

Department of Commercial Law



A minor-dissertation submitted to the Faculty of Law in the partial fulfilment of the requirements for the LLM in International Taxation

PRACTICAL CHALLENGES IN APPLYING THE PLACE OF EFFECTIVE MANAGEMENT TEST FOR TAX RESIDENCY IN THE CONTEXT OF SOUTH AFRICA'S HEADQUARTER COMPANY REGIME

Student: Sinenhlanhla Dumisa

Student Number: DMSSIN001

Supervisor: Professor J Hattingh

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ABSTRACT

It is common for residency to be determined by place of incorporation or place of effective management ('POEM'). As a result, the place of effective management test often results in two rival claims regarding taxation based on residency. Prior to 2017, paragraph 3 of article 4 of the OECD Model expressed that a non-individual 'shall be deemed to be a resident only of the State in which the "place of effective management" is situated.' In 2017, the term 'POEM' was abandoned, and the revised 2017 OECD Model now expresses that 'the competent authorities of the Contracting States shall endeavour to resolve, by mutual agreement, cases of dual residence of a person other than an individual.'

Most commentators interpret POEM as the point where key and commercial and strategic decisions are made. As such, a company headquartered in South Africa with a presence in other regional countries may have senior management based in South Africa and senior management in the regions, but may find the subsidiary restricted by the interpretation of POEM. The South African-headquartered company would be resident of South Africa if the key pronouncements were made by executives in South Africa. This study explores the practical challenges in the application and interpretation of the term 'place of effective management' in tax treaties to establish the residency of South African-headquartered companies investing in selected African jurisdictions.

An analysis of the Mutual Agreement Procedure ('MAP') is conducted, including in the form of a case study of Botswana and Lesotho. One of the challenges identified in the MAP is the lack of resources and empowerment to reach a resolution. Consequently, the OECD formed a forum to address the administrative and practical challenges by providing the competent authorities with adequate resources to individual agreements under negotiating the MAP, as well as to train employees. This study concluded that the test for residency should account for where the economic nexus is strongest. Future research could be conducted on the unique challenges that multinational businesses with a significant digital (but little physical) presence encounter, as well as value creation.

Key words: Place of effective management, mutual agreement procedure, tax resident, gateway into Africa, multinational groups.

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CHAPTER 1

OVERVIEW OF STUDY

1.1 INTRODUCTION AND BACKGROUND

1.1.1 Place of effective management

It is common for residency to be determined by place of incorporation or place of effective management ('POEM'). As a result, the POEM test often results in two rival claims regarding taxation based on residence. In determining the corporate entity's tax obligation, the term of residence is crucial. Under many tax regimes across the world, including South Africa, a resident is liable to income tax on worldwide income, whereas a non-resident is liable to income tax on income from a source within the respective country.¹

Globally, there is no consensus as to the meaning of the expression 'place of effective management',² nor does the Income Tax Act 58 of 1962 (hereafter the 'Act') define it. In South Africa, SARS has defined POEM to mean, in short, the place where a corporate entity's key blueprint and commercial considerations are concluded.³

The judicial test for corporate tax residence in the United Kingdom (UK) is based on the *De Beers*⁴ case and applies the concept of 'management and control', which is also not statutorily defined and, as a result, is the subject of a fair body of case law. There seems to be a desire to denote a concept different from a place of management and control, chiefly because of the ease in which a person can manipulate the place of management and control.⁵

¹ Definition of "gross income" in section 1(1) of the Income Tax Act, No. 58 of 1962.

² SARS Discussion Paper on Interpretation Note 6 *Place of Effective Management*, September 2011, para 7.

³ Interpretation Note 6 (Issue 2), 3 November 2015.

⁴ *De Beers Consolidated Mines Ltd V Howe* (Surveyor of Taxes) [1906] AC 455, 5 TC 198.

⁵ Singh, N., 2015. *A discussion of the concept, "place of effective management" and the proposed changes, in the context of South African tax law* (Doctoral dissertation, RHODES UNIVERSITY).

Section 1(1) of the Act provides that a person other than a natural person is a 'resident' if such person is incorporated, established or formed in South Africa, or if such person has his/her POEM in South Africa. The definition of a resident excludes a person who is deemed a resident of another country exclusively for the application of any tax treaty for the avoidance of double taxation.

To resolve the issue of dually resident double taxation, the Organisation for Economic Co-operation and Development (OECD) has devised a mechanism contained in the Model Tax Convention (hereafter the 'OECD Model') under article 4, generally known as the 'tie-breaker rule.' The tie-breaker rule attempts to resolve the dual residency issue by recognising that a dual citizen is a resident of only one State, provided that the relevant States have entered into a Double Taxation Agreement (DTA).

Prior to 2017, paragraph 3 of article 4 of the OECD Model expressed that a non-individual 'shall be deemed to be a resident only of the State in which the "place of effective management" is situated.' The identical wording of article 4(3) of the OECD Model is also contained in the United Nations (UN) Model Convention (hereafter the 'UN Model').⁶

POEM was abandoned as a tie-breaker in the revised 2017 OECD Model. The 2017 OECD Model expresses that 'the competent authorities of the Contracting States shall endeavour to resolve, by mutual agreement, cases of dual residence of a person other than an individual.'⁷ The UN Model contains no description of the term 'POEM', but uses similar wording in the 2017 version of the OECD Model.⁸

South Africa is not a member State of the OECD; however, it has been awarded an observer status and, as result, has adopted a mix of the OECD and UN Model as the basis for drafting its DTAs. Accordingly, the majority of DTAs incorporate the OECD tie-breaker rule.

⁶ Vogel, K. 1997. Klaus Vogel on Double Taxation Conventions. 3rd ed. London: Kluwer Law international. 1688p.

⁷ Article 4(3), Para 24 of the OECD Commentary 2017.

⁸ Nations, U., 2017. United Nations Model Double Taxation Convention between Developed and Developing Countries 2017. *New York: United Nations*, Article 4(3).

1.1.2 The impact of POEM on multinational entities operating from international or regional headquarters situated in South Africa

Regarding foreign subsidiaries in Africa, it is often difficult and costly to appoint or relocate the appropriate level of management. While senior managers may be employed in a certain territory to execute and implement key decisions, these decisions may be made by a management team consisting of in-territory senior managers as well as South African-based senior managers and directors as part of overall control and governance. This problem may best be illustrated by way of an example: say there is a division of a South African-headquartered company that 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. The companies in Swaziland, Lesotho, Mozambique and Malawi are established as subsidiaries of the South African headquarter 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 — and is staffed by sales personnel, finance personnel, 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 to reside in each of these non-South African 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 headquarter company must establish a regional management team that is dedicated to managing the operations of the division in the aforementioned four countries. This team consists of a chief operating officer, a chief finance executive, a chief operation executive, a human resources executive, a marketing executive and a risk executive. While the members of this team visit the territories on a regular basis, they are based predominantly in South Africa. The headquarter company charges the three subsidiaries an arm's length fee for the services rendered by the South African regional management team. Therefore, each

of the operations in Africa is arguably managed jointly by senior managers of the local subsidiary in the country of incorporation and by the regional management team in South Africa.

It is submitted that the determination of the POEM in cases such as the above is going to give rise to practical difficulties if the policy and strategic decision-making role of the regional management team employed by the South African-headquartered company must be taken into account in determining the POEM of the foreign subsidiary. Such a dilemma will arguably entail a determination as to which managers comprise 'senior management'; an analysis of the functions performed by each senior manager involved, taking into account the relevant time spent by the regional management team in relation to each of the four foreign subsidiaries; a classification of these activities between top and operational levels of management; and, finally, a judgment call as to where the top level of management is primarily or predominantly based.

1.2 RESEARCH QUESTION

This study aims to provide answers to the following question: what are the practical challenges in the application and interpretation of 'place of effective management' in tax treaties with regards to establishing the residency of South African-headquartered companies investing in selected African jurisdictions?

1.3 RESEARCH METHOD

- This dissertation will be completed through an evaluative literature review. Applicable academic journals, books and court cases will be considered.
- Exploratory research will be performed by drawing a comparison of case studies between Lesotho and Botswana in relation to the challenges faced by South African-headquartered companies investing in the rest of Africa. The analysis in respect of the above-mentioned countries will include:

- how the term 'place of effective management' is interpreted by these countries;
- how these countries determine a company's tax residency from a domestic tax law perspective and how they determine double tax agreements (DTA) with South Africa; and
- whether there are various fashions in which the countries determine a company's residency from a domestic law perspective that would amount to a more effective tie-breaker rule.

1.4 LIMITATIONS OF STUDY

This study has certain limitations in that only two of the 54 countries in Africa (Botswana and Lesotho) are represented.

1.5 STRUCTURE OF DISSERTATION

Chapter 1

Chapter one provides the reader with a general background to the relevant research question for this study.

The researcher identifies certain limitations and informs the reader of certain assumptions that were made when the study was performed.

Chapter 2

The reader is introduced to the literature review of the study and will gain better clarity as to the term 'place of effective management.' Moreover, the SARS', OECD's and several academic authors' interpretations of the term will be presented.

Chapter 3

Chapter three considers the limitations and challenges of using the POEM as both a determinant of residency in the context of Africa as well as a tie-breaker. The complexity identified is in determining where the POEM of a company is situated based on the generic managerial structures, taking into account the unique challenges of a South African-headquartered company investing in Africa.

Chapter 4

The OECD commentary provides that the competent authorities of the Contracting States shall endeavour to resolve, by mutual agreement, cases of dual residence of a person other than an individual.⁹

Chapter four examines the treaty network that South Africa has with Botswana and Lesotho, which requires mutual agreement procedures. The chapter also examines the challenges posed by a MAP in resolving the dual residency of companies created under the interpretation of the term POEM. A case study focusing on Lesotho and Botswana will be considered.

Chapter 5

Chapter five unpacks how the challenges highlighted above can be resolved. It also recommends a viability of solutions by the OECD, considering the circumstances associated with trading in Africa.

Chapter 6

Chapter six draws a conclusion as to the most beneficial option to address the above-mentioned challenges and limitations.

⁹ Para 24, OECD Model Commentary, Article 4, 2017.

CHAPTER 2

INTERPRETATION OF THE TERM POEM

2.1 INTRODUCTION

In chapter two, the reader will gain better clarity about the term ‘place of effective management.’ The features below are imperative in establishing what is meant by the expression ‘place of effective management’:

- the SARS’ interpretation;
- the case law interpretation;
- the views contained in the OECD Commentary.
- Botswana and Lesotho domestic interpretation of the term POEM, as contained in the residency tests;
- the views of commentators.

2.2 THE SARS’ INTERPRETATION

In the Act, a resident is defined, in the context of companies, as ‘a person who is incorporated, established or formed in the Republic or which has its place of effective management in the Republic.’¹⁰

A corporate entity, irrespective of its formation or incorporation, will be considered a South African resident as stipulated under the definition if it has its POEM in South Africa. It is thus liable to income tax in South Africa, based on its worldwide income. The person who is considered to the resident of another country entirely is excluded from the definition of a South African resident.. Prior to the use of the tax treaty, a company that is formed in South Africa is a South African resident, as per the definition.¹¹

¹⁰ Section 1(1) of the Income Tax Act.

¹¹ Interpretation Note 6 (Issue 2), 3 November 2015.

The court ruling was not in place to interpret the term corporate entity's 'effective management' until the issuance of Interpretation Note (IN) 6 (Issue 1) on 26 March 2002 by SARS. SARS' view was that 'effective management' was where the decisions of the directors or senior management were implemented, irrespective of where the control was exercised or the location of the meeting of the board of directors. Furthermore, the IN6 (Issue 1) expressed that the POEM was the 'place where the controlling shareholders [made] key management and commercial decisions in relation to the company.' This interpretation subsequently attracted scrutiny and criticism in that it seemed to suggest that every company operating a business in South Africa had had its POEM in South Africa. There was additional confusion as shareholders do not make management decisions according to the company law of South Africa.¹²

It was only at the judgment in *Oceanic Trust Co. Ltd NO v. CSARS* (2012) 74 SATC 127 that the confusion was clarified: SARS accepted the test used in the *Smallwood* case¹³ ('that a company's place of effective management is the place where key management and commercial decisions that are obligatory for the supervision of its business as a whole are in substance concluded') was the most appropriate test to be employed for regulating the residency of companies under South Africa's tax act. This resulted in SARS issuing a revised version of the IN6 (Issue 2) on 3 November 2015 to align its practice with the decision in the *Oceanic Trust* case.

The POEM requires the identification of those persons who are in full command of the entity (that is, those who 'calls the shots').¹⁴ The IN provides that in defining the company's POEM, key factors and settings must be analysed. According to the IN, 'Because the list [for definition place of effective management] serves only as a guideline, it is not meant to be exhaustive. The list nonetheless includes the following factors':¹⁵

¹² Brunton, L., 2015. Determining corporate residence-The concept of 'place of effective management' in a shifting domestic and international fiscal landscape. *Business Tax and Company Law Quarterly*, 6(2), pp.13-37.

¹³ Commissioner for Her Majesty's Revenue and Customs v Smallwood [2010] EWCA Civ778.

¹⁴ Interpretation Note 6 (Issue 2), 3 November 2015, page 7.

¹⁵ *Id.*

Head office

- A company's principal place of business can easily be established when all the executive and operational personnel are in one site and that site is not held in South Africa as the company's head office or headquarters.
- A company may be more regionalised. For example, different executives may operate from time to time at offices located in the various countries from which the company operates. In such instances, the company's principal place of business would be where the executives are largely based; where after the tour to other sites they return to; or the location where the vital procedures and strategies for the company in its entirety are concluded.
- Members of senior management may operate from different locations on a roughly permanent basis. In these situations, the members may participate in meetings via telephone or video conferencing rather than through being physically present at meetings in the principal location. In these situations, the head office would normally be the location, if any, where the highest levels of management (for example, the managing director and financial director) and their direct support staff are located.
- Finally, in certain circumstances, the executives may be regionalised in such a manner that it is impossible to establish the company's principal place of business with a sensible level of certainty. Thus, the principal place of business in such cases would be less important with regards to establishing the location from which the company is effectively managed.

Delegation of authority

- Where the senior team members (that is, the board's delegation of authority) of the company articulate and advance key procedures and plans for mere consent by the full board will often be where the company's POEM is deemed. The critical

consideration is what the executive committee does in assessing whether its functions amount to making key management and commercial decisions that are beyond the scope of the delegation of authority granted.

Board

- The assumption of the corporate entity's POEM should not be where the meeting of the board is held; rather, the consideration should be where the board regularly meets and makes crucial business-related decisions and where executive conclusions are reached. The involvement in decision-making of different directors must be established and be considered against other directors' rulings.

Modernisation and global travel

- Sometimes, what could be seen as the place of pronouncements (that is, where the board meets) may not be the main location where the crucial executive decisions take place. In some instances, the majority of key directors with the power to override the decisions are not present in the physical location of the meeting and may attend the meeting via modern means of technology (that is, round robin voting). Accordingly, one must not place undue focus on where the board gathers in person without considering relevant details.

Shareholders

- Fundamental decisions that involve the privileges of the investors or the survival of the corporate entity — besides the behaviour of the corporate entity's enterprise and executives — are not important in normal circumstances to resolve the dispute over the interpretation of POEM.
- In addition, it is typical for a multinational group's parent to have authority that is restrictive, as well as procedures and strategies to examine, manage and guide the entire group's actions. This does not mean that the conclusions are not made

by the subsidiary company. Such details are important to evaluate by the party making the vital executive and business-related decisions.

Operational management versus broader top-level management

- The individual who makes vital business-related and executive conclusions may be the one who makes the operative decisions. By the same token, what may constitute the key managerial and commercial decision in one business may constitute an operational decision in the other. The location of this decision-making place is critical, and it is therefore vital to differentiate between the two types of decisions:
 - the supervision of the everyday functions and process of the organisation are normally taken by operative executives.
 - The senior executive team is responsible for the vital business-related and executive decisions. These decisions concern policy and the wider strategy of the organisation. However, determining what constitutes key management and commercial decisions may be considered on a case-by-case basis, taking into account the nature of the business.

Legal factors

- The location of where the organisation has its place of incorporation and where it is founded and established, as well as the place where the organisation is registered and that of the organisation's representative, location of the registered office and that of the Public Officer, are not important in determining the location of where the company is effectively managed.

Economic nexus

- The commercial link of the organisation with the state is to some level not considered when resolving the location where the organisation is effectively managed. However, consideration of this feature may incidentally be taken into

account and be bestowed some weight in instances where additional aspects are uncertain.

Support functions

- A corporate group may house support services in the group's ultimate headquarter company or in a separate subsidiary that provides services to all members of the group. However, the location where these services is performed and where the senior management is located may be different. The location of the support services and where accounting records are kept would not necessarily be indicative of the place where key management and commercial decisions are made. Therefore, the location is irrelevant in determining the company's POEM.

2.2.1 Summary of the key differences between IN6 (Issue 1) and IN6 (Issue 2)

- IN6 (Issue 1) interpreted the POEM to be where the company was managed on a day-to-day basis or on a regular basis. IN6 (Issue 1) emphasised the place where the decisions made by directors and senior management were implemented, which would be at the operational level of the company. IN6 (Issue 1) was subject to criticism due to the misalignment of the guidelines and principles of the OECD Model.
- IN6 (Issue 2), contrastingly, locates the POEM where key management and commercial decisions are made. IN6 (Issue 2) looks at the top tier level of decision-making concerning the company as a whole. The IN6 (Issue 2) refers to where the senior management 'calls the shots.' IN6 (Issue 2) is more aligned to global primacy and sufficient guidance is provided.

2.3 CASE LAW INTERPRETATION OF POEM

2.3.1 The decision of the Cape High Court in *Oceanic Trust Co Ltd NO v. Commissioner, South African Revenue Service* 2012 JOL 28880 (WCC) adopted the criteria for determining the POEM of a company from a decision in the England and Wales Court of Appeal; in the *Smallwood* case¹⁶, it was decided that ‘effective management is located in the tax jurisdiction in which key management decisions and commercial decisions necessary for the conduct of the entity’s business [are] made, a place where the most senior group of persons (for example, a board of directors) makes its decision, where the actions to be taken by the entity as a whole are determined.’¹⁷

2.3.2 In *Smallwood and Another v. Revenue and Customs Commissioners* [2010] EWCA Civ 778 (08 July 2010), the POEM was interpreted to mean the place that was the ‘centre of top-level management: that is, where the key management and commercial decisions are actually made.’¹⁸

2.3.3 The concepts of POEM and ‘central management and control’ were compared by the courts. In *Wood and Another v. Holden* (HM Inspector of Taxes) 2006 EWCA Civ 26 (26 January 2006), the court held that the two tests be the same for practical purposes. The same view was found in *Trevor Smallwood Trust v. HM Revenue and Customs* (2008) at 653 UKSPC SPC00669 (19 February 2008), where the court held that ‘though theoretically the two terms were used in different contexts, there was essentially no difference between them.’¹⁹

¹⁶ *Smallwood and Another v. Revenue and Customs Commissioners* [2010] EWCA Civ 778 (08 July 2010).

¹⁷ *Oceanic Trust Co Ltd NO v. Commissioner, South African Revenue Service* 2012 JOL 28880 (WCC).

¹⁸ *Smallwood and Another v. Revenue and Customs Commissioners* [2010] EWCA Civ 778 (08 July 2010).

¹⁹ *Trevor Smallwood Trust v. HM Revenue and Customs* (2008) at 653 UKSPC SPC00669 (19 February 2008).

2.3.4 In *De Beers Consolidated Mines Limited ('De Beers') v. Howe* 1906 AC 455, 5 TC 198, De Beers held meetings in both South Africa and London and the court found the company to be tax resident in the UK (where most of the directors were situated). Moreover, real control was exercised in the UK because it was where the important business of the company was conducted. Lord Loreburn stated the following: '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...the real business is carried on where the central management and control actually abides.'²⁰

2.3.5 In *Wood and Another v. Holden (HM Inspector of Taxes) [2006] EWCA Civ 26 (26 January 2006)*, a distinction between the instance where 'management and control of the company is exercised through its own constitutional organs (the board of directors or the general meeting)²¹ and where 'management and control is exercised independently of, or without regard to, those constitutional organs(the board of directors or the general meeting)²² was made.

2.3.6 In *Commissioner for the South African Revenue Service v. Tradehold Ltd (132/11) 2012 ZASCA 61 (8 May 2012)*, the company was effectively managed in the country in which the board meetings were regularly held.

2.3.7 Conclusion

The decision in the *Ocean Trust* case was the first to interpret the term POEM in South Africa and to provide guidance as to the factors to be considered in determining the POEM of the corporate entity. The court acknowledged that POEM is the place where key management and commercial decisions are in substance made, not where the decisions are *implemented*.

The judicial understanding in the *Ocean Trust* case differs from that of the other aforementioned court decisions in that the court interprets POEM (in the *Ocean Trust* case) to be where 'management and control is exercised', 'board meetings are regularly held' and the 'centre of top management' is located. It is therefore my view that the

²⁰ *De Beers Consolidated Mines Limited ('De Beers') v. Howe* 1906 AC 455, 5 TC 198.

²¹ *Wood and Another v. Holden (HM Inspector of Taxes) [2006] EWCA Civ 26 (26 January 2006)*

²² *Id.*

general judicial understanding of the term is similar, though not the same (because different terminology is used), based on the common element, which is where the key decisions are made instead of where the key decisions are implemented.

2.4 OECD'S INTERPRETATION

Tax treaties have rules that apply based on the residence of the taxpayer and the source of the income. For these rules to be effective, a single treaty residence must be determined for each relevant taxpayer and, where each State claims to be the State of residence of the taxpayer for the purposes of the treaty, a conflict of law rule must determine which country will be the State of residence and will consequently be able to subject the taxpayer to comprehensive taxation (which will, among other things, allow that State to tax third country income).²³

The legal controversy around the issue of the tax residency of companies exists primarily due to some countries having adopted a simple rule that provides maximum certainty — but leaves ample opportunity for forum shopping — while other countries have adopted a rule that is less certain but more difficult to take advantage of. This is essentially the dilemma between residency rules based on the place of incorporation and rules that attempt to determine where the company has its 'real seat.' Such conflicts may also arise where two States adopt different approaches for determining the 'real seat' of companies.²⁴

Article 31(1) of the Vienna Convention on the Law of Treaties (VCLT) of 1969 determines that 'a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.'²⁵

²³ J. Sasseville, Chapter 9 The Meaning of "Place of Effective Management" in Residence of Companies under Tax Treaties and EC Law (G. Maisto ed., IBFD 2009).

²⁴ Id.

²⁵ Vienna Convention of Law of Treaties of 1969, article 31(1).

The ordinary meaning of any term is typically obtained from a dictionary. The meaning of the term 'effective' is defined in *Merriam-Webster's* dictionary as 'producing a decided, decisive or desired effect, being in effect: operative, actual and ready for service or action.'²⁶ Management is defined by the same dictionary as 'the act or art of managing: the conducting or supervising of something (such as a business), judicious use of means to accomplish an end, the collective body of those who manage or direct an enterprise.'²⁷

2.4.1 OECD Commentary on article 4(3) prior to 2017

Article 4(3) provides that 'where 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.'²⁸The OECD does not define the term POEM; however, guidance is provided in the OECD Commentary on article 4(3). Paragraph 3 covers companies and other bodies of persons, irrespective of whether they are legal persons or not²⁹, and POEM was adopted as the preferred criterion for persons other than individuals. POEM is 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.'³⁰

The OECD Model was a stringent legal standard which considered the making of key management decisions as a pivotal action which indicated effective management.³¹

2.4.2 OECD Commentary on article 4(3) 2017

²⁶ *Merriam-Webster.com*. Merriam-Webster, 2011. <https://www.merriam-webster.com/dictionary/hacker> (8 May 2011).

²⁷ *Merriam-Webster.com*. Merriam-Webster, 2011. <https://www.merriam-webster.com/dictionary/hacker> (8 May 2011).

²⁸ OECD Model Tax Convention on Income and on Capital, Condensed Version 2014.

²⁹ OECD Model Tax Convention on Income and on Capital, Condensed Version 2014: Commentary on Article 4(3), para 21.

³⁰ OECD Model Tax Convention on Income and on Capital, Condensed Version 2014: Commentary on Article 4(3), para 24.

³¹ Van der Merwe, B.A., 2002. Residence of a Company-The Meaning of Effective Management. *S. Afr. Mercantile LJ*, 14, p.79.

Paragraph 3 of article 4 of the 2017 OECD Model is designed to determine a single company residence for the purposes of tax treaties, and provides that:

[W]here by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, 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 the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.

Article 3(1) of the treaty provides the definition of certain words used in the treaty, with article 3(2) of the 2017 OECD Model determining that:

[A]s regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of mutual agreement procedure (MAP) in article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

The 2017 OECD Model, however, is an unrestricted rule that bestows power to the competent authorities to resolve the dual residency dispute. Chapter four deals in detail with the discretionary rule (MAP) and its challenges.

2.5 DOMESTIC LAW INTERPRETATION OF THE MEANING OF POEM IN BOTSWANA AND LESOTHO CONTAINED IN THE RESIDENCY TESTS

In the event that the term POEM is not defined in the convention, the domestic law interpretation can be used unless the context indicates otherwise. A contracting state can make use of the meaning of the term under the tax laws of that state.³²

Vogel³³ expresses that:

[I]t must also hold true for treaty interpretation by domestic courts if domestic application of the tax treaty is not to conflict with international obligations of the States in question. For the effective interpretation of international treaties, it is therefore necessary to reconcile the various national methods of interpretation.

Vogel further states that ‘the fundamental principles of interpretation for international agreements, see as a whole, are not so different from those which would govern interpretation under domestic law.’³⁴ Therefore, this section looks at the interpretation of the term POEM provided under the domestic law of the two selected countries.

2.5.1 Botswana

- A company is resident in Botswana if (according to section 2 of the Income Tax Act):³⁵
 - it has its registered office or place of incorporation in Botswana; or
 - it is managed and controlled from Botswana.

2.5.2 Lesotho

- A company is resident in Lesotho if it (according to section 6 of the Income Tax Act):³⁶
 - is incorporated or formed under the laws of Lesotho;
 - has its management and control in Lesotho; or
 - undertakes the majority of its operations in Lesotho.

³² Oguttu, A.W., 2008. Resolving double taxation: the concept ‘place of effective management’ analysed from a South African perspective. *Comparative and International Law Journal of Southern Africa*, 41(1), pp.80-104.

³³ Klaus Vogel on Double Taxation Conventions, Fourth Edition, para 75, p36.

³⁴ Id.

³⁵ A.R. Masuku-Chimbombi, Botswana - Corporate Taxation sec. 1., Country Tax Guides IBFD, para 1.2.1

³⁶ P. Khanare, Lesotho - Corporate Taxation sec. 1., Country Tax Guides IBFD, para 1.2.1

The term POEM is neither explicitly used nor defined under the domestic laws of neither Botswana nor Lesotho. However, both states seem to use the wording from the *De Beers*³⁷ case where the court defined POEM as the place where 'management and control' reside.

2.6 COMMENTATORS' INTERPRETATIONS

2.6.10 According to Vogel:

- POEM is the place where the management's important policies are undertaken.
- What is decisive is not the place where the management directives take effect but rather the place where the directives are given.
- The 'centre of management' of a company generally is the place where the person authorised to represent the company carries on his/her business management activities.
- A place from where the business is merely supervised would not qualify as the POEM.
- If the commercial and non-commercial sides of the business are managed at different places, the location of commercial management is of significance.
- If the above criteria are inconclusive, the top manager's residence will regularly determine the residency of the company.³⁸

2.6.2 The views of various authors³⁹

³⁷ *De Beers Consolidated Mines Limited ('De Beers') v. Howe* 1906 AC 455, 5 TC 198.

³⁸ Klaus Vogel on Double Taxation 3rd Edition Page 262.

³⁹ G. Maisto et al., Dual Residence of Companies under Tax Treaties, Intl. Tax Stud. 1 (2018), Journal Articles & Opinion Pieces IBFD.

- The authors' aim is to define the meaning of the term POEM by adopting the wording 'the place where key management and commercial decisions that are necessary for the conduct of the business as a whole are in substance made.'⁴⁰
- In addition, a substance-based feature relying on the place where the business activity is primarily carried on strengthens the independent meaning.
- The authors also propose for the definition of POEM to include 'primary' as a tie-breaker.

2.6.3 Meyerowitz is of the view that POEM is where the directors meet to discuss the business of the company not where the board of directors meet. However, Meyerowitz also considers where the board meeting takes place, taking into account the structures of the company.⁴¹

2.6.4 Olivier regards POEM as the place where 'most vital' management actions take place.⁴²

2.6.5 Van der Merwe disagrees with rest of the commentators and asserts that POEM includes the place where management and administration are executed day-to-day.⁴³

2.7 SUMMARY

2.7.1 'Effective management', while not interpreted consistently as noted above in paragraphs 2.3.7 and 2.6.5, generally encourages the location of the highest (strategic) level of decision-making rather than that of the day-to-day management decisions. This is the standard to be used to determine the location of effective management.

⁴⁰ Article 4(3), Para 24 of the OECD Commentary 2014.

⁴¹ Meyerowitz, D. 2008. Meyerowitz on income tax. Cape Town: The taxpayer CC.

⁴² Olivier, L. & Honiball, M. 2011. International tax, A South African perspective. 5th ed. Cape Town: Siber Ink.

⁴³ Van der Merwe, B. A. 2002. Residence of a company – the meaning of 'effective management'. *SA mercantile law journal = SA tydskrif vir handelsreg*, 14(1):79-92.

CHAPTER 3

CHALLENGES OF USING POEM FOR A SOUTH AFRICAN-HEADQUARTERED COMPANY INVESTING IN AFRICA

3.1 INTRODUCTION

In 2010 the National Treasury declared South Africa to be the ‘gateway into Africa.’⁴⁴ Since then, various legislative amendments have been enacted to render South Africa more appealing to foreign investors looking to enlarge their operations in the African continent.

The headquarter company regime was subsequently introduced with the purpose of providing a base from which these investments would be managed. The regime sought to provide the tax benefits for companies that elected to be classified as headquarter companies, provided that certain requirements could be satisfied. These requirements specifically made mention of investments in qualifying foreign companies. The reference to foreign companies inevitably necessitates that the resident definition be considered. In South Africa, the residence of a person other than a natural person is the place where the company is formed, incorporated or established, or is the POEM — a term subject to various interpretations. Notwithstanding the various interpretations of POEM, as discussed in the previous chapter, all interpretations allude to a senior level of management.

Foreign incorporated companies, with their POEMs in South Africa, are excluded from the definition should they qualify as controlled foreign companies (CFCs) with foreign business establishments subject to inflated tax rates. This is if the POEM is ignored.⁴⁵ The skills shortage in African countries — a product of deficits in the quality of education — leads to challenges in establishing suitably skilled management teams.⁴⁶ When a centralised management team is set up at the headquarter company in South Africa, the African subsidiaries risk being resident in South Africa and, as a consequence, the

⁴⁴ Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010, para 5.4.

⁴⁵ Explanatory Memorandum Taxation Laws Amendment Bill, 2012, 10 December 2012, page 122.

⁴⁶ *UN Handbook on Selected Issues on Administration of Double Tax Treaties for Developing Countries* p. iii (UN 2013).

structure will not qualify for the benefits of the headquarter company regime. More challenges arise when the exclusion to the resident definition is applied, as shares held by a headquarter company are ignored when the controlled foreign company status of the subsidiaries are determined.

Chapter three will consider the restrictions and challenges of using the POEM as a determinant of residency in the context of Africa. A tie-breaker rule will also be discussed. The complexity to be unpacked is that of determining where the POEM of a company is to be situated, based on the generic managerial structures. A case in point will be the unique challenges of a South African-headquartered company investing in Africa.

3.2 THE HEADQUARTER REGIME IN SOUTH AFRICA

3.2.1 The headquarter company is defined as the company in respect of any year of assessment that is a resident⁴⁷, and that meets the following the following three requirements in respect of which an election has been made in terms of that section:⁴⁸

- ‘...each holder of shares in the company (whether alone or together with any other company forming part of the same group of companies⁴⁹ as that holder) holds 10 per cent or more of the equity shares and voting rights in that company, provided that the company commenced the carrying on of trade.
- eighty per cent or more of the cost of the total assets of the company is attributable to one or more of the following:
 - (i) any interest in equity shares in;
 - (ii) any debt owed by; or
 - (iii) any intellectual property, as defined in section 23I(1), that is licensed by that company to,

⁴⁷ Section 9I(1)(a) of the Income Tax Act No 58 of 1962.

⁴⁸ Section 9I(2)(a)-(c) of the Income Tax Act No 58 of 1962.

⁴⁹ “group of companies” means *two or more companies in which one company (hereinafter referred to as the “controlling group company”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “controlled group company”), to the extent that— (a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and (b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company.*

Any foreign company in which that company (whether alone or together with any other company forming part of the same group of companies as that company) holds at least 10 per cent of the equity shares and voting rights, provided that in determining—

(aa) the total assets of the company, there must not be taken into account any amount in cash or in the form of a bank deposit payable on demand; and

(bb) whether a company complies with the requirements prescribed by this paragraph in relation to any year of assessment of that company, no regard must be had to any such year of assessment if the company did not at any time during such year of assessment own assets with a total market value exceeding R50 000 (fifty thousand rand); and

- where the gross income of the company for that year of assessment exceeds R5 million (fifty million rand), or where 50 per cent or more of that gross income consisted of amounts in the form of one or both of the following:
 - (i) any rental, dividend, interest, royalty or service fee paid or payable by any foreign company contemplated in paragraph (b); or
 - (ii) any proceeds from the disposal of any interest contemplated in paragraph (b)(i) or of any intellectual property contemplated in paragraph (b)(iii):
- Provided that, in determining the gross income of the company, there must not be taken into account any exchange difference determined in terms of section 24I in respect of any exchange item as defined in that section to which that company is a party.’

3.2.2 A headquarter company is subject to normal tax (including normal tax on capital gains) in the same way that any other resident company is but is also subject to several additional arrangements and entitled to certain relief not applicable to resident companies that are not headquarter companies.⁵⁰

⁵⁰ Interpretation Note 87(Issue 3), 29 May 2020, para 4.

Controlled foreign companies

Controlled foreign company legislation is presided over by section 9D of the Act. Under section 9D(1), the controlled foreign company legislation clearly excludes shares held in participation, as well as voting rights, by headquarter companies. Furthermore, section 9D(2) exempts headquarter companies from assigning their portion of income of controlled foreign companies — in which they hold more than 10 per cent of participation rights — to their taxable income.⁵¹

Dividends, foreign dividends and related exemptions from normal tax

Under section 10(1)(k)(i), the dividends and foreign dividends collected or accrued by a headquarter company and the dividends declared or paid by a headquarter company are free from normal tax. Foreign dividends collected or accrued by a headquarter company may be spared from normal tax under section 10B.

Transfer pricing

Section 31 of the Act regulates the taxation of international transactions between connected persons not dealing at arm's length if any person who is a party to that transaction, scheme, agreement, operation or understanding obtains a tax benefit from it.

A headquarter company must comply with section 31 of the Act, unless the following circumstances are present:⁵²

- where there is a non-resident to a headquarter company, section 31 will not apply to so much of that financial assistance as is directly applied or to so much of the use, right of use or permission to use intellectual property as is granted to any foreign company in which the headquarter company directly or indirectly holds at least 10 per cent of the equity shares and voting rights and, in the case of intellectual property, the headquarter company does not use it otherwise [section 31(5)(a) and (c)]; or

⁵¹ Interpretation Note 87(Issue 3), 29 May 2020, para 4.2.1.

⁵² Id, para 4.2.3.

- where a headquarter company to a foreign company in which the headquarter company directly or indirectly holds at least 10 per cent of the equity shares and voting rights, section 31 will not apply to that financial assistance or granting of the use, right of use or permission to use that intellectual property [section 31(5)(b) and (d)].

Gains from the sale of foreign investments

The Eighth Schedule to the Act allows for the exemption of capital gains and losses from the disposal of equity shares in a foreign company by a headquarter company. Paragraph 64B(2) expresses that the gains and losses from such a sale by a headquarter company must be ignored when calculating capital gains and losses of the company on condition that the headquarter company holds a qualifying share immediately before the disposal of the shares.⁵³

Interest and royalty income paid to non-residents

With regards to section 37K(1)(a)(cc) of the Act, interest paid to a foreign resident shall not be subject to the withholding of tax if it is paid by a headquarter company on financial assistance, to which section 31 does not apply in terms of section 31(5).⁵⁴ Any royalty remittance made by a headquarter company to a foreign resident for authorisation, use, or right of use of intellectual property — as defined by section 23I of the Act and to which section 31 does not apply in terms of section 31(5) — is free from royalties withholding tax in terms of section 49D(b).⁵⁵

Tax treaty network

The headquarter company is unquestionably a South African resident company but, even though certain exemptions have been implemented. It should be noted, however, that

⁵³ The Income Tax Act, section 64B.

⁵⁴ The Income Tax Act, section 37K.

⁵⁵ The Income Tax Act, section 49D.

there are several other areas in which the company is taxed in the same manner as any other resident. Accordingly, it cannot actually be said that the company would no longer be a resident of South Africa.⁵⁶

It follows that all of South Africa's tax treaties continue to apply, including those entered into with a number of African countries. This is one of the supposed strengths of using South Africa as the base, as South Africa possess more tax treaties with African countries than most other non-African countries⁵⁷.

3.3 FEATURES OF SUCCESSFUL HEADQUARTER COMPANY REGIMES

3.3.1 Relevance to the overall research aim

In chapter one, it was established that the residence of a company not incorporated in South Africa would be established based on the place where the company is effectively managed, commonly understood to be where the senior management takes decisions.

The purpose of the headquarter company regime in South Africa was explained in paragraph 3.1, where it was concluded that the function of effective management would be performed at the headquarters of the company to ensure effective and efficient utilisation of skills. As such, South Africa would want to establish an attractive platform for foreign companies wanting to expand their operations into Africa to set up their headquarters in South Africa.

Luxembourg and the Netherlands — two states popular for establishing headquarter regimes for multinationals and with similarities to the South African regime⁵⁸ — will be analysed.

⁵⁶ E. Mazansky, *New Headquarter Company Regime*, 65 *Bull. Intl. Taxn.* 3 (2011), *Journal Articles & Opinion Pieces IBFD*, para 4.1.10.

⁵⁷ E. Mazansky, "South Africa's Treaty Network – Why is South Africa the Meat in the Sandwich?", *Bulletin for International Taxation* 4 (2009), p. 145 et seq.

⁵⁸ Legwaila, T. 2011. *The tax treatment of holding companies in Mauritius: lessons for South Africa*. *South African Mercantile Law Journal*, 23(1):1–15.

Mauritius has established itself as a favourable headquarter jurisdiction worldwide in comparison to South Africa. However, since Mauritius has identified itself as a 'tax haven', the provisions of the headquarter regime in South Africa are not comparable since South Africa does not identify itself as a 'tax haven.' Mauritius will therefore not be analysed further.

Botswana is, however, an African state not considered as a 'tax heaven' and is a member of the Southern African Development Community (SADC).⁵⁹

3.3.2 Luxembourg

3.3.2.1 Luxembourg is described as the ideal gateway into the European market.⁶⁰ Luxembourg is a popular destination for the establishment of headquarter companies due to its highly skilled workforce, its favourable tax environment⁶¹ and because it has the lowest level of value added tax (VAT) in the European Union. Furthermore, its tax legislation includes various aspects that are attractive to headquarter operations.⁶²

3.3.2.2 Highly skilled expatriates enjoy favourable tax exemptions regarding the remuneration received based on their specific assignment(s) in Luxembourg. Additionally, there are particular tax relief systems for expenses incurred when relocating to and from Luxembourg.⁶³

⁵⁹ Id.

⁶⁰ KPMG. 2012a:4 Corporate headquarters in Luxembourg.
<https://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Documents/Corporate-Headquarters-in-Luxembourg-final.pdf>.

⁶¹ Luxembourg for business. 2012. A rewarding tax climate for business and employees.
<http://www.luxembourgforbusiness.lu/business-taxation>. Date of access: 24 Aug. 2013.

⁶² KPMG. 2012a:4 Corporate headquarters in Luxembourg.
<https://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Documents/Corporate-Headquarters-in-Luxembourg-final.pdf> Date of access: 17 Jul. 2012.

⁶³ KPMG, 2012a:5 Corporate headquarters in Luxembourg.
<https://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Documents/Corporate-Headquarters-in-Luxembourg-final.pdf> .

3.3.2.3 Luxembourg has the lowest VAT rate in Europe and is the only country that does not have import VAT. There are also ‘free zones’, where VAT is exempt within such zones until the goods leave the zones.⁶⁴

3.3.2.4 The other provisions that either eliminate tax, reduce tax or provide incentives include non-taxation of foreign-sourced income; low or no withholding tax on interest; and royalties, dividends and/or credit granted on acquisition of investment.

3.3.3 The Netherlands

3.3.3.1 The Netherlands is an appealing location for a holding company owing to its infrastructure and favourable tax regimes.⁶⁵

3.3.3.2 The concepts of ‘holding’ and ‘headquarter companies’ are not incorporated in the tax legislation of the Netherlands.⁶⁶

3.3.3.3 The favourable provisions that render the Netherlands the location of choice of a holding company include the participation exemption endeavours to remove or reduce the second tax;⁶⁷ extensive tax treaty networks that provide zero withholding tax on interest, dividends and royalties;⁶⁸ and an advanced tax ruling system that enables the discussion of the tax system, which can subsequently be formalised into agreements.⁶⁹

⁶⁴ Id

⁶⁵ Gerritsen, R. & Kuipers, I. 2012. Netherlands: the advantages of a Dutch holding company. <http://www.internationaltaxreview.com/Article/3068219/Netherlands-The-advantages-of-a-Dutch-holding-company.html>.

⁶⁶ Legwaila, T. 2012c. Taxation of holding companies in the Netherlands: a South African observation. *Obiter*, 33(1):1-26.

⁶⁷ Legwaila, T. 2012c:2:11-12 Taxation of holding companies in the Netherlands: a South African observation. *Obiter*, 33(1):1-26.

⁶⁸ Legwaila, T. 2012c:10. Taxation of holding companies in the Netherlands: a South African observation. *Obiter*, 33(1):1-26.

⁶⁹ Van Min, P. 2009. Tax benefits in The Netherlands for foreign investors. <http://www.foreigninvestments.eu/pages//ET---Tax-benefits-in-The-Netherlands-for-foreigninvestors.html>.; Legwaila, T. 2012c:10. Taxation of holding companies in the Netherlands: a South African observation. *Obiter*, 33(1):1-26.

3.3.3.4 An additional benefit is that company structures where only limited shareholdings are held in the subsidiaries will still stand to benefit from these provisions, and these provisions are available regardless of whether interests are held in foreign or domestic companies.

3.3.4 Botswana

3.3.4.1 Botswana is an ideal local in respect of socio-economic criteria. The rate of tax is similar to South Africa.

3.3.4.2 The absence of exchange control and CFC is the beneficial feature. The withholding tax and the capital gains tax are not competitive with South Africa, especially since the opportunities to reduce the withholding taxes via DTA are fewer.

3.3.4.3 The International Financial Service Centre (IFCS)⁷⁰ regime is a competitive regime in relation to the South African headquarter regime, with a 15 per cent effective tax rate.⁷¹ The main objective of the IFCS regime is to target companies working across many sectors in Botswana and on projects in sub-Saharan countries.⁷²

3.3.4.4 The drawback of Botswana is that the company will be limited to certain services, and anti-avoidance provisions⁷³ — such as provision of debt (in addition, to 3:1 debt: equity ratio)⁷⁴ — are a reality. This compares unfavourably with South African-headquartered companies who have fewer restrictions.

3.3.4.5. The IFCS regime has interest deductions⁷⁵ and no capital gains tax on the sale of shares and subsidiaries. The dividends are exempt from tax as well as withholding

⁷⁰ Sections 137-142 of the Income Tax Act CAP 52.01.

⁷¹ Eighth Schedule of the Botswana Income Tax Act CAP 52.01.

⁷² Sections 137-142 of the Income Tax Act CAP 52.01.

⁷³ Section 36 of the Botswana Income Tax Act CAP 52.01.

⁷⁴ S141(3) of the Botswana Income Tax Act CAP 52.01.

⁷⁵ Botswana Income Tax Act CAP 52.01.

taxes to payment of royalties, dividends and management fees to non-residents. The IFCS regime is also exempt from VAT.

3.4 COMPLEXITY IN DETERMINING WHERE THE PLACE OF EFFECTIVE MANAGEMENT OF A COMPANY IS SITUATED, BASED ON THE GENERIC MANAGERIAL STRUCTURES. CASE IN POINT: THE UNIQUE CHALLENGES OF A SOUTH AFRICAN-HEADQUARTERED COMPANY INVESTING IN AFRICA

3.4.1 As mentioned above, tax residency in South Africa for persons other than natural persons can be triggered either by being incorporated, formed or established (hereafter referred to as ‘incorporation’) in South Africa, or by establishing the person’s POEM in South Africa.⁷⁶

3.4.2 In most countries, tax residency is also triggered by incorporation in that specific country.

3.4.3 Multinational enterprises often have regional headquarters from which legal entities incorporated in different countries are effectively managed for a variety of commercial reasons, including cost savings, increased efficiency and governance, and avoiding a duplication of efforts. When these regional headquarters are situated in South Africa, the regional companies — despite having a substantial presence in countries outside South Africa and having been established outside South Africa purely for commercial reasons — are now dually resident in South Africa as well as in their countries of incorporation.

3.4.4 The interpretation of POEM adopted in IN6 in short defines POEM as the place where the key commercial and strategic decisions affecting a person are taken. This is in accordance with the interpretation adopted by the OECD and is therefore aligned with South Africa and the international community.

3.4.5 While the above interpretation has been applauded, it is also important to understand the impact that this interpretation has on multinational entities operating from international or regional headquarters situated in South Africa.

⁷⁶ Section 1 of the Income Tax Act, 1962.

3.4.6 It is extremely difficult to establish where the POEM is situated in the case of multinational entities. Even IN6 (Issue 2) acknowledges the difficulties that can arise when determining the POEM of entities that are part of a multinational group managed according to divisions. In a divisional group structure, the local management in a foreign subsidiary may not be sufficiently senior as to be regarded as part of the top management of the division ‘calling the shots.’ The local management nonetheless comprises of senior managers executing and implementing key decisions.

3.4.7 Additionally, it is often impossible to operate in certain African territories through a branch. For example, some African countries require commercial vehicles operating in that country to be registered and licensed in the name of a company incorporated in that country.

3.4.8 Despite the fact that the operations of foreign subsidiaries are firmly established and foreign operations are incorporated into each respective country for commercial purposes, in practice these foreign companies may effectively be managed in South Africa and, as a result, would constitute South African residents.

3.4.9 The resolution of dual residency is extremely difficult in practice because of the following:

- where there is no DTA — as is still relatively common in Africa — the company is regarded as resident in two countries, creating a compliance burden on the two countries. Often, no increased taxes will be due in South Africa as the tax rates in Africa tend to be high; and
- where there is a DTA, the tie-breaker rule is either POEM or a requirement for the tax authorities to reach a consensus as to the residency of the person.

3.4.10 Where POEM is the tie-breaker, it is in practice difficult to motivate to the other tax authority that the company is now resident in South Africa despite being incorporated in another country and that the situation will have an impact on headquarter taxes. Some source-based countries even deny access to the DTA tie-breaker rule based on the wording of article 4(1), which excludes from the definition of ‘resident’ in the DTA ‘any

person who is liable to tax in that State in respect only of income from sources therein.⁷⁷ The OECD has, however, clarified that exclusion is not the intention. The OECD, in its commentary on the aforementioned clause of the Model Tax Treaty, expresses:⁷⁸

Thus article 4(1) has to be interpreted restrictively because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.

3.4.11 Tax authorities in Africa are currently resisting all attempts to acknowledge residency in light of the above effective management clause.⁷⁹

3.4.12 Even once single residency in South Africa has been determined, registering the company for tax purposes in South Africa first requires the company to register with the Companies and Intellectual Properties Commission (CIPC).

3.4.13 The Act is not written with the above situations in mind, which, in certain instances, prejudice the foreign incorporated companies with South African tax residency status. For example, a foreign incorporated entity would not be able to claim a section 11(l) of the Act deduction as these retirement funds are unlikely to have been approved by SARS (though there is contestation as to whether a deduction can be claimed under section 11(a) of the Act.) The situation is similar in relation to section 12H allowances (it is unlikely that learnership agreements would have been registered with a SETA, as required in terms of section 12H) and section 18A donations (it is unlikely that donations would be made to public benefit organisations sanctioned in terms of the Act.)

3.5. SUMMARY

3.5.1 In many instances, the South African headquarter company regime has the same features as the successful regimes discussed in paragraph 3.4. The South African-headquartered company regime equates well with these other regimes in that it does not

⁷⁷ OECD Model 2017 Condensed: Article 4 (1).

⁷⁸ OECD Model 2017 Condensed: Commentary on Article 4(1).

⁷⁹ Comments to the IN6 (Issue 2) by South Africa Institute of Chartered Accountants.

raise withholding taxes on qualifying royalty payments, dividends and interest. The South African-headquartered regime also does not raise capital gains tax at the disposal of qualifying foreign shareholdings. Furthermore, South Africa has a wide-reaching network of tax treaties which limit occurrences of double taxation.

3.5.2 These features — along with the exclusion of headquarter companies from controlled foreign company legislation, the immunity from certain qualifying transactions and agreements from transfer pricing, and the tenuous capitalisation rules — have the outcome of the South African regime conforming to the ideal holding company regime. Legislation does not make provision for exemptions relating to management fees.

3.6.3 From the above analysis, it is evident that South Africa limits the headquarter company legislation to companies holding notable interests in foreign companies.

3.5.4 The guidance provided in the IN6 (Issue 2) to distinguish between what key operational management decisions are and what key management and commercial decisions are, is insufficient when considering the significant influence that the concept of 'key management and commercial decisions' has in the determination of POEM.

3.5.5 If we regard African-incorporated entities as South African tax resident because of POEM despite these entities having substantial operations in the other territories and a strong economic nexus to these territories, it will result in little to no additional income to the fiscus as tax rates in Africa tend to be more or less the same as in South Africa. POEM does, however, significantly increase the administrative burden on taxpayers now having to comply in two territories.

3.5.6 The above may also impact negatively on the decision of international companies to shape South Africa into the 'gateway into Africa.'

3.5.7 All things considered, the recommendation is that the headquarter company legislation be amended to conform to successful regimes such as Luxembourg and the Netherlands; that is, the legislation should cease to apply to foreign investment only. It is further advocated that the definition of 'resident' be amended to exclude the POEM test group structure. This amendment would comply with section 9I.

CHAPTER 4

CHALLENGES POSED BY THE MAP PROCESS

4.1 INTRODUCTION

Chapter four examines the South Africa treaty network with Botswana and Lesotho, which requires mutual agreement procedures (MAPs). In addition, it also examines MAP challenges in resolving the dual residency of companies created by the interpretation of POEM by means of a case study focusing on Lesotho and Botswana.

The chief purpose of tax treaties is to eliminate double taxation and to prevent fiscal evasion. Additionally, a tax treaty will serve, in effect, to allot tax revenues on transactions taking place between residents of signatory countries. A tax treaty may to these ends resolve some common disputes and provide rules determining:⁸⁰

- the country wherein a taxpayer is resident;
- the treatment given to specific types of income;
- the permitted rates of withholding tax on specific types of cross-border payments; and
- the manner in which issues of taxation not in accordance with a tax convention are to be resolved.

International double taxation can be juridical or economic. Juridical double taxation is the imposition of income taxes on two or more states on the same taxpayer concerning the same income. Juridical double taxation can arise where a resident of one country obtains income from his/her sources in the other country and those resources are taxable under the domestic laws of both countries. It can also arise where the taxpayer is considered a resident of both countries under the domestic laws of each country.⁸¹ Economic double

⁸⁰ Manual on Effective Mutual Agreement Procedures, para 1.1.1.

⁸¹ Id, para 1.1.2.

taxation is the inclusion of the same income when the income is in the possession of different taxpayers, such as transfer pricing transactions.

Tax treaties serve to minimise juridical double taxation by allocating taxing rights between residence and source states on various categories of income. The residence state is required to grant aid for the source state through a credit or exemption mechanism, or by limiting taxation by the source country.

Double taxation has adverse implications for movements of capital, technology and persons, as well as for trade. Hence tax treaties, when correctly applied, remove the double taxation barrier, which consequently promotes the development and flow of international trade and investment.

Prior to 2017, the OECD Model specified that in cases of dual residency, the dually resident person was to be treated as a resident in the contracting state where his/her POEM was situated. However, following the conclusion of the OECD/G20 BEPS Project, the OECD Model and commentaries were amended to provide for a new standard tie-breaker rule. Rather than using the POEM standard, the replacement standard rule is that the competent authorities of the contracting states are to endeavour to determine the matter by mutual agreement.⁸²

4.2 MUTUAL AGREEMENT PROCEDURE

The Mutual Agreement Procedure ('MAP') contained in article 25 of the 2017 OECD Model is the customary procedural rule that stands apart from, but nevertheless is intrinsic to, the effective operation of a tax treaty's distributive and other rules.⁸³ Article 25 in a tax treaty permits designated representatives (the 'competent authorities') from the governments of the contracting states to interact with the intent to resolve international

⁸² B.R. Obuoforibo, Article 4: Resident - Global Tax Treaty Commentaries, Global Topics IBFD, para 5.1.

⁸³ J.S. Wilkie, Article 25: Mutual Agreement Procedure - Global Tax Treaty Commentaries, Global Tax Treaty Commentaries IBFD.

tax disputes. These disputes include cases of double taxation (juridical and economic) as well as inconsistencies in the interpretation and application of the treaty.⁸⁴

The MAP article calls for the competent authorities to endeavour to resolve, by mutual agreement, any tax disputes. However, there is no obligation under the article that the agreement be reached. The competent authorities are generally expected to undertake this obligation in good faith, without being hindered, if possible, by the domestic law of the other contracting states involved or by any other process to dispute a tax claim that article 25 of the OECD Model acknowledges may arise and continue in spite of a parallel MAP.⁸⁵

New paragraph 5.1 of the commentary on article 25 of the OECD Model elucidates the expectations of competent authorities to achieve an outcome, even in the absence of a prescribed obligation. Paragraph 37 notes that:

In short, despite such a prescriptive obligation or duty, there is such a serious expectation that unwarranted taxation will be resolved that it seems almost tantamount to a duty, which is only reinforced by the attention being paid in article 25 and beyond, including in the MLI, to arbitration.⁸⁶

Scarcely any treaties include arbitration in their MAP articles.

4.2.1 The MAP criteria in article 4(3)

With respect to article 4(3), scholars have argued that such wide-ranging discretion may lead to delay or even failure by the competent authorities to reach a decision and may even exceed the powers granted to such competent authorities under their own domestic laws. Additionally, such wide discretion could, in some jurisdictions, actually conflict with constitutional principles. Furthermore, where the competent authorities have almost free

⁸⁴ Manual on Effective Mutual Agreement Procedures, para 1.1.2.

⁸⁵ J.S. Wilkie, Article 25: Mutual Agreement Procedure - Global Tax Treaty Commentaries, Global Tax Treaty Commentaries IBFD, para 2.7.3.1

⁸⁶ *Id.*

rein in how they exercise their discretion, the scope of judicial remedies available to the taxpayer could be restricted.⁸⁷

The dually resident person is required to request a determination of his/her residency status by invoking the mechanism provided for under article 25(1) of the OECD Model (2017). This stipulation is set out in the OECD commentary on article 4. Article 4(3) of the OECD Model (2017) itself does not expressly refer to the MAP set out under article 25, and this invites the question of whether the MAP to be entered into under article 4(3) should then be subject to the conditions set out under article 25(1). On this point, several scholars have argued that the condition set out in article 25(1) (namely that access to the MAP should be based on cases where there has been taxation 'not in accordance with the Convention') does not apply to a MAP under article 4(3).⁸⁸ As such, the dually resident person may access the MAP under article 25(1), irrespective of the fact that he/she has in fact been taxed in accordance with the convention.

The request by the dually resident person must be made as soon as it becomes probable that he/she would be treated as resident in both contracting states. In any case, the request must be made within three years of the person being notified of the dual residency status whereby the competent authorities had not previously endeavoured to resolve the dual residency via mutual agreement and the person was being denied treaty reliefs or exemptions. The OECD recommends that, when deciding under the MAP, the competent authorities clarify the time period to which the decision relates. This is because it is likely that the facts upon which the decision was made changed over time.⁸⁹

⁸⁷ G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, p. 51 (2019), Journal Articles & Papers IBFD.

⁸⁸ G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, p. 52 (2018), Journal Articles & Papers IBFD

⁸⁹ B.R. Obuoforibo, Article 4: Resident - Global Tax Treaty Commentaries, Global Topics IBFD, para 5.2.1.1.1.

4.2.2 Consequences of no mutual agreement

Article 4(3) provides that the dually resident person is barred from the treaty benefit relief and exemptions in the absence of the mutual agreement. However, the taxpayer would still be regarded as a resident of each of the contracting states for purposes other than the granting of treaty reliefs or exemptions except to the extent as may be agreed upon by the competent authorities of the contracting states.

Article 4(3) does not address the situation regarding the application of treaty relief to a person who derives income from a dually resident person other than an individual whose residency status has not been resolved by the MAP. As a result, there are circumstances in which such persons may, by virtue of their dealings with the dual resident, suffer negative tax consequences.⁹⁰ These negative consequences would concern reliefs or exemptions regarding income arising in either contracting state, and even in third states, due to being barred from treaty reliefs and exemptions.⁹¹

In the event of failure by the competent authorities to reach an agreement, the competent authorities may nevertheless agree to avail treaty reliefs and exemptions. It has been suggested that this approach would ensure that each contracting state grants double tax relief for income taxes in the other contracting state even if the other contracting state has not been the taxpayer's state of residence.⁹²

There is no absolute requirement for the competent authorities to find a solution, but only to 'endeavour to determine' the contracting state of which a person is to be treated as a resident. The absence of absolute requirement to find a solution would likely result in the competent authority of the contracting state — who may be unsuccessful in the procedure — having little or no interest in reaching the agreement, leading to a difficulty for the taxpayer to seek redress.⁹³ The suggested solution to such difficulty is suspending

⁹⁰ G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, pp. 63-66 (2018), Journal Articles & Papers IBFD.

⁹¹ Id, pp 57-61.

⁹² Id, pp 63.

⁹³ Id, pp 51.

collection of taxes while a MAP persists — by penalty protection or even by allowing for interest to be paid on any refund of taxes — which is contingent on the agreement.⁹⁴

The question that therefore arises is whether the taxpayer may seek arbitration under article 25(5). The view of the OECD is that the taxpayer may not, as article 25(5) provides access to arbitration for taxation that is ‘not in accordance’ with the double tax treaty. The argument is that failure by competent authorities to resolve dual residency is provided for in the treaty and therefore falls outside the scope of article 25(5). However, it has been counter-argued that the taxpayer should be entitled to article 25(5) if the access to article 25(1) is granted⁹⁵, and that it is even better for tax treaties to mention the entitlement by taxpayers to access arbitration under article 25(5).⁹⁶

One of the most significant drawbacks of the POEM test is that the term ‘POEM’ has been open to different understandings by contracting states, resulting in ambiguity. The question, then, is whether the mutual agreement has remedied this uncertainty. On the divergent side, it would appear that the taxpayer is in an even more perilous and ambiguous state under the POEM rule. One may argue that the mutual agreement provision serves more as a limit than a tool for resolving problems of dual residency: a taxpayer who wishes not to be trapped in such an unsafe place would be careful to order his/her affairs so as to avoid being dually resident.⁹⁷

A group of notable scholars is challenging the OECD’s statement that such dual residency must necessarily have abuse as its aim. The scholars highlight the point of unintended dual residence⁹⁸, particularly as it may affect small and medium-sized enterprises that may lack robust in-house knowledge. The scholars also point out that, even where dual residency may have been intended, this does not on its own point to an

⁹⁴ Id.

⁹⁵ Id, pp 54.

⁹⁶ Id, pp 55.

⁹⁷ B.R. Obuoforibo, Article 4: Resident - Global Tax Treaty Commentaries, Global Topics IBFD, para 5.2.1.3.

⁹⁸ G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, p. 43 (2018), Journal Articles & Papers IBFD. See also C. Gerlach & N. Niemeyer, *The New Tie-Breaker Rule for Companies According to BEPS Action Point 6: A (Too) Radical Change?*, 46 Intertax 10 (2018).

abusive motive.⁹⁹ They cite examples of situations in which dual residency may arise without an abusive motive, which include but are not limited to¹⁰⁰ genuine mergers, regulatory constraints and dually listed companies having the same board of directors.¹⁰¹ In instances where dual residency would be abusive, an alternative solution could be the provision of special anti-abuse rules (SAARs) or general anti-abuse rules (GAARs). The inclusion of the principal purpose test set out in article 29 of the OECD Model (2017) should have rendered the amendments to the dual residency rule unnecessary, as article 29 includes the abuse of dual residency.¹⁰²

Ultimately, the issue that the OECD was attempting to resolve remains the issue of dual residency. This remains an issue because the definition of 'resident' is found within the domestic laws of the contracting states. A much simpler way to proceed would have been for the OECD to provide a complete treaty definition of the term 'resident' — one that does not have recourse to the domestic law of the contracting states.¹⁰³

4.3 PRACTICAL APPLICATION 'CASE STUDY' ON THE SOUTH AFRICAN PERSPECTIVE ON RESOLVING DUAL RESIDENCY DISPUTES

Multinational corporations may find that they are simultaneously resident in two countries under the domestic laws of each of the countries. In these circumstances, contemporary tax treaties have tie-breaker rules to determine dual residency. The tie-breaker rule is essentially a test that enables the company to determine residency for tax purposes. Under the new test, the future of a company's taxation jurisdiction is at the government's discretion, with the outcome contingent solely on discretionary negotiation.

⁹⁹ G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, p. 43 (2018), Journal Articles & Papers IBFD. The authors concede that this scenario might more readily appear within Europe as a result of the way companies operate frequently across borders.

¹⁰⁰ Id., pp 43.

¹⁰¹ J.S. Wilkie, Article 25: Mutual Agreement Procedure - Global Tax Treaty Commentaries, Global Tax Treaty Commentaries IBFD, para 5.2.2.1.

¹⁰² G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 Intl. Tax Stud. 1, pp. 46-47 (2018).

¹⁰³ Id.

In resolving dual residency conflicts concerning companies, some countries give preference to the place of incorporation. This approach might be taken by countries that determine residency based on incorporation. The issue arises when place of incorporation and effective management differ, or where two countries simultaneously claim effective management.

Below is the illustration of the operation of the tie-breaker rule in the case of Company A incorporated in Lesotho and Company B incorporated in Botswana. Company C is tax resident in South Africa and a headquarter company for both Companies A and B. Company D is a supplier to Company A.

4.3.1 Lesotho

Company D appointed Company C as its exclusive dealer in South Africa, Lesotho and Swaziland. Company C in turn appointed Company A as its dealer representative for Company D's products in Lesotho. Company A distributes Company D's equipment to customers situated in Lesotho and provides after-sales service to customers in Lesotho in relation to caterpillar equipment.

In terms of Lesotho tax legislation, a company is tax resident in Lesotho if it is incorporated into or formed under the laws of Lesotho (see section 6(1) of the Income Tax Act of Lesotho, Act No 9 of 1993 [the 'Lesotho Tax Act']).

The date of entry into force of the new South Africa-Lesotho DTA was 27 May 2016. Its provisions applied in relation to taxes withheld at source from 26 June 2016 and for all other taxes from the first year of assessment after 26 June 2016.

As mentioned above, in terms of domestic legislation of South Africa, a company is a resident if effectively managed in South Africa because all the key management and commercial decisions.

Based on the above, Company A, in terms of the domestic legislation, is a resident in both Lesotho and South Africa as a result of its incorporation in Lesotho and effectively managed in South Africa. The DTA between South Africa and Lesotho in relation to residency provides as follows in terms of article 4:

1. For the purposes of this Agreement, 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 that person's domicile, residence, place of management or any other criterion of a similar nature, and 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 therein.
2. Whereby 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 by mutual agreement endeavour to determine the mode of application of the Agreement to the person. In the absence of such agreement by the competent authorities of the Contracting States, the person shall not be entitled to any relief or exemption from tax provided by the Agreement.

Company A would approach the competent authority of South Africa to determine the tax residency status of Company A by mutual agreement. The competent authorities of South Africa and Lesotho would endeavour to reach an agreement on determining the tax [residency status] of the company in terms of article 4(3) of the Lesotho-South Africa DTA. In the event that no agreement could be reached, the MAP case would be closed.

The implication of no agreement is that a company cannot rely on the reduced withholding tax rates provided for under the two countries' DTA. In relation to the case study, SARS would view the company in Lesotho as a South African resident and would henceforth deny a DTA rate. A company attempting to determine its tax residency status could approach the other country's tax authority — which is Lesotho in this case — to gain DTA rates on transactions sourced in Lesotho but paid to South Africa. Lesotho in this case does not consider the company incorporated in Lesotho to be a South African resident. The company is therefore liable to taxation in both South Africa and Lesotho.

SARS is of the view that in the event that two countries cannot reach a DTA, the taxpayer may not enjoy tax relief 'except to the extent and in such a manner as may be agreed

upon by the competent authorities.’ This clause is not contained in article 4(3) of the South Africa-Lesotho DTA. The DTA is not open for the competent authority to have the discretion to decide on relief or exemptions. The companies may use the exemptions under domestic law. The competent authority will refer to the applicable exemption under domestic law, specifically for dividends, and will express that those dividends are exempt from tax in South Africa.¹⁰⁴ Company C could apply for any domestic relief applicable under the LRA.

4.3.2 Botswana

Company B is incorporated in Botswana and is therefore tax resident in Botswana under Botswana domestic legislation.

The strategic and commercial decisions relating to Company B are taken in South Africa by an executive team located in and working from South Africa. The executive team does not attend any board or executive meetings in Botswana, as these meetings are held in South Africa.

In terms of the principles laid down in SARS’ IN6 (Issue 2), the POEM of Company B is South Africa. This means that Company B is tax resident in both Botswana and South Africa — hence the request that the matter be resolved in terms of the tie-breaker rules contained in the South Africa-Botswana DTA which provides that ‘the competent authorities of the Contracting States shall settle the question by mutual agreement.’¹⁰⁵

Table 4.1 sets out factors that the competent authorities of South Africa and Botswana may consider when forming an overview of Company B and when endeavouring to conclude the MAP process.

Table 4.1 An example of the questionnaire and responses as part of the MAP in relation to Company B with the competent authority of Botswana.

¹⁰⁴ Section 64F(1)(a), section 10(1)(k)(i) of the Income Tax Act 58 of 1962.

¹⁰⁵ South Africa-Botswana DTA, article 4(3).

<p>1. Where are the meetings of Company B's board of directors — or its counterpart — usually held (that is, meetings relating to key management and commercial decisions which are essential for the conduct of the organisation's business as a whole)?</p>
<ul style="list-style-type: none"> ▪ Board meetings of Company B are held via round robin in South Africa and Botswana. The meetings are therefore not physically held in either South Africa or Botswana.
<p>2. Where do the chief executive officer (CEO) and other senior executives usually conduct their activities?</p>
<ul style="list-style-type: none"> ▪ Company B is managed from South Africa. Company B does not employ senior managers in Botswana. The senior executives in charge of Company B do not travel to Botswana on a regular basis. ▪ Company B does not have any employees (all employees required for fulfilling the company's obligations in terms of the transportation contract, which is its sole business activity, are provided by a labour broker).
<p>3. Where is the senior routine management of the company conducted?</p>
<ul style="list-style-type: none"> ▪ Company B does not employ senior management in Botswana (see response to question 2 above). The senior day-to-day management is conducted in South Africa.
<p>4. Where are the company's headquarters located?</p>
<ul style="list-style-type: none"> ▪ South Africa.

5. Which country's laws govern the company in terms of its legal status?
<ul style="list-style-type: none"> ▪ As Company B is incorporated in Botswana, Botswana's laws govern the company.
6. Where are Company B's accounting records kept?
<ul style="list-style-type: none"> ▪ South Africa.
7. How many board or similar meetings were held from 1 October 2015 to 1 October 2017? Kindly supply a list of the dates and location(s) of the meetings held. SARS may select minutes of meetings for further discussion.
<ul style="list-style-type: none"> ▪ No meetings were held.
8. Kindly provide details of the person or persons who make the key management and commercial decisions for conduct of the entity's business as a whole ('key decisions'), setting out their responsibilities.
<ul style="list-style-type: none"> ▪ The CEO and financial director, together with executive team, make the key decisions and are based in South Africa.
9. Kindly provide the letter of authority or documents to substantiate the role and level of authority bestowed on these persons to make such key decisions. Is there a distinction between senior management's level of authority in making decisions in South Africa and senior management in Botswana? Please provide documents to substantiate. Please provide a list of all employees of the company, their job descriptions and where they are located.
<ul style="list-style-type: none"> ▪ No decisions are taken in Botswana. As noted, Company B does not have any employees.
10. Where is the head office of the company located from which orders are issued (that is, where is the chief administrative office of the organisation)?

<ul style="list-style-type: none"> ▪ South Africa.
<p>11. What other records are kept at the head office? SARS has noted that accounting records are kept in South Africa.</p>
<ul style="list-style-type: none"> ▪ Except for the secretarial work that is outsourced to a service provided in Botswana, all records are kept in South Africa.
<p>12. Are any meetings where key decisions for the conduct of the company's business as a whole are made, held in Botswana? If yes, how frequently?</p>
<ul style="list-style-type: none"> ▪ No meetings are held in Botswana.
<p>13. Are any discussions held via telecom meetings where key decisions are taken? If yes, how regularly are key decisions made and where are the directors [persons — see question 2] responsible for the key decisions located at the time of the telecom meetings?</p>
<ul style="list-style-type: none"> ▪ No meetings are held via telecom.
<p>14. Please explain the process of making key decisions, the approval thereof and the ultimate implementation. Are decisions taken approved at the meetings or separately approved, and by whom and what records are kept of the approval of these key decisions? Kindly provide documentation that reflects the approval given relating to key decisions.</p>
<ul style="list-style-type: none"> ▪ Discussions and decisions taken form part of management meetings in Company B with Management Committee.
<p>15. Do the persons taking the key decisions retain and exercise their authority to govern the company? Are any powers delegated?</p>
<ul style="list-style-type: none"> ▪ The powers are vested in the three directors of the company: the CEO, the chief financial officer (CFO) and the chief operating officer (COO). They are all located in South Africa. None of their powers are delegated.

16. Are the directors involved in the decision-making or approval (ratifying) of a decision made by others?
<ul style="list-style-type: none"> ▪ All decisions are made by the management team in South Africa and these decisions are not subject to ratification by any other person.
17. Are decisions made by circular resolution or round robin voting? If yes, how frequently are decisions made in that manner and where are the parties involved located?
<ul style="list-style-type: none"> ▪ All decisions are made by the management team in South Africa.
18. Is there a limitation on the level of authority placed by the shareholders in the making of key decisions?
<ul style="list-style-type: none"> ▪ There is a letter of authority.

The consideration by the Botswana Revenue Authority to the MAP, which commenced in October 2016, was finally received in October 2021. Botswana's view is the following:

...[A]n agreement may not be reached in this case. The Competent Authority of Botswana holds a strong view that place of incorporation forms the primary basis upon which residency is determined under the DTA. Botswana therefore conclude that in their view, the taxpayer is a resident of Botswana for tax purposes and the relevant taxes will apply to [the taxpayer].

Though the Botswana and Lesotho cases were not resolved, the taxpayer would still not be able proceed to arbitration as South Africa has not committed to MAP arbitration under article 14 with any of the African countries.¹⁰⁶

¹⁰⁶ SARS Guide on Mutual Agreement Procedures (Issue 3) 20 March 2020, para 7.4.

4.3.3 In practice, the mutual agreement process takes more than 24 months to complete and places a significant strain on SARS' resources. In the interim period, the company is placed in a highly precarious tax position as it does not know where it is resident for tax purposes. In this regard, it is important to note that the mutual agreement process may serve as the tie-breaker rule in all of South Africa's DTAs as South Africa has signed the Multilateral Instrument developed by the OECD and has indicated that it will follow article 4 thereof. Paragraph 1 of article 4 reads as follows:

Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, 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 the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.

4.3.4 Where POEM is the tie-breaker, it is in practice very difficult to explain to the other tax authority that the company is now resident in South Africa despite being incorporated in another country. This will undoubtedly have an impact on withholding taxes. Some source-based countries even deny access to the DTA tie-breaker rule based on the wording of article 4(1), which excludes from the definition of resident in the DTA any person who is liable to tax in that State in respect only of income from sources therein.

This is despite the OECD elucidating that this is not the intention behind the exclusion in paragraph 8 of the commentary on paragraph 4 of the Model Tax Treaty¹⁰⁷, which goes as follows:

[T]hus [the DTA tie-breaker rule] has to be interpreted restrictively because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation — a result which is clearly not intended.

4.3.5 There are several MAPs that have been instituted where the process either remains ongoing (two years under way) or the competent authorities cannot not reach an agreement despite overwhelming evidence that the entity was effectively managed in South Africa. The consequence of this is the company becoming tax resident in both countries. This leads to a further period of uncertainty — that is, both competent authorities need to endeavour to agree on the extent of the entity being able to rely on tax treaty relief provided for in the tax treaty.¹⁰⁸

4.3.6 It is plain that the tax authorities in Botswana and Lesotho are resisting all attempts to acknowledge residency based on effective management above residency principle, which results from incorporation.

4.3.7 The South African Act is not written with these situations in mind, which, in certain instances, prejudices the foreign incorporated companies with South African tax residency status.

4.4 SUMMARY

The mutual agreement tie-breaker may be perceived as an obstruction to trade and investment and therefore not feasible. SARS is of the view that in the 'unlikely event' that a mutual agreement cannot be reached, the section 6 rebate authorises tax relief for tax paid by a resident company in a foreign country. This way, double taxation can be averted.

¹⁰⁷ Commentary on article 4 of the OECD Model 2014. <http://www.oecd.org/tax/transfer-pricing/36221030.pdf>

¹⁰⁸ South Africa dispute resolution profile. <https://www.oecd.org/tax/dispute/south-africa-dispute-resolution-profile.pdf>; <https://www.oecd.org/tax/dispute/2020-map-statistics-south-africa.pdf>.

The South Africa-Africa treaties with Botswana and Lesotho which were selected for the above case study contain OECD mutual agreement tie-breaker rules. These rules do not place any obligation on the contracting states to resolve the dual residency dispute by reaching a mutual agreement. Instead, agreements are entirely discretionary.

Using a mutual tie-breaker rule to settle the matter of dual corporate residence is by no means distinctive to the South Africa-Mauritius DTA. South Africa first adopted the mutual tie-breaker rule in 1995 in its tax treaties with Finland and Poland. Apparently, the rationale behind the mutual tie-breaker rule is to prevent the utilisation of dual residence companies by penalising such utilisation with double taxation, which can only be averted if the dual resident takes measures itself.

The phrase 'the competent authorities shall endeavour to determine by mutual agreement' is found in most South African DTA mutual agreement tie-breaker rules. Considering this, there is the eventuality of the competent authorities failing to agree on a single country of residence. In this case, a company could find itself being considered as a resident by both contracting states as in the above examples of Lesotho and Botswana. The company would be obliged to pay taxes in both states. Article 4 paragraph (3) of the South African-Lesotho and Botswana DTA sets out the provisions for a competent tie-breaker rule:

In Lesotho, there is a MAP provision which expresses that there is no entitlement to any treaty relief or exemption whatsoever. Botswana has a simplified MAP rule: if the taxpayer is a dual resident, there should be a MAP, with no explanation of how the agreement should be achieved or the implications of no agreement.

Essentially, this dual residence tie-breaker rule follows the other test under paragraph 24.1 proposed by the commentary to the OECD Model Tax Convention. If South Africa, Lesotho and Botswana cannot reach a consensus as to where the company is resident, the company will be a resident in both countries and taxed on residency basis in both.

Therefore, it is prudent for taxpayers to plan satisfactorily by ensuring that the company's structure is set up solely in one country or another. It is not incumbent on the contracting states to settle the double taxation dispute if either country chooses not to take measures.

It appears that the company considered resident in the contracting states is responsible for initiating the MAP in the DTA. It is likely that dual residency presents tax advantages, one of which may be the right to set off the same loss in both contracting countries to duplicate a loss.

Interestingly, the South Africa tie-breaker provision does not express any determinants for dual corporate residency within its tax treaty. The determination is entirely discretionary under the limited wording of the law. To make the process more transparent, however, South Africa and Mauritius signed a Memorandum of Understanding (MOU) on 22 May 2015. The MOU contains the factors that both contracting states' competent authorities must use when entering discussions to settle the dual fiscal domicile of companies. (See *Ben Nevis Holdings Ltd & Another v Commissioner for HM Revenue & Customs* [2013] EWCA CIV 578, where the court held that, for the purpose of fairness, an MOU be readily available to taxpayers as the MOU may have a significant bearing on the position of taxpayers.) The determinants in the MOU are in accordance with the amendments to paragraph 24 of the commentary on article 4, which contains the UN Model Taxation Convention and the OECD's BEPS final report. According to the MOU, corporate residency may be decided by the following factors: where the CEO and other senior executives normally conduct their business activities; where the senior management of the resident in question is routinely conducted; where the resident in question's headquarters are situated; which country's laws govern the legal status of the individual; where the resident in question's accounting records are held; any other factors listed in paragraph 24.1 of the 2014 OECD commentary (article 4, paragraph 3), as may be amended by the OECD/BEPS Action 6 Report; and any such other factors that may be recognised and agreed upon by the competent authorities in deciding the residency of the individual.

The order in which the factors appear is arranged according to rank, meaning that those at the top of the list are paramount. These factors are centred around economic nexuses to make certain that the economic substance in a contracting country is considered. However, the MOU provides no indication as to how long it will take for the relevant competent authorities to settle any tie-breaker issues. Until there is a competent authority

resolution, companies will possibly be subject to double taxation. Regarding the South African tax treaty policy, it appears that the South Africa–Mauritius tax treaty is the only route for tie-breaker treaty clauses. Consequently, if dual residency exists, no relief can be supposed by way of treaty or otherwise. Tax planners will need to proceed by arranging their affairs with greater care. True substance substantiated by administrative proof will be the predominant practice.¹⁰⁹

¹⁰⁹ A South African perspective on resolving dual residence disputes, Ben Johannes, South Africa Institute of Tax Practitioners, 1 January 2016.

CHAPTER 5

DISCUSSION OF POSSIBLE SOLUTIONS TO CHALLENGES ARISING FROM THIS STUDY

5.1 INTRODUCTION

Globalisation and technological advancements have led to the integration of economies, enabling multinational enterprises (MNEs) to operate more efficiently and adapt their supply chains to new ways of doing business. This development presents both opportunities and challenges for stakeholders. A notable opportunity is the ease of operation and access to the international economy. However, MNEs often operate through intricate structures, presenting both administrative and technical challenges.

Recently, there have been myriad discussions to find solutions to enable countries to safeguard their tax bases. Cross-border transactions that frequently receive attention include management and technical service payments, interest payments and royalty payments. In view of this, most countries now apply domestic legislation that refuses treaty benefits and disallows or restricts deductions. Tax disputes may result, which can take lengthy periods to settle. Most countries have a pile-up of tax cases and there is a great need to settle these disputes.¹¹⁰

For these reasons there have been developments in the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, which commenced in 2013. The intention of the BEPS Project was to address the concerns of countries worldwide regarding the erosion of their tax bases. Base erosion is a consequence of discrepancies in a country's tax rules. These discrepancies enable the use of planning strategies that move profits to low or no-tax jurisdictions with minimal or no economic activity. These discrepancies arise from the interplay between different countries' national rules in the context of cross-border dealings and transactions involving MNEs. The BEPS Project initially launched as an enterprise

¹¹⁰ E. Muyaa, Introduction in Base Erosion and Profit Shifting: A Blueprint for Africa's Response (IBFD 2021), Books IBFD.

driven mainly by advanced economies (OECD member states). It was later opened to others to participate, including developing countries, through the Inclusive Framework initiative. The Inclusive Framework was founded in 2016 in acknowledgement of the important role that developing countries could play in ensuring a feasible global tax framework through the application of the BEPS Package. As of February 2021, the BEPS Project has 139 member states.¹¹¹

Chapter five unpacks the challenges highlighted in the previous chapters of using the POEM as a determinant of residency in the context of Africa. It also analyses how a tie-breaker can be resolved. Moreover, it suggests potential solutions proposed by the OECD, considering the cases associated with trading in Africa.

5.2 INCONSISTENT AND DIFFERENT INTERPRETATIONS OF THE TERM ‘POEM’

Chapter two of the study explored the meaning of the term POEM, and the challenge that arose due to the different interpretations. For ease of reference, included below is a summary of the different views regarding the term POEM.

Case law interpretation

In the court of law, it was decided that effective management was situated in the tax jurisdiction wherein key management decisions and commercial decisions essential to the conduct of the entity's business were made, a place where senior management (for example, a board of directors) made its decisions and where the actions to be taken by the entity as a whole were decided.¹¹²

The views of commentators

Vogel's view is that the POEM is found where the key management policies are decided. What is crucial is where the directives are given and where the location of commercial management is.¹¹³

¹¹¹ Id.

¹¹² Chapter 2, para 2.3.

¹¹³ Chapter 2, para 2.5.

Domestic law interpretation contained in the residency tests in Botswana and Lesotho¹¹⁴

- Botswana and Lesotho drew their POEM definition from the *De Beers* case. POEM is where the central management and control resides.

OECD'S and SARS' interpretation

SARS' interpretation is aligned to that of the OECD's. SARS defines the term POEM to mean:

[A] Place where the meetings of the board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on and where the person's headquarters are located.¹¹⁵

5.2.1 Summary

A major challenge is that the OECD does not in itself provide a specific definition of the term 'POEM', and hence some countries have resorted to using their own domestic definitions as provided for by article 3(2) of the OECD Model Convention. The OECD Model Convention also makes clear that though article 3(2) allows countries to apply domestic definitions to the term 'POEM', the definition must be done in the context of the intentions of the OECD Model Convention. In addition, the OECD is clear that there can only be one POEM at any one time.¹¹⁶

Despite the invaluable guidance provided by SARS in IN6 (Issue 2) to interpret the term POEM, the IN is not law and it has been maintained in several cases that SARS is not obliged to use interpretations in its Practice Notes and Interpretation Notes. This therefore

¹¹⁴ Chapter 2 above, para 2.4.1.

¹¹⁵ OECD Model Tax Convention on Income and on Capital 2017: Commentary on Article 4 para. 24.1; Id.

¹¹⁶ Oguttu, Annet Wanyana. "Resolving Double Taxation: The Concept 'place of Effective Management' Analysed from a South African Perspective." *The Comparative and International Law Journal of Southern Africa*, vol. 41, no. 1, Institute of Foreign and Comparative Law, 2008, page 87, <http://www.jstor.org/stable/23252719>.

implies that South Africa courts in general are not bound by Practice Notes and Interpretation Notes.¹¹⁷

SARS' interpretation provides a non-exhaustive list of factors that may be relevant when determining POEM. However, it is not clear if all the factors carry the same weight.

Though there are differences in interpretation, there is a strong unanimity that POEM should be interpreted as the place where the decisions by the top management in substance are reached.

5.2.2 Possible solutions

The recommendation is that SARS' interpretation be given force of law by inserting the definition of POEM into subsection section 1 of the Income Tax Act as was recommended in the Katz Commission Report. This would serve as valuable guidance to the taxpayers and competent authorities in determining the residence of a dually resident company.¹¹⁸

5.3 DIVISIONAL GROUP STRUCTURES WITHIN A MULTINATIONAL GROUP

5.3.1 Summary

Multinationals companies that are legal entities but are run through the divisions in which they operate may have an impact on deciding of the POEM and residency of the legal entity. IN6 (Issue 2) also acknowledges the difficulties that can arise in determining the POEM of entities that are part of a multinational group managed according to divisions.

In a Divisional group structure, the local management in a foreign subsidiary may not be sufficiently senior to be regarded as part of the top management of the division "calling the shots" but are nonetheless senior managers executing and implementing key decisions in-country.

¹¹⁷ Id, page 102.

¹¹⁸ Id, page 104.

Despite the fact that the foreign subsidiaries have well established foreign operations and have been incorporated in each respective country for commercial reasons, these companies are effectively managed in South Africa and therefore South African resident as well as resident in their country of incorporation.

5.3.2 Possible solutions

Consideration should be given to reintroducing the amendment to the section 1 definition of “resident” introduced by section 2(1)(w) of the Taxation Laws Amendment Act of 2012 which in short, exclude the POEM trigger in relation to controlled foreign companies in high tax jurisdictions with foreign business establishments. This amendment resolved many of the practical problems set out above.

5.4 RESOLVING THE CHALLENGES OF MAP TREATY DISPUTES

The OECD has previously conducted work to determine the reason for ineffectiveness of MAPs and solutions to making MAPs effective. The OECD’s first work on MAPs was its 2004 report titled ‘Improving the Process for Resolving International Tax Disputes’, which put together proposals on resolving cross-border tax disputes. Following this report, in 2006 the discussion draft for public comment was released by the OECD, titled ‘Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes’¹¹⁹, which recommended that arbitration provisions be added to the MAP process in the draft changes to the OECD Model as well as for the purpose of developing an online manual on effective mutual agreement procedures.¹²⁰ This resulted in the 2007 report titled ‘Improving the Resolution of Tax Treaty Disputes’¹²¹ and the development of a ‘Manual

¹¹⁹ OECD, *Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes* (OECD 2006), International Organizations’ Documentation IBFD.

¹²⁰ Id

¹²¹ OECD, *Improving the Resolution of Tax Treaty Disputes* (OECD 2007), International Organizations’ Documentation IBFD, also available at www.oecd.org/ctp/dispute/38055311.pdf .

on Effective Mutual Agreement Procedures' (MEMAP).¹²² These comprise of reports on the operation of MAPs and the best practices regarding MAPs.

Despite the recommendations, the desired progress was not achieved on resolving treaty disputes under MAPs. At a 2012 OECD Roundtable on Dispute Resolution,¹²³ concerns were raised by practitioners about the obstacles to accessing MAPs, the ineffectiveness of MAPs in multilateral cases, the numerous MAP practical issues and the restricted number of arbitration provisions in tax treaties.¹²⁴ The OECD acknowledged that the effective and efficient dispute resolution mechanisms were of crucial importance with regards to the implementation of tax treaties and that increasing the operation of the MAP, such as by the inclusion of arbitration, required urgent attention.¹²⁵

5.4.1 Summary

5.4.1.1 The challenges are lack of resources, lack of mutual trust and inadequate empowerment among competent authorities to reach principled case resolutions. As a result, it is difficult to obtain MAP statistics for most developing countries.¹²⁶

5.4.1.2 There is a lack of an arbitration provision in most tax treaties.

- Though many states from developed countries have renegotiated treaties to include arbitration clauses, none of the states from developing countries (including the states with MAP clauses discussed in chapter four above) include the arbitration provision in their treaties.¹²⁷ One reason for this is that in some countries, there are difficulties regarding the interrelationship between domestic

¹²² OECD, Manual on Effective Mutual Agreement Procedures (OECD 2007), International Organizations' Documentation IBFD, also available at www.oecd.org/ctp/38061910.pdf.

¹²³ OECD, Obstacles that Prevent Countries from Resolving Treaty Related Disputes Under the Mutual Agreement Procedure para. 7 (OECD 2015).

¹²⁴ Id.

¹²⁵ Resolving Treaty Disputes: The Challenges of Mutual Agreement Procedures with a Special Focus on Issues for Developing Countries in Africa, Annet Wanyana Oguttu, para 4.1, page 730; Id, para 9.

¹²⁶ Id, para 61.1, page 734.

¹²⁷ <https://www.oecd.org/tax/dispute/country-map-profiles.htm>.

court decisions and MAP decisions. Countries are free to exclude arbitration from the tax treaties.¹²⁸ The other reason is that the other countries cannot successfully implement the arbitration provision where domestic law does not permit the MAP decision to override a court decision.¹²⁹

- Currently, tax arbitral proceedings are confidential. There are no publicly available outcomes with regards to MAPs. The justification for confidentiality is that taxpayers do not want their tax strategies to be public; confidentiality enables flexibility in realising a mutually acceptable result between governments without any external influences. However, secrecy in respect of MAPs means it is challenging for countries to draw on the experience gained in each case or to monitor the fairness and effectiveness of the arbitration process. The emphasis placed on confidentiality over transparency makes it difficult to be confident in the system as taxpayers cannot ascertain if the same decision would have been applied in other similar cases.¹³⁰
- Guidance as to the selection of arbitrators is limited. Accordingly, there is no guarantee that the arbitrators will be impartial.¹³¹

5.4.1.3 There are concerns around sovereignty with respect to the tax treaty's intentions; the treaty confers too much discretionary power on individuals who are third parties. These individuals can decide on tax treaty matters without the possibility of any other party reviewing or challenging such decisions. Checks and balances regarding the actions taken by the

¹²⁸ The footnote at the end of art. 25(5) OECD Model (2014) states that: "In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so. However, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals."

¹²⁹ OECD Model: Commentary on Article 25(5) (2014), para 65.

¹³⁰ Resolving Treaty Disputes: The Challenges of Mutual Agreement Procedures with a Special Focus on Issues for Developing Countries in Africa, Annet Wanyana Oguttu, para 6.2.1, page 735.

¹³¹ Id, para 6.2.2, page 734.

arbitrators — as well as logistical costs relating to the process — are lacking.¹³²

5.4.2 Possible solutions

- 5.4.2.1 The OECD formed a forum¹³³ to address the administrative and practical challenges by providing the competent authorities with adequate resources to individual agreements under negotiating MAP.
- 5.4.2.2 The UN recommends that the tax administrators set aside funds to train their employees on MAP.
- 5.4.2.3 In other instances, states have entered into what is termed ‘optional arbitration’, which does not require a state to submit a case for arbitration, except where both Competent Authorities (CAs) and the taxpayer agree to do so. In other tax treaties, even though the equivalent of article 25(2)(b) of the OECD Model provides that a person may present a case for arbitration within two years, the tax treaties may or may not set a time limit as to when the arbitration process may commence if the agreement has not been reached.¹³⁴
- 5.4.2.4 The OECD recommends that, even where contracting states have not included an arbitration clause in a tax treaty, it is still possible for these states — if they so wish — to implement an arbitration process for general application or to deal with a specific case by mutual agreement.¹³⁵
- 5.4.2.5 The OECD acknowledges the dynamics associated with MAPs — that is, with and without arbitration — and is committed to working on articulating explicitly the circumstances in which a state, in a manner consistent with its treaty

¹³² Id, para 6.2.6, page 734.

¹³³ OECD Forum on Tax Administration (FTA), Mutual Agreement Procedure Forum (OECD 2013/2014), available at www.oecd.org/site/ctpfta/ftaworkprogramme201213.htm

¹³⁴ Id para 24.

¹³⁵ OECD Model 2017: Commentary on Article 25(5), para 69.

- obligations and the principles of treaty interpretation contained in the Vienna Convention (1969), may justifiably deny access to MAPs.¹³⁶
- 5.4.2.6 Countries should ensure that their administrative processes promote the prompt resolution of treaty-related disputes.
- 5.4.2.7 Countries ought to publish guidance on MAP and ensure that the agreement reached is implemented regardless of any limitations in the domestic law.
- 5.4.2.8 Article 14 of the OECD recommends the best practices for MAP, which are:
- to include the equivalent of article 9(2) of the OECD Model in their tax treaties and include the economic double taxation which results from the inclusion of profits of associated enterprises in article 9(1). Double taxation not in accordance with a tax treaty should fall within the scope of a MAP;
 - to publish agreements reached between states in terms of article 25(3) of the OECD Model;
 - to develop the 'global awareness' of the audit and/or examination functions involved in international matters by ensuring that personnel attend the Global Awareness Training Module of the OECD's Forum on Tax Administration (FTA);
 - to implement bilateral advance pricing agreements (APAs) programmes;
 - to permit taxpayer requests for multi-year MAPs with regards to recurring issues in respect of filed tax years where the relevant facts and circumstances have been verified through audit;
 - to suspend the collection of tax during a MAP process, as taxpayers may face financial difficulties and double taxation if both countries collect the disputed taxes. Moreover, a CA may find it difficult to enter into MAP discussions in good faith if he/she may have to refund taxes already collected;
 - to implement administrative measures to facilitate taxpayer recourse to MAPs, in recognising that the choice of remedies remains with the taxpayer;

¹³⁶ Oguttu, A. W. (2015). Resolving Double Tax Treaty Disputes: The Challenges of Mutual Agreement Procedure with a Special Focus on Addressing the Concerns of Developing Countries in Africa, para 4.2.6.

- to ensure that published MAP guidance deals with the relationship between MAPs and domestic law administrative and judicial remedies, as well as whether the relevant CA is legally bound to follow a domestic court decision instead of the MAP decision; and
- to allow taxpayers to access MAPs in the case of bona fide taxpayer-initiated foreign adjustments that are allowed under the domestic laws of a treaty partner state. A taxpayer is permitted to amend a previously filed tax return and to make adjustments thereof.

CHAPTER 6

CLOSING CHAPTER

6.1 INTRODUCTION

“The chief objective of this study was to answer the question concerning the practical challenges in the application and interpretation of the ‘place of effective management’ in tax treaties. This was for the purpose of establishing the residency of South African-headquartered companies investing in selected African jurisdictions.

Even though article 4(3) of the OECD Model expresses that there can only be one POEM, there could in practice be more than one place considering the OECD’s Interpretation Note’s emphasis on the location of senior management. This can lead to multiple places of effective management.¹³⁷

In the past, many senior managers used to operate and convene in one location — such as the head office — and, as a result, it was not difficult to establish the place where key management and commercial decisions were taken. The place where key management and commercial decisions would normally occur were where the company was incorporated, where directors and senior managers resided and where business activities occurred.¹³⁸ It was therefore not common to have more than one location of effective management.

However, the way people run their businesses has evolved significantly due to developments in communications and technology. E-commerce activities, which can be performed with little physical interaction, can result in certain functions easily moving from one country to another. The increased movement of resources and functions performed can be reorganised and have a significant impact on the taxation of dual residents and

¹³⁷ Resolving Treaty Disputes: The Challenges of Mutual Agreement Procedures with a Special Focus on Issues for Developing Countries in Africa, Annet Wanyana Oguttu, page 87.

¹³⁸ Id.

POEM as a tie-breaker rule. Consequently, global communications are rising beyond territories and laws based on geographic boundaries are being undermined.¹³⁹

The Australian Tax Office notes that:

The instantaneous and global facilities by the internet are expected to allow residents to influence the operations of their offshore subsidiaries more easily (which will include tax-haven entities). There is no clear guidance as to where such a business will be regarded as being carried on....The possibilities of the undetected, anonymous or unverifiable nature of these transactions could make it even more difficult...to obtain evidence of these activities should a taxpayer wish to conceal or disguise them.¹⁴⁰

Technology may render it problematic to determine the single POEM in the instance where the board of directors of a multinational enterprise agrees to meet on a rotational basis at different group offices around the globe. Due to such mobility, it may become difficult to determine the POEM.

Two major changes have led to the question of whether the POEM is an appropriate tie-breaker for headquarter companies in South Africa. The first change is that of the modus operandi of the boards of multinationals: due to advancements in telecommunications, the traditional practice of board directors convening to make key management decisions in a single place is declining. The second change is that of multinationals: companies tend to be run more through the divisions in which they operate rather than the legal entities in which the components of those divisions are found.¹⁴¹

¹³⁹The law of the Internet in South Africa, second edition, 2004 at 300, R Buys and F Cronje Cyber Law.

¹⁴⁰ Australian Taxation Office 'Electronic commerce project: tax and internet', 1997, para 7.2.2.1. Available at www.cse.buffalo.edu/DBGGROUP?nov6taxinte.pdf.

¹⁴¹ Confédération Fiscale Européenne 'Opinion statement: place of effective management- suggestions for changes to the OECD Model', 2003 at 2, available at http://european-tax-adviser.com/wordpress/wp-content/uploads/2007/08/2003_07.pdf.

6.2 MOST SUITABLE OPTIONS TO ADDRESS CURRENT CHALLENGES AND LIMITATIONS OF THE STUDY

It is recommended that the revised IN6 (Issue 2) considers the unique circumstances associated with trading in Africa. In the context of Africa, there is a strong case that the test for residency should consider where the economic nexus is strongest.

Consideration should be given to reintroducing the amendment to the definition of 'resident' to exclude the POEM. This is particularly relevant to controlled foreign companies in high tax jurisdictions with foreign business establishments. It is South Africa's policy to be the gateway into Africa, but adopting principles and practices that were designed for high-income countries without modification may hinder the achievement if commerce is the objective.

It recommended that IN6 (Issue 2) provides guidance on the interpretation of the term 'effective management' when dealing with a treaty partner. When domestic legislation is in contradiction to a provision in a DTA, the DTA overrides domestic legislation. The argument can therefore be made that when interpreting the term 'effective management' in the context of a DTA, the definition proposed by the OECD commentary on the Model Tax Treaty should prevail. However, the application of the tie-breaker rule in the Model Tax Treaty can be problematic for South African companies operating in other African countries for the above-mentioned reasons.

The guidance provided in the IN to distinguish between what key operational management decisions are versus what the key management and commercial decisions are, are not sufficient when considering the central importance of the concept of 'key management and commercial decisions' in the determination of POEM.¹⁴²

The focus should be on the purpose behind why certain processes are implemented. If the purpose is to manage an entity from a foreign jurisdiction, then it could be argued that the place of management should be where these types of transactions are approved. However, if the reason for not duplicating a specific function in multiple countries is

¹⁴² SARS Interpretation Note 6 (Issue 2), Para 4.2.6.

because it is commercially unsustainable to do so, then adding the administrative burden in respect of compliance (especially in high tax jurisdictions) does not add value to parties involved.

6.3 CONSIDERATIONS FOR FUTURE RESEARCH

The tax challenges that have been realised are unique to digital business models. Future research could be conducted on the unique challenges that multinational businesses with a significant digital (but little physical) presence encounter, as well as value creation. This can be done through using voluntarily provided user data to resolve any double taxation issues that may arise. Moreover, further research could be conducted on solutions to promote tax certainty through mandatory and binding dispute resolution procedures where competent authorities are not only instructed to endeavour but are required to succeed. Furthermore, research should be conducted as to which arbitration processes are most suitable for developing countries.

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