arose on the disposal of the shares. Accordingly the question on appeal and which the Commissioners had to decide was, amongst other findings, whether Eulalia was resident in the Netherlands or in the United Kingdom.

Eulalia was certainly regarded as resident in the Netherlands for purposes of the Netherlands tax. In terms of section 66 of the UK Finance Act 1988, a company incorporated in the United Kingdom is automatically treated as resident in the United Kingdom. However, since Eulalia was not incorporated in the United Kingdom, the section is irrelevant in this case. It was decided though, that Eulalia was resident in the UK under the common law principles of corporate residence. As there is a double taxation convention between the United Kingdom and Netherlands, it is to be decided whether Eulalia is resident in the United Kingdom based upon the test laid down in Article 4 of the double taxation agreement between the two countries. The ultimate determinant of residence in the instances where it is contended by each of the

\textsuperscript{26} Copsewood Investments Ltd, a British Virgin Islands company
\textsuperscript{27} Ron Wood Greetings Cards Holdings Ltd; United Kingdom company formed to carry out certain steps in the course of the scheme.
\textsuperscript{28} Eulalia Holdings BV; Netherlands company; acquired by CIL; acquired the shares in Holdings from CIL and later resold them to an unconnected purchaser.
states that a company is a resident of its jurisdiction is the so-called ‘tie-breaker’ in Article 4(3)\(^{29}\) of the double taxation agreement, stating that the effective management of the company must be determined.

Eulalia had a corporate director, a Dutch trust company. Immediately after CIL acquired Eulalia, it entered into a management agreement with the trust company to the effect that the trust company would be responsible for the management of its day-to-day affairs. In the following three weeks, the Netherlands Company’s (Eulalia’s) director resolved in Amsterdam that the company enters into an agreement to acquire an interest in a UK company, Holdings. Eulalia’s director engaged the UK professional adviser to advise on the disposal of the shares. Both agreements were prepared in the UK, but were signed in Amsterdam.

After a lapse of two months, the Netherlands Company received a letter from the UK advisers informing that an offer had been received for the shares in Holdings, the UK Company, and that the other shareholders had accepted the offer in principle. Eulalia was requested to advise whether it was prepared to accept the offer. After some negotiation between Eulalia, its co-shareholders and the proposed purchasers, Eulalia’s directors signified their acceptance of the offer. Afterwards the directors signed the agreement of sale in Amsterdam and forwarded it to the UK for implementation.

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\(^{29}\) “Where … a person other than an individual is resident of both states, then it shall be deemed to be a resident of the State in which its place of effective management is situated.”
In determining where the place of effective management was situated, the Court distinguished between influence and management. The test required that there should be a “place” of effective management and that is has to be situated in one of the two states. It did not refer to influence exercised by various parties. The court rejected the proposition by the UK Revenue that the director of Eulalia in Amsterdam was “merely going through the motions of passing and signing documents”. It was found that the director had indeed applied his mind to the transactions in question before committing the company to them. The directors of Eulalia were not by-passed nor did they stand aside since their representatives signed or executed the documents.

Eulalia’s registered office and postal address were in Amsterdam. All documents, which were required to be signed by its management, were signed in Amsterdam. Its books and records were maintained in the offices in Amsterdam. The Netherlands tax authorities regarded it as a resident of the Netherlands. Based on all these facts, the Court found that it was prima facie a resident of the Netherlands. Although not much effective management was required for what Eulalia did, the place where the effective management was carried out was in Amsterdam. Once the taxpayer had established that the place of effective management appeared to be in Amsterdam, the evidential burden shifted to the UK Revenue to produce some evidence that the place of effective management was not there after all, but rather was situated at a place in the United Kingdom; a place furthermore which the Revenue needed to identify specifically.
As the UK Revenue had failed to discharge this burden, Eulalia was found to be a resident of the Netherlands and the gain was not taxable in the United Kingdom.

Although South Africa is not bound to follow decisions of other jurisdictions, this decision provides relevant guidance to the, as yet undecided, issue of corporate residence under SA tax law.

The decision indicates the importance of the board of directors, without which a company cannot act, and the fact that the degree of management that a company requires may not necessarily be significant in some circumstances.

It places doubt upon the interpretation of SARS that the place of effective management is not where overriding control is exercised or where the board of directors meets.

Further, it makes the point that, once the taxpayer has shown that management may have been in another jurisdiction, it is insufficient for the tax authority merely to state that it considers the place of effective management to be in a particular location, but that it must be prepared to produce evidence to substantiate any such assertion.

5.3.4. Netherlands

The main criterion for residence derived from Dutch law is “the place of effective management”. The Dutch Courts found the place of effective
management to be the place where the management of the company concerned takes the decisions and prepares, implements and coordinates these decisions. According to findings by Dutch courts, control at the highest level is more appropriate than the day-to-day management of a company.

The place of effective management will not necessarily be the location of the parent company in a case where it has a strong influence on the decisions of the management of its subsidiary. Only in the case of puppet-on-string management do the courts conclude that the place of effective management is the location of the parent company.

5.3.5. **Klaus Vogel**

In his view effective management is at the location where top management actually exercise the powers bestowed upon them to influence the usual conduct of the business. It is not located where the day-to-day decisions are made. What is decisive is not the place where the management directives take effect but rather the place where they are given. Decisions of top management would have a significant influence on how the transactions of a company are arranged. In order to make such decisions, top management would have to be continually informed of the transactions of the business (e.g. their nature, impact, effect, etc).

It is also stated that a controlling shareholder could be looked at when considering the place of effective management if he is involved with the usual conduct of the business on a regular basis. This will include instances where
he is continually informed of the various transactions and if by his decisions he has a decisive influence on how current transactions are executed and dealt with. A place from which a business is merely supervised will not qualify as a place of effective management though.

If the commercial and the non-commercial management are located at different places, the location of the commercial management will be controlling.\textsuperscript{30}

If the place of effective management cannot be determined by applying the aforementioned criteria, the top manager’s residence will determine the residence of the company.

5.4. \textbf{Guidance from “Place of Management”}

In the absence of any specific definition of place of effective management, many commentators have been influenced by concepts used in various domestic tax law residence rules, such as “place of management” and ”central management and control”.

Place of management is a residence test adopted by countries such as Germany. In describing the meaning of place of effective management, Professor Vogel\textsuperscript{31} suggests that it is similar to the place of management concept used under the German domestic law.

\textsuperscript{30} Vogel. K: Double Taxation Conventions
\textsuperscript{31} Refer 5.3.5 above for details
According to the German case law, a place of management is regarded as the place where the management’s important policies are actually made. This will ultimately be the place where the highest level of control of the business of the company is exercised. If the place of management cannot be determined by the application of these criteria, the top manager’s place of residence may determine the residence of the company.

5.5. **Guidance from “Central Management and Control”**

The closest concept to place of effective management, which is a subject of a fair body of case law, is that of the place of “central management and control”. A few cases in the South African tax law also deal with this issue. Nevertheless, the use by the legislature of a different terminology must surely indicate a desire to apply a concept different from the place of central management and control. Central management and control is one of the residence tests adopted in a number of countries such as Ireland and Australia. An understanding of the factors that determine this concept may provide assistance in determining a place of effective management.

Central management and control ordinarily coincides with the place where the directors of the company exercise their power and authority. This will generally be where they meet and where real control is exercised.\(^{32}\) It is important to note, that although it is often the place where the board of directors meets, it is not necessarily the decisive factor.

\(^{32}\) *De Beers Consolidated Gold Mines* (1906) AC455
Other court cases held that the place of central management and control was where the company really keeps house and does business. Some factors to determine this place include:

- The place of residence of shareholder and directors;
- Where business operations take place;
- Where financial dealings of the company occurred; and
- Where the seal and minute books of the company are kept.

These factors are by no means conclusive and there could be other considerations based on the facts of each case. For example, directors could meet at a location as a mere matter of convenience, in which case a place of control will not be established. It must also be determined who takes the responsibility for the success or failure of the company.

Central management and control is therefore directed at the highest level of control of the business of the company, rather than the place where the main operations of the company are to be found. These two places, however, can coincide.

It is important however, to distinguish effective management from control and from management and control. Nevertheless it is not that easy to divorce the two concepts. In the vast majority of cases they will be located in the same place.

33 Canadian cases such as: Birmount Holdings Ltd v R (1978) CTC 358 & Capitol Life Insurance Co v R (1984) CTC 141
There are instances though, where the place of effective management will be found to be in a place different from the place of central management and control. This could happen, for example, where a company is run by executives based abroad in Country A, but the final directing power rests with non-executive directors who meet locally in Country B. In such circumstances the company’s place of effective management might well be in Country A but, depending on the precise powers of the non-executive directors, it might be centrally managed and controlled in Country B.

5.6. **Multiple places of effective management**

The question arises whether it is possible for an entity to have more than one place of effective management.

Article 4(3) of the OECD Model Tax Convention states that ‘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’\(^{34}\).

By inserting the word “only” after the second word “resident” in paragraph 3 the OECD confirms the function of determining a sole state of tax treaty residence for companies. Treaty law is specifically designed to provide clarity in cases of dual taxation attachment and therefore dual residence is not supposed to be an option under treaty law. As the place of effective management is the tiebreaker rule as per Article 4(3) of the Model Tax Convention, it is therefore assumed that

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\(^{34}\) Articles of the model convention with respect to taxes on income and on capital (OECD), Article 4, Para 3 at p. 8, 28 January 2003
the effective management of an entity should be located at one place only. Paragraph 24 of the OECD Model Commentary is also emphatic in this respect when it says that a company ‘may have more than one place of management but it can only have one place of effective management at any one time’35.

In my opinion this will not always be the case if effective management refers to the place of superior management and not to where the company is managed on a day-to-day level. There are arguments for the effective management to be at more than one location at certain points in time. This can specifically be the case in the context of e-commerce as well as the emergence of the digital workplace. If a company’s directors are resident in various countries, technology now permits these directors to have all board meetings via telephone conferences, video conferencing or communicating only via round robin e-mail. In such a context the directors do not meet in a specific physical location and there may be more than one place of effective management at any given point in time. In such circumstances it could be beneficial to introduce a hierarchy of tests as discussed previously to serve as a tiebreaker rule.

SARS’ interpretation recognizes however, that a company could be in a situation where it has more than one place of effective management at a point in time. Interpretation Note 6 determines that if the regular management of the company by its directors or senior managers is not executed at one single location due to the fact that the management functions take place via distance communication, the view is held that the place of effective management would

35 The OECD commentary on Article 4 of the Model Tax convention, Para 24
best be reflected where the day-to-day operational management and commercial decisions taken by senior managers are actually implemented. Therefore, the place where the business operations and activities are actually carried out or conducted. If the business operations are conducted from various locations, one needs to determine the location with the strongest economic nexus.\footnote{36} This conclusion raises some questions and uncertainty though. Why should distance lend disenchantment to the place where the directors or senior managers exercise their management powers?\footnote{37}

5.7. Summary

As can be seen, the South African view of interpretation of place of effective management is currently somewhat different to that of the rest of the world. All parties agree though that one must look at the management of the business of a company and not at the management of the company as a legal entity.

This agrees with the notion that effective management does not relate to shareholder control. Shareholder control usually refers to the management of a company as a legal entity. The place where a shareholder exercises his control is not necessarily the place where management of the company is exercised. Where the shareholders reside or where the shareholder meetings are held is of little significance to the determination of the effective management and control of a company. In \textit{American Tread Company v Joyce}\footnote{38} it was held that the ‘shareholders can, no doubt, by virtue of their votes control the corporation; they

\footnote{36} \textit{Income Tax Reporter}, Volume 41 Part 5 2002 at p212
\footnote{37} Meyerowitz, Emslie & Davis, \textit{The Taxpayer}, Volume 51 No. 4 at p. 69
\footnote{38} (1911) 6 TC 1 at 163
can compel directors…to do their will, but it does not follow that the shareholders are managing the corporation. The contrary is the truth, they are not. It is the directors who are managing the affairs of the corporation…”.

Even locally there are differences of opinion as to what is exactly meant by the term place of effective management and the interpretation of SARS’ view. Some favour where superior management decisions are taken, whilst others rather emphasize hands-on management to be of decisive importance.

The view of parties such as the OECD and Klaus Vogel appear to be a more correct and accurate interpretation of what place of effective management mean. In my view the term rather refers to the place where management directives are given than to the place where they take effect.

My view of the meaning of the term can best be described by the view of Brincker, Honiball and Olivier who hold that the place of effective management is ‘the place where the higher level of day-to-day running of the business takes place. Running of a business is not limited to implementation of decisions and administration. It also necessarily includes a range of decision-making steps necessary for the functioning of the business. However, it does not necessarily include the strategic decision-making’.

I am of the opinion though, that if an offshore party must exercise discretion, or can alone implement any decision taken, and this is a sine qua non for

39 Brincker, Honiball & Olivier: Supra at p22
management decisions, then management elsewhere cannot be regarded as
effective. This was also illustrated and supported in the Wood case where it was
decided that the degree of management is not decisive, but rather the occurrence
of actual or effective management.

The continental view, however, contrasts with the view of SARS as laid down
in Practice Note 6. As per South African interpretation the mere ability to make
decisions would not be sufficient to constitute a place of effective management;
rather the place where strategic and policy decisions are finally executed and
implemented is considered relevant.

It is important to notice however, that Interpretation Notes are not legally
binding in South Africa. It has no legal authority, but merely conveys the way
SARS interprets a concept. Local courts are therefore not bound to follow these
Notes. The taxpayer can form his own opinion with supporting arguments, such
as international precedent and contest SARS’ opinion on the matter.

The other side is also true. The taxpayer can accept the interpretation of
SARS and use it to his advantage in the business place. In such a case, the
taxpayer might rely on the doctrine of legitimate expectation.40

It is important to notice however, that its own Practice Notes do not bind
SARS either.41 SARS can therefore still contest the place of effective

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40 The Doctrine of legitimate expectation forms part of the South African common law. It advances the
view that taxpayers may well have an enforceable expectation that the Revenue will honour and be
bound by its Practice Notes.
management of a company even though the taxpayer followed the views as per the Interpretation Note.

The concept of place of effective management as is currently stands is largely a geographical concept, together with personal interpretation, which make it open to manipulation. The subject is often approached too facile and simplistic in manner, when in actual fact it is a difficult decision to make and many factors to consider.

5.8. Example

A holding company (Holdco) situated in a foreign country, has an operating subsidiary (Subco) in South Africa.

The board of Holdco takes all strategic decisions relating to Subco and the subsidiary is bound to these decisions. These decisions include their capitalization, their ability to raise debts and their target cost structures and profit margins.

The South African General Manager of Subco, according to his job description, is only responsible for the managing of the subsidiary and other than the management of Subco; he has no authority at all to influence the strategic direction of the company.

\[41\text{ IT}C\ 1675\ 62\ SATC\ at\ p\ 219\]
The General Manager has no authority to:

- Override any budget of the company without authorization of a director of Holdco.
- Incur any capital expenditure, even if it is provided for in the budget, without the approval of a Holdco director.
- Employ or discharge staff, other than at the lowest level, or increase staff salaries without the appropriate Holdco approval.
- Conducting necessary marketing and advertising.

Holdco approves all budgets and material expenses. The managing director in the foreign country makes the vast majority of decisions regarding the group, including Subco. These decisions are conveyed to Subco by way of e-mails, telephone calls, etc. on a regular basis. Subco therefore has an extremely narrow mandate; in fact, Subco hardly makes any real operating decisions.

Members of Holdco’s management team regularly visit South Africa in order to supervise and observe whether the work done by the South African employees are within the given mandate.

It is clear that the managing director of Holdco and his management team make company policy, take commercial decisions and ensure that Subco implement those policies and decisions.

Looking at the above situation, the place of effective management could be in any of the two countries, depending whose view is followed and interpreted as correct.
If SARS’ view, in line with Interpretation Note 6, were followed Subco’s place of effective management would be situated in South Africa. This argument will be supported by the fact that all company policies and decisions are implemented in South Africa. The fact that all material decisions are made by the managing director and his management team in the foreign country does not detract from the simple fact that the day-to-day operational management and commercial decisions are actually implemented in South Africa. That is the reason why there is the regular contact between Holdco and Subco and not between Holdco and any other place outside of South Africa. SARS is not concerned with the location where the decisions are made, but with where they are implemented. The fact that the General Manager does not have the power to influence the strategic direction of the company, or that he cannot make material decisions is irrelevant because this does not have a bearing on the actual implementation of the policies and decisions.

I am not in agreement with this view, as no real management takes place in South Africa. The General Manager and his team are merely puppets or persons that just rubber-stamp the decisions made by Holdco.

If the continental view of parties such as the OECD, were followed Subco’s place of effective management would be in the foreign country. This also correlates with the view of Brincker, Honiball and Olivier. The higher level of day-to-day running of the business takes place in the foreign country. All vital management actions that carry some weight in the ordinary course of the business
are performed in the foreign country. I am in agreement with this view, as it constitutes a place from which the shots are called.

I am also of the opinion that should the General Manager of Subco have more authority relating to the operating decisions, the place of effective management would be situated in South Africa. This would be irrespective of the fact that the strategic decisions are taken by Holdco in the foreign country.

This example illustrates the complexity of the determination of the place of effective management and the conflict between the views of various parties.

6. **Dual Residence**

6.1. **Double Taxation Agreements**

Due to the fact that South Africa and many of its trading partners has a residence basis of taxation, the problem of international double taxation must be addressed. The situation can easily arise where a company is a resident in more than one country and will therefore be taxed more than once on the same income.

International double taxation can generally be defined as ‘the imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter’.\(^{42}\) International double tax arises because different countries levy tax in different ways.

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\(^{42}\) Huxham, K & Haupt, P: *Notes on South African Income Tax*
In order to reduce the impact of double taxation, most developed countries have entered into double tax agreements (or double tax treaties).

The US courts held that the general purpose of a Double Taxation Agreement was ‘not to assure complete and strict equality of treatment – a virtually impossible task in light of the different tax structures of the two nations – but rather, as appears from the preamble to the Convention itself, to facilitate commercial exchange through elimination of double taxation resulting from both countries levying tax on the same transaction or profit; an additional purpose was the prevention of fiscal evasion’. 43

The OECD model tax treaty discusses two methods namely the exemption method and the credit method to eliminate double taxation that may still occur. 44 The exemption method tries to allocate the rights to tax certain forms of income to one state, not both, to avoid any double taxation. 45 The credit method provides tax credits where amounts are taxed in both countries by allowing the foreign taxes paid as a credit against the local tax payable.

6.2. The consequences of dual residence: Example

Even though local tax laws and Double Taxation Agreements strive to eliminate cases of double taxation, this event might still occur in some instances. Double residence of companies may have severe tax consequences and could lead to the

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43 Maximov v US
44 Article 23A and Article 23B of the ‘Articles of the model convention with respect to taxes on income and on capital (OECD)’
45 Article 23A, paragraphs 1 – 4 of the ‘Articles of the model convention with respect to taxes on income and on capital (OECD)’
Company A, the holding company of a group of companies, is incorporated in a foreign country. The foreign country has a residence basis of taxation, the same as that of South Africa.

According to the interpretation of Company A, their place of effective management is also in the country of incorporation. They are therefore taxed on their worldwide income in the foreign country, according to their interpretation.

SARS though, deem Company A to have their place of effective management in South Africa. Therefore, according to SARS’ interpretation, Company A is a resident in South Africa as well and will be taxed in South Africa on their worldwide income.

There is no Double Taxation agreement between the country of incorporation and South Africa. Therefore, the company will be resident in both countries.

Company A will be subject to corporate income tax in both countries on its worldwide income. Dividends paid by the foreign entity would be subject to the local withholding taxes in the foreign country as well as STC in South Africa.
A foreign company may claim foreign tax credits in South Africa for foreign
taxes paid in terms of section 6quat of the Income Tax Act.\textsuperscript{46} However, foreign
tax credits are not available in relation to South African source income.\textsuperscript{47} SARS
sees the place of effective management to be the place where the directors or
senior managers of the company manage the company on a regular or day-to-day
basis.\textsuperscript{48} SARS could therefore argue that as the place of effective management of
the company is in South Africa; the income of the foreign company is South
African source income as the business is actually conducted in South Africa.

Therefore no foreign tax credits could be claimed for the foreign taxes paid
and Company A would indeed be subject to double taxation on the same income.
The above situation will be avoided in most cases if there is a double taxation
agreement between South Africa and the foreign country. The company will then,
according to Article 4(3) of the OECD model treaty be resident only in the
country where it has its place of effective management. As per the example this
will then be in South Africa.

The following recommendation is made in order to prove place of effective
management in South Africa in terms of the Interpretation Note: ‘should a
company wish to establish the place where the board of directors meets as the
place of effective management of the company, the board members should have
the real authority and sufficient involvement in and knowledge of the business

\textsuperscript{46} S6quat: ‘Rebate in respect of foreign taxes on income. (1) … a rebate determined in accordance with
this section shall be deducted from the normal tax payable by any resident in whose taxable income is
included-(a) any income received by or accrued to such resident from any source outside the Republic
which is-(i) not deemed to be from a source within the Republic…”
\textsuperscript{47} Section 6quat(a)(i)
\textsuperscript{48} Interpretation Note: No. 6
transactions of the company to be in the position to make the principle decisions for the company. However, the ability to make decisions would not be sufficient in terms of the Note; rather, the place where these decisions are finally implemented is considered relevant. Therefore it would also be important that these decisions were implemented outside of South Africa to ensure compliance with SARS’ interpretation of effective management.  

In other words, ensure all board meetings are held in the country of incorporation of the offshore company and that foreign directors run the day-to-day management of the offshore company outside South Africa. These foreign directors must be authorised, not only on paper but also in reality, to run the business. Therefore, it is crucial to distinguish between the real board of directors and the so-called puppet directors. It is of the outmost importance that the executive committee, charged with the effective management of the company, is competent and has the essential executive power to make and implement important decisions.

However, company management nowadays can meet anywhere in the world to decide on strategic or policy issues concerning the company. Daily activities normally take place where the company conducts its business and this is normally located at one place. Therefore the key element to determine place of effective management would be to identify the place where the business objectives are being physically implemented. In view of the above it would be practically impossible to prove implementation elsewhere.

49 Brincker, Honiball & Olivier: Supra at p20
In the existence of a double taxation agreement use can also be made of the provisions of Article 23A & B in order to eliminate any double taxation. It is therefore important to do proper tax planning in order to avoid such situations and avoid all possible pitfalls of dual residence and/or double taxation. In most instances it would be more tax efficient to conduct business between countries that have double taxation agreements in place, as this will eliminate most problems regarding double taxation. Entering the realm of double taxation agreements might then create a problem with the interpretation of effective management.

It is however, ‘both lawful and sensible to arrange business affairs in such a way as to attract the lowest possible incidence of tax’\textsuperscript{50}. Many transactions can be structured in any of several different ways and still accomplish the intent of all the parties concerned. Companies operating globally can therefore undertake cross-border tax planning and locate its operations in tax-efficient jurisdictions.

7. Conclusion

In general tax law is concerned only with the legal aspects of taxation, not with its financial or economic aspects. That is where tax planning comes in. International tax planning must be seen as a separate aspect of business planning. A company’s attitude toward tax planning in all circumstances is of utmost importance. Active tax management will result in good business decisions and profitable transactions.

It is important to keep in mind though, as one navigates the shoals of international tax planning, just what the hazards are. The widening scope of tax laws, both in

\textsuperscript{50} Spitz Barry, \textit{International Tax Planning} at p1
South Africa and abroad, and its complexity make it more essential than ever for businesses to plan a company’s taxable events with considerable care. It is fair to say that one cannot attain the desired business objectives if the proper tax effect of the operations and transactions is not taken into account. An unnecessarily increased tax burden represents a business waste, a reduction in profits and loss of competitiveness.

One of these possible hazards to be kept in mind is the determination of the place of effective management. This term can be discussed by asking a few crucial questions:

1) Who manages the company?

Determining who manages a company always involves a factual enquiry. It is generally accepted that the voting powers of shareholders does not constitute management. I agree with the notion that shareholder control will not as the norm constitute effective management.

2) What level of management is important?

This is a point that is the subject of many conflicts in interpretations and opinions. The question is whether it relates to management of daily operational requirements or to a broader policy-type management. The weight of international opinion seems to favour decision-making at a higher level of management rather than mere day-to-day operations and implementation. I agree with this opinion, but it does not necessarily have to include strategic management.
3) What is the nature of effective management?

Does the term refer to the making of decisions or does it include their implementation. Many parties hold that effective management functions involve both taking and implementing decisions. My opinion is that it does not relate to the implementation only as is the view of SARS. It would most probably be a combination of decision-making and implementation. It could also only relate to the decision making process. It is where the most vital actions are taken that determines the place of effective management.

4) Can guidance be obtained from other terms?

Phrases such as “management and control” allow for enough cross-analysis and a fair amount of guidance. I believe that the place of effective management can include, but are not restricted to, the place where management and administration is performed on a day-to-day basis, unlike the concept “central management and control”, which refers only to the place where the superior policy and strategic decisions are taken.

5) Could there be multiple places of effective management?

Although many parties believe this is not possible, I am of the opinion that such a situation can arise. This has specific relevance in the technologically advanced business arena in which we operate these days.

When one considers the place where the company is effectively managed, it is necessary to have regard to all relevant facts and circumstances, including the organization of the company and the nature of its business.
It is imperative to keep the above considerations in mind when determining the residence of a company. As it is likely that the courts will test the term place of effective management in due course, it is better to exercise more conservative tax planning around this issue. Due to different interpretations it is essential to become aware of the fact that the term plays a big role not only in domestic legislations, but also in a treaty context.

It will be beneficial if companies are proactive and address all relevant issues before they materialize. Good tax planning however requires a thorough knowledge of the tax laws involved. The taxpayer must in all instances be able to defend his case in an argument with Revenue Authorities, while still remaining within the realm of arguable legality.

Of utmost importance is to remember that tax planning merely helps one to plan in advance and anticipate the outcome of taxation. The payment of taxation will never be excluded. It is a truth internationally acknowledged that in all business transactions, tax is a cost like any other, and, like any other, it ought to be – if the business is to remain competitive – no greater than it has to be.
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