

**A CRITICAL ANALYSIS OF THE IMPACT OF THE MLI IN THE  
DETERMINATION OF CORPORATE RESIDENCY IN SOUTH  
AFRICA: A SYNTHESIS OF A HIERARCHY OF FACTORS TO  
USED FOR RESOLVING DUAL RESIDENCY UNDER MAP**

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**Student:** Akira Naamdhew

**Student Number:** NMDAKI001

**Supervisor:** Dr Alison Futter

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## DECLARATION

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## ABSTRACT

South Africa was a signatory to the Multilateral Instrument (“MLI”) on 7 June 2021. South Africa has deposited its ratified, accepted, and approved MLI and list of reservations and notification with the OECD on 30 September 2022. The MLI applies from 1 January 2023 in South Africa.

In alignment with the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) Action 6, South Africa has elected to include Article 4(1) of the MLI. Article 4(1) deals with the determination of corporate residency and modifies the existing tie-breaker rule in South Africa’s Double Taxation Agreements (“DTAs”) to solving cases of dual residency through a Mutual Agreement Procedure (“MAP”). The MLI’s approach of using MAP as a tie-breaker includes a non-exhaustive list of criteria that tax authorities may consider as relevant. This approach lacks clear criteria of factors to resolve dual residency, which may lead to delays, uncertainty, and the risk of double taxation where tax authorities do not reach agreement.

This research considers South Africa's domestic tax legislation concerning corporate residency and the application of Article 4(1) of the MLI on its treaty network. The study overlays the South African considerations with the United Kingdom and Mauritius domestic legislation and case law in determining corporate tax residency and how this interacts with the application Article 4(1) of the MLI.

The result of this study is a proposed hierarchy of factors for taxpayers and tax authorities to consider when determining corporate residency for MAP purposes in instances of corporate dual residency. The study concludes that while Article 4(1) of the MLI acts as an anti-abuse measure, it imposes challenges that should be managed by tax authorities to maintain the fairness and certainty for taxpayers. Thus, suggesting that tax authorities adopt a structured sequence of criteria to provide certainty for corporate dual residency cases.

**Keywords:** Tax residency; Dual residency; Multilateral Instrument (MLI); Mutual Agreement Procedure (MAP); Place of Effective Management

(POEM); Management and Control; Double Taxation; Base Erosion and Profit Shifting (BEPS)

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*“What is life without love?” – Alex Isley*

**GLOSSARY**

<b>BEPS</b>	Base Erosion and Profit Shifting
<b>BVI</b>	British Virgin Islands
<b>CMC</b>	Centrally managed and controlled
<b>CTA</b>	Covered Tax Agreement
<b>UK Corporation Tax Act</b>	Corporation Tax Act of 2009
<b>DTA</b>	Double Tax Agreement
<b>HMRC</b>	His/Her Majesty's Revenue and Customs
<b>IN6</b>	Interpretation Note 6, Issue 3, dated 30 June 2023
<b>MAP</b>	Mutual Agreement Procedure
<b>Mauritian ITA</b>	Mauritian Income Tax Act 1995
<b>MLI</b>	Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
<b>MoU</b>	Memorandum of Understanding
<b>MRA</b>	Mauritian Tax Authority
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OECD Model</b>	OECD Model Tax Convention on Income and Capital
<b>POEM</b>	Place of effective management

<b>SARS</b>	South African Revenue Authorities
<b>the Act</b>	Income Tax Act No. 58 of 1962
<b>UK</b>	United Kingdom

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## CHAPTER 1

### INTRODUCTION AND OVERVIEW

#### 1.1. INTRODUCTION AND BACKGROUND

A company may be considered to have dual residence due to the domestic tax laws and tax authorities of multiple jurisdictions considering the company to be a resident of their State (Bräumann, 2015: 2). The determining factors for a jurisdiction to consider a company as a resident is dependent on its domestic tax laws. Non-exhaustive examples of such factors include place of incorporation, domicile, and place of effective management (“POEM”) or place of management and control. Dual residency for a company may therefore occur if one State (State A) determines that a company is a resident due to it being incorporated in State A and another State (State B) determines that the company is a resident of its State due to the activities carried out by the company which considers it effectively managed and controlled in State B.

Dual residency may result in double taxation for a company, where treaty relief is not provided, as the tax authorities for each jurisdiction will seek to tax the company in its respective jurisdiction to protect its own tax base. This is also dependent on the tax regime of each jurisdiction which may result in double taxation. For instance, if a jurisdiction taxes its residents on a worldwide income basis and if another jurisdiction includes factors such as POEM in its domestic definition of resident, both jurisdictions will seek to tax the company on its income.

In the case where there is a Double Tax Agreement (“DTA”) in force between the two jurisdictions, the allocation of taxing rights on the income generated in a State is set out by the DTA. Depending on the type of income being allocated, the basis for allocation of income may be on residence basis, emphasising the importance of determining residency.

The Organisation for Economic Co-operation and Development’s (“OECD”) Model Tax Convention on Income and Capital (“OECD Model”) provides a model for which residency may be determined by States in Article 4,

specifically 4(1) and 4(3) in the case of dual residence for companies. Article 4(1) of the OECD Model defines tax residence for a company in terms of the domestic law of the jurisdiction such as place of incorporation, domicile, and residence, the place of management and “other criterion of similar nature”. DTAs in force for each State may vary based on when such agreement was entered into force and whether such State adopts the OECD Model. Where it is determined that a company is a resident in more than one State when applying Article 4(1), Article 4(3) must apply (Ismer, 2017: 43).

Prior to the 2017 version of the OECD Model, Article 4(3) included a single tie-breaking criterion for determining the residency of a company, namely POEM. However, as the use of the concept of POEM has been questioned over time, it was determined that it was no longer an appropriate method to solely determine residency in the OECD Model (Staringer and Moldaschl, 2020: 87).

The OECD updated the wording of Article 4(3) in the 2017 version is follows:

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. (OECD, 2019: 45)

The OECD released the Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting Multilateral Instrument (“MLI”), as one of the outcomes of the OECD/G20 Project to address Base Erosion and Profit Shifting (“BEPS”). The MLI was released as a tool to enable jurisdictions to easily update their existing treaties and to address the protection of their tax base. This is due to the rising amount of tax planning strategies carried out which exploit gaps and may artificially shift profits to low or at times jurisdictions with zero tax where there is a lack of

commercial substance or no economic activity. The result of which is little or no overall corporate tax being paid in a jurisdiction (OECD, 2016a).

The MLI also addresses instances of dual residency in Article 4(1), which countries can opt into. The wording of Article 4(1) of the MLI corresponds with the wording in Article 4(3) of the 2017 OECD Model convention. The MLI applies to jurisdictions who have signed the MLI, included their treaties as covered tax agreements (“CTA”) and specifically opted into Article 4(1) to apply to their tax treaties. The updated or replaced wording in the CTA for Article 4(1) of the MLI is suggested to be read as:

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 Jurisdiction (OECD, 2016b).

It is noted that the wording in Article 4(1) MLI mirrors that of Article 4(3) of the 2017 OECD Model with slight contextual changes. These terms differ in the context of the nature of the agreements such as “Covered Tax Agreement” replaces “Double Tax Agreement” and “Contracting Jurisdiction” replaces “Contracting State”.

Notwithstanding this, concern has been raised in the updated wording and new approach to determining residency of companies from removing the tie-breaker clause and including the wording of Article 4(3) of the OECD Model and Article 4(1) in the MLI. Some concerns being that there is no hierarchy provided for the tax authorities on how to take into account the numerous factors to be considered for determining residency. Further, that the competent

authorities are not bound to follow any of the list factors either (Oguttu, 2017: 235).

As the process of determining residency is undertaken by the relevant tax authorities, the taxpayer would not be included in the process of such determination. This may result in each jurisdiction not reaching agreement and the company being taxed in both States, until such agreement is reached. To this end, it can be argued that the MLI appears to be more focused on preventing instances of tax avoidance than solving for cases of dual residence. It must be questioned whether the application of the MLI is effective or not and may have a further impact on the free flow of capital (Olika, 2023).

A further issue raised is that there is no obligation for the tax authorities to reach an agreement at the conclusion of the Mutual Agreement Procedure ("MAP"). In addition to the known time inefficiencies in concluding a MAP, the wording "shall endeavour" does not put an obligation on the tax authorities to conclude the MAP process. This may be a severe risk in the view of a taxpayer as the entitlement to the benefit of the treaty is dependent on the conclusion of such an agreement (Staringer and Moldaschl, 2020: 95).

In the case where reliance was placed on the wording in the existing tax treaty (prior to the 2017 OECD Model and MLI), factors such as POEM could have been used to determine the residency of the company at that time. The introduction of the MLI would result in the company ceasing to be a tax resident of a State as initially determined by the treaty. This example exists in the case of the Mauritius-South Africa DTA, where a Mauritian incorporated company which was determined to be effectively managed from South Africa. This would have granted South Africa taxing rights but the company would now be considered to be a Mauritian tax resident until the authorities reach agreement on the residency (Maisto *et al.*, 2018: 76).

Whether the application of Article 4(1) of the MLI is in line with the principles of good tax policy has also been raised. This is on the basis that it may result in uncertainty and positions of unfairness on the taxpayer. It can be further raised that not all instances of dual residency are as a result of tax avoidance,

for which the provision seeks to solve. In the case where dual residency has arisen without the intention of tax avoidance, it would deviate from the purpose of tax treaties which would be to provide relief from double taxation (Olika, 2023).

## **1.2. RESEARCH QUESTION**

The application of MAP in the tie-breaker clause in cases of dual residency for companies, as set out in Article 4(1) of the MLI results various challenges ultimately causing uncertainty for tax authorities and taxpayers. One of which being that in determining the residency of a company, the factors considered relevant by tax authorities of one jurisdiction may differ to another depending on its local tax policy views which guides tax legislation and its interpretation. There may also be a difference in interpretation between tax authorities and taxpayers.

The purpose of the research is to, through the methodology carried out, present the challenges which may be faced by taxpayers and tax authorities from the application of Article 4(1). It will consider whether solutions can be drawn from analysing the domestic tax legislations and interpretation of South Africa, the UK and Mauritius. This will be overlaid with South Africa's treaty interaction with the UK and Mauritius. Ultimately, the purpose will be to assist the South African tax authority and taxpayers to use in solving for cases of dual residency for companies in the instances of MAP being the tie-breaker.

This study aims to provide a solution to taxpayers and tax authorities alike by answering the primary question of: In a tax treaty context, what are the challenges to solve for a case of a company's dual residency where MAP is the tie-breaker clause, as set out in Article 4(1) of the MLI?

This study will further seek to answer a secondary question of: What are the solutions to the challenges in solving for a case of a company's dual residency where MAP is the tie-breaker clause, as set out in Article 4(1) applies to a Covered Tax Agreement? Specifically, the second question will address: What factors should be considered as relevant to the South African tax authority and taxpayers and in what hierarchical order?

### **1.3. RESEARCH METHOD**

A doctrinal research methodology will be followed which makes use of documentary data appropriate or relevant to address the research question.

This research will specifically analyse:

- the domestic tax legislation regarding the determination of a company's tax residence; and
- The wording of tax treaties in determining a company's tax residence in instances of dual residency; and
- relevant interpretation used by tax authorities in determining a company's tax residence (such as court cases and interpretative guidance).

Specifically, the analysis will be on the domestic tax legislation and interpretation in South Africa, the UK and Mauritius. This will be overlaid with an analysis of the tax treaties agreed between South Africa and the UK and Mauritius.

### **1.4. LIMITATIONS OF SCOPE**

The scope of the research is limited to two of South Africa's tax treaties being the UK and Mauritius. The basis for the UK being analysed is that the UK has opted to apply Article 4(1) of the MLI in its CTA with South Africa and its interpretation of relevant factors provided in the form of case law. For Mauritius, the wording of the Mauritius-South Africa DTA as it stands includes MAP as its tie-breaker clause (without the application of Article 4(1) of the MLI). Further, the Mauritian and South African tax authorities have concluded a Memorandum of Understanding ("MoU") setting out criteria that shall be taken into account when determining the residency of dual resident companies through a MAP procedure. The interpretation from the UK case law and Mauritius-South Africa MoU may provide a unique insight into the view of these tax authorities which may assist in answering the research question.

Further, the scope of the research s will not include an analysis in respect of the Model Tax Convention on Income and Capital of the United Nations and the United States Income Tax Model Convention.

## **1.5. STRUCTURE OF DISSERTATION**

Chapter one provides an introduction and background to this study. It also provides the research question, methodology and scope limitations.

Chapter two will provide a review of the literature in respect to Article 4(1) of the MLI, including an interpretation of its wording, the intended implication for the implementation and the possible unintended implications in determining residency for companies in respect of its CTAs.

Chapter three will present the challenges that may result from the application of Article 4(1), specifically in the context of South Africa. This chapter will consider South Africa's current domestic tax law and analyse the current wording of South African tax treaty network in determining the residency of companies.

Chapter four will consider the domestic tax legislation of UK and Mauritius and analyse how the determination of residency of a company in two jurisdictions interact with South Africa in a treaty context.

Chapter five will present the authors suggested solutions, if any, for the challenges encountered in the implementation of the MLI in determining residency in the context of South Africa's CTAs and factors to be considered as relevant in determining a company's tax residence in the case of dual residency under MAP.

Chapter six will provide conclusionary remarks to the study.

## **CHAPTER 2**

### **CONTEXTUALISING DUAL RESIDENCY FOR COMPANIES AND THE MLI**

#### **2.1. INTRODUCTION**

This chapter seeks to set out the context around the concept of corporate residency, specifically in cases of dual residence and the approach taken in the MLI to solve for this. This chapter also considers the implications and challenges in determining residency under the application of the MLI. This will take place by performing a review of the relevant literature on these concepts. This chapter will form as the foundation of the study.

It is necessary to start at understanding what cases of dual residency are solving for, more specifically, what the concept of corporate residence is. This will delve into the importance of corporate residence in a tax context and the implications of a company having dual residence. It is also necessary to understand how the concept of corporate residence, specifically in relation to dual residency, interacts with the OECD Model and the MLI. Understanding the intention for the position taken by the OECD and what unintended implications such position may have on taxpayers and tax authorities would be of importance here.

#### **2.2. CONCEPT OF CORPORATE RESIDENCY**

A “corporation” is referred to as an entity which has authority under law to act as a separate person from the shareholders who own it, have rights to issue shares and exist until a point of deregistration. The actual definition for a corporation or company will vary based on a jurisdiction’s domestic law. Defining corporate residence is, however, a harder task to solve for (Ismer, 2017: 27).

The function of the concept of corporate residency can be used to solve for how to define it. The first function of corporate residency is to provide a domestic connecting factor between a company and the tax net of a State. Secondly, to assist in the allocation of the income of a company in terms of its relevant tax treaties (Ismer, 2017: 27).

When applying the OECD Model to determine the corporate residency and the allocation of its income, a company must be a resident of at least one State. Article 4(1) of the OECD Model sets out that residency is determined in accordance with its domestic law considering factors such as place of incorporation, domicile or POEM. As the criteria set out by the OECD Model in determining is broad, it is possible for more than one State to be of the view that a company has corporate residency in its State (Staringer and Moldaschl, 2020: 87).

The importance of determining the residency of a company is then highlighted in the case where two States determine themselves as being the resident State. Where treaty benefits are granted by both States it results in the income being treated as non-taxable in another State and the treaty benefits provided by the treaty would not be granted to the company. It is therefore crucial to determine in which State a company is a resident and in which State a company may be deriving source income from (Staringer and Moldaschl, 2020: 87).

### **2.3. CHANGE IN TIE-BREAKER CLAUSE**

Article 4(3) of the OECD Model sets out the criteria to determine the residency of a company in the case of dual residency. Article 4(3) of the OECD Model is applied to resolve the dual residence status of companies for treaty purposes which solves for possible double taxation, non-taxation and the allocation of income. The purpose of Article 4(3) is to ensure legal certainty and practicability for the taxpayer and for the tax authorities of a Contracting State (Gerlach and Niemeyer, 2018). The 2017 version of the OECD Model has updated its criteria in determining residency for cases of dual resident companies, which is mirrored by the wording in Article 4(1) of the MLI.

The rationale for the change of Article 4(3) of the OECD Model was to be in line with BEPS Action Point 6 as a measure 'Against the Grant of Treaty Benefits in Inappropriate Circumstances'. Whilst BEPS Action Point 6 mainly deals with the limitation-on-benefits and principal-purpose-test provisions, to deny treaty benefits in cases where there is treaty abuse for tax purpose,

Article 4(3) forms part of the targeted anti-abuse rules. The reason for this is that dual resident companies are often involved in tax avoidance arrangements, the change in Article 4(3) seeks to address this form of treaty abuse pursuant to BEPS Action Point 6 (Gerlach and Niemeyer, 2018). Within the wording of Article 4(3) there is no distinction made between a *bona fide* dual resident company and those with the intention of tax avoidance (Chen, 2017b).

This updated wording regarding the tie-breaker clause has gathered varied responses, some in agreement that the concept of POEM solely as the tie-breaker in determining the residency of a company may not be viable. Alternatively, some responses criticise the wording by highlighting that it may create legal uncertainty and possible double taxation scenarios for the taxpayer, without any treaty relief. This means that the objectives of a DTA, being the avoidance of double taxation and double non-taxation, would not be met. Further that resolving cases of dual residence may only be achieved if both contracting States synonymously use the same interpretation on concepts included in a DTA (Janiszewska, 2019).

Criticism has been raised as to the appropriateness of the POEM criteria used in the tie-breaker clause due to its varied interpretation (Gerlach and Niemeyer, 2018). This is an issue which is far reaching due to the type of tasks are considered to be “effective management” by different tax authorities (Janiszewska, 2019). It has been questioned as to whether the interpretation of the tax authorities and domestic tax law in different jurisdictions achieve the purpose of the tie-breaker clause (Staringer and Moldaschl, 2020). In these differing interpretations, there is no explicit interpretation of POEM provided by the OECD in the Model commentary (Chen, 2017b).

There are counter arguments for the use of POEM in determining residency. Considering that the POEM criteria follows a “substance over form” approach. Therefore, if a company has structured its operations for the purpose of obtaining a tax benefit, in determining its POEM, the place of decisions and substantial key management will be considered rather than its legal form

(Staringer and Moldaschl, 2020: 90). Thus, the POEM criteria would achieve the rationale of BEPS Action 6 and is itself an anti-treaty abuse measure.

There are various implications of updated wording of Article 4(3) of the OECD Model and Article 4(1) of the MLI have been raised in determining residency for companies.

## **2.4. IMPLICATIONS IN DETERMINING RESIDENCY**

The main implication in the amended tie-breaker rule is the replacement of the POEM criteria with a MAP. This replacement brings a myriad of issues which exist in the change from one determination to another and in the case of applying the new rule.

### **2.4.1. Entitlement to treaty benefits and requesting MAP**

There may be issues when applying MAP regarding the taxpayer having the entitlement of requesting such MAP. Although the wording in the 2017 OECD Model and MLI do not define how the MAP procedure must be carried out, in terms of the OECD Commentary, it must be initiated in line with Article 25(1) of the Model (Staringer and Moldaschl, 2020: 92). Article 25(1) in the 2017 OECD Model reads as:

Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention (OECD, 2019: 99).

Although the wording of Article 25(1) states that the taxpayer can apply in either jurisdiction, a case may exist where a competent authority wishes to apply the older version of Article 25(1). This requires a taxpayer, in the case of a dual residency scenario, to apply for a MAP in the State of which it is a resident. However, the residency of the taxpayer must be determined by a MAP in line with Article 4(3) (Staringer and Moldaschl, 2020: 87). Without

procedural guidance provided in the OECD Model and the MLI if the pre-2017 wording of Article 25(1), the taxpayer is left unanswered as to which State it should request a competent authority to apply a MAP to solve its case of dual residency.

Where the 2017 OECD Model wording of Article 25(1) is applied to dual-resident companies, a company must apply to a Contracting State to which it is entitled treaty benefits. However, a taxpayer is not extended the treaty benefits until the MAP has been concluded under Article 4(3) and Article 4(1) of the MLI. With this interpretation of the wording, it may be impossible for a taxpayer to request a MAP to solve its case of dual residency (Staringer and Moldaschl, 2020: 87).

It can be considered that the OECD did not intend for the literal wording of Article 25(1) to be applied strictly to solving for dual residency in Article 4(3). It may be interpreted that when initiating a MAP, a taxpayer may initiate a MAP and then follow the procedure in terms of Article 25(1). The OECD has not indicated the intention or interpretation in the discrepancy of the wording to solve for dual residency companies in Article 4(3) and initiating a MAP in line with Article 25(1) (Staringer and Moldaschl, 2020: 87).

This illustrates that the taxpayer must ultimately bear the cost of no clarity provided in the MLI or by the OECD on the role of competent authorities to resolve for dual resident companies. The fairness of this provision is raised for there being no obligation for a competent authority to act in any specific manner (Olika, 2023).

#### **2.4.2. Timing concerns and reaching agreement regarding MAP**

The updated wording of Article 4(3) of the OECD Model and Article 4(1) of the MLI denies treaty benefits from a taxpayer until the date the MAP is resolved. Neither Article 4(3) nor Article 25(1) of the OECD Model sets a time limit for which the competent authorities must resolve a MAP. This lack of clear timelines for resolving a MAP may result in a taxpayer being in limbo regarding the application of the treaty to them for an undetermined period of time (Olika,

2023). If an agreement can be reached between tax authorities, it may still take a substantial period of time for this to be completed (Chen, 2017a).

It is noted that a proposal was put forward to include a period for which a MAP must be resolved, which was not included in BEPS Action Point 6 (Gerlach and Niemeyer, 2018). The 2017 OECD commentary encourages the competent authorities to resolve the request for MAP expeditiously and to communicate their response as soon as possible, including no specific deadline (OECD, 2019: 271). Further, Article 25 of the OECD Model also does not set out any clear timelines for resolving matters which relate to the interpretation of a treaty. This highlights the need for clearer rules in relation to arbitration, which was not made mandatory in the MLI (Olika, 2023).

On this basis, a taxpayer resolving its case of dual residency through MAP will only obtain treaty benefits for the future (if any). Additionally, the time period which a MAP resolved in is a period that the taxpayer will not qualify for any treaty benefits and receive no retrospective tax suspension or tax deferral (Staringer and Moldaschl, 2020: 88). There is also the issue of whether a company can reclaim the tax paid in the time which it takes to resolve the case. This means a taxpayer will suffer a cash-flow loss with no certainty on its recoverability (Chen, 2017b).

Further to the timing concerns, as there is no obligation on the contracting States to resolve a MAP, it may easily leave taxpayers in the position of the tie-breaker being unbroken. This leaves the taxpayer in an uncertain position and to cases of double taxation (Olika, 2023). The tax authorities of a country will not have any initiative to reach agreement (Chen, 2017b). The case of double taxation can only be avoided if one Contracting State follows the interpretation of the other (Janiszewska, 2019).

### **2.4.3. Unspecific criteria to determine residency**

Another concern raised in the new approach is that there are no clear rules in determining residency in a dual-residence scenario for companies. The wording of the amendment states that the residency is solely determined by considering relevant factors by the competent authorities through a MAP.

Although the wording does list factors which the competent authorities can consider such as place of incorporation, POEM and other relevant factors, there is no guidance on the hierarchy for the application of these factors. Further, the nature of the testing of each factor may differ from one another and result in different answers (Oguttu, 2017). This results in uncertainty for the taxpayer as well as the competent authorities (Olika, 2023).

It must also be considered that if competent authorities are determining which factors to determine residency, they may choose the determining factor to be one of legal form and thereby negate anti-treaty abuse which is the rationale of the updated wording. It is noted that the OECD in its Commentary have commented that the sole use of the legal criterion is not regarded as a suitable tie-breaker, which may deter competent authorities to use such criteria (OECD, 2019: 270).

Including the two factors of incorporation and POEM must be questioned considering that, these factors have historically been used to determine residency. With place of incorporation, this factor has been disregarded by the OECD previously and there has been no justification for its inclusion as a factor in the MLI. The inclusion of POEM is viewed as problematic due to the broad acknowledgement of its inefficacy (Olika, 2023). It must also be noted that these factors themselves result in a case of dual residency from Article 4(1). The taxpayer is therefore provided with a vague criteria of what may be considered by the competent authorities (Staringer and Moldaschl, 2020: 88). These factors shows that the OECD has not introduced a pragmatic or original solve for determining residency for companies in the MLI (Olika, 2023).

The third criteria provided in the updated wording includes “any other relevant factor” without a definition of what may be considered as a relevant factor. The 2017 OECD Commentary does however include a non-exhaustive list of factors that can be considered as follows:

Competent authorities having to apply paragraph 3 would be expected to take account of various factors, such as where the meetings of the person’s 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, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc. Countries that consider that the competent authorities should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose may want to supplement the provision to refer to these or other factors that they consider relevant (OECD, 2019: 271).

The non-exhaustive list merely provides guidance to the competent authorities; however, the competent authorities may deem what factors are relevant in resolving the MAP. Considering the nature of the MAP, the decision of the MAP will be shared with the taxpayer however, the taxpayer would not have sight of the factors that were considered by the competent authorities in determining its residency. The margin of discretion provided to competent authorities in this sense is wide. Companies are no longer in a position of autonomously determining their residency for tax treaty purposes (Pinto Nogueira, 2024). This again provides uncertainty for the taxpayer as they would be unsure of the outcome of the MAP and which factor the competent authorities would apply in its case (Olika, 2023).

## **2.5. CONCLUSION**

The stated purpose of Article 4(3) is to prevent tax treaty abuse, its inclusion without renegotiation of the tax treaties into the tax treaties due to the MLI creates significant uncertainty for dual resident taxpayers. This may be in the form of taxpayers who do not have recourse to the MAP procedure in the absence of resolving which Contracting State that they are resident in. Taxpayers in this case may have no access to the treaty benefits resulting in double taxation. Furthermore, there is no time period in which a tax authority should reach their determination to complete a MAP process. In addition, those countries that have not included arbitration of the determination have no recourse to courts where the competent authorities fail to reach an agreement.

It is recommended that a hierarchy of determining factors is derived to guide the tax authorities in reaching a consistent determination of residency. This would aid taxpayers in the planning of their affairs in such a manner as to prevent possible double taxation. In Chapter 3, the determining factors in a South African context will be examined in further detail and a possible hierarchy advanced.

## **CHAPTER 3**

### **DETERMINING RESIDENCY FOR COMPANIES IN SOUTH AFRICA AND ANALYSIS OF SOUTH AFRICA'S TREATY NETWORK**

#### **3.1. INTRODUCTION**

Instances of double taxation arise between two jurisdictions regularly from differing interpretation or concepts defined in a tax treaty. This is due to the application of the domestic tax law and a different view on the interpretation of terms in both jurisdictions (Janiszewska, 2019). This emphasises the need to first analyse the domestic law of a jurisdiction and further its interpretation of terms included in the tax treaty.

This chapter will analyse the concept of tax residency in South Africa in the domestic legislation. Together with the domestic legislation, consideration of the South African interpretation on concepts such as POEM by the tax authorities will be analysed. This chapter will also consider how to determine tax residency in a South African tax treaty context. Specifically, the author has carried out an analysis of the South African tax treaty network to present the effect of the application of Article 4(1) of the MLI and cases where MAP already applies as a tie-breaker clause.

#### **3.2. SOUTH AFRICAN TAX RESIDENCY**

In South Africa, "residents" are liable for corporate income tax on their worldwide income and capital gains (i.e., irrespective of where the amounts are derived), whereas non-residents are only subject to tax on their South African source income.

A resident in relation to a company is defined in section 1 of the Income Tax Act No. 58 of 1962 ("the Act") to mean a company:

which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the

governments of the Republic and that other country for the avoidance of double taxation.

In terms of the definition in the Act, various factors may be considered to determine corporate residency in South Africa, mainly the legal company law form and notably includes POEM. The term POEM is, however, not defined in the Act. Guidance on the interpretation thereof is provided in relevant publications issued by the South African Revenue Authorities (“SARS”).

Although the guidance provided by SARS is non-binding in law in South Africa, it does assist in determining and interpreting POEM in a South African context. In Interpretation Note 6, Issue 3, dated 30 June 2023 (“IN6”), SARS (2023: 4 & 7) states its interpretation of POEM as follows:

‘A company’s place of effective management is the place where key management and commercial decisions necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD’s commentary on “place of effective management”.

A company may have more than one place of management, but it can only have one place of effective management at any one time. There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is therefore necessary to determine a single dominant place where effective management is located.

Definitive rules cannot be laid down in determining the place of effective management and all relevant facts and circumstances must be examined on a case- by-case basis.

The place of effective management test is one of substance over form, that is, ignoring the evident formalities and determining the real intention or substance. It therefore requires a determination of those persons in a company who actually ‘call the shots and exercise ‘realistic positive management’.

From SARS’ interpretation, it can be understood that the economic nexus and support functions of a company are of limited relevance in determining a company’s POEM. Whereas, legal factors such as place of incorporation, formation or establishment are of no relevance. The interpretation by SARS

then shows that the legal factors, if viewed in isolation, may potentially be indicative of legal form only and POEM instead focuses on commercial substance.

IN6 provides multiple factors which are to be considered when determining the POEM, often involving multiple locations. From those facts and locations it is necessary to determine a single dominant place where effective management is located.

The determination, as provided by SARS, considers where the key management and commercial decisions are regularly and predominantly made. It must be noted that this is also not a snapshot which requires an assessment at a particular moment in time and that an examination can be made over a number of years.

Further factors which SARS has published in considering the POEM of a company include, amongst others, where the board meetings take place, location of head office and executive management, whether the board's authority might be delegated to, or usurped by, others, etc. It is notable that in the version 3 of IN6, SARS has made a clear point that one must consider economic substance of these factors for a company and places even less focus on the form of the company's legal transactions or status.

This guidance provided by SARS in determining the POEM of a company not only assists in the determination of residency in South Africa, but also in a treaty context. The use of POEM as a tie-breaker clause in the case of dual residency for companies has been in use in treaties, however, has also been questioned as a valid means to determine residency in many countries.

### **3.3. DETERMINING RESIDENCY FOR DUAL RESIDENT COMPANIES IN A SOUTH AFRICAN CONTEXT**

South Africa has a vast treaty network which naturally grew following the end of Apartheid. At the time of South Africa's signing the MLI, it had 79 DTAs in force and since signing the MLI, there is one new DTA that has entered into force together with two new protocols. South Africa's general tax treaty

position aligns with that of the OECD Model, other than its explicit positions against the Model (Hattingh and West, 2020: 737).

In terms of the MLI, South Africa included 76 of its treaties (and amending protocols) as CTAs in signing the MLI (Hattingh and West, 2021: 1). Based on the authors analysis, of the 76 countries, 58 have signed the MLI with the outstanding countries having not signed amounting to 17 and one providing no notification on its reservations. (The author performed an analysis of the South African treaty network to record the status of the countries who have signed the MLI set out in Appendix A.)

The South African CTAs, for treaty partners both signed and unsigned to the MLI, that make use of POEM as the tie-breaker clause to determine residency amount to 46 of its 76 CTAs. The CTAs which included MAP as a tie-breaker amount to 22 countries; those with both POEM and MAP as the determining factors amount to 5 countries and the registered office for 1 country. It is noted that for the balance of the outstanding two CTAs, these are treaties which are not yet in force and therefore their determination criteria for dual residency cannot yet be ascertained. This is based on the authors analysis of the CTAs at the time. (The author the tie-breaker criteria applied for dual residence companies and whether the treaty partner opted to apply Article 4(1) of the MLI.)

In order to understand the effect of the MLI on South Africa in relation to its CTAs and determining dual residency for companies, it must first be gathered as to the number of CTAs that will actually be affected by the MLI. This is dependent on whether a country has either decided to opt into applying Article 4(1) of the MLI and update its existing determination criteria for cases of dual residency for companies to the MAP. Alternatively, it may be that the country could have opted out of Article 4(1) of the MLI applying as the existing CTA which already includes applying a MAP as the determination criteria (and therefore yields a similar result).

Out of South Africa's 76 CTAs, based on the authors analysis, 24 treaty partners have opted into applying Article 4(1) of the MLI and amend its existing

wording. It must be noted that based on the authors analysis the determining factors in the tie-breaker clauses for these countries have been updated from the initial DTA as: 16 countries have updated from POEM; 3 countries have updated from both POEM and MAP and 5 countries are updating their existing MAP tie-breaker clause. (The author analysed the cases where the DTA does not opt to apply Article 4(1), whether the DTA wording aligns to that of Article 4(1)).

Interestingly in the alternative, drawn from the authors analysis that 34 of South Africa's treaty partners have opted out of apply Article 4(1) of the MLI to its CTAs. The effect on the application of the tie-breaker in determining residency for companies for the countries who have opted out of applying Article 4(1) to its DTAs, based authors analysis, is that: 21 countries will still apply POEM as its tie-breaker; 12 countries will apply their existing MAP as their tie-breaker and one country will apply both POEM and MAP.

The result of the authors analysis on the implementation of the MLI on South Africa's CTAs results in 36 countries now using MAP as its tie-breaker in determining residency for companies. This is the result of the 24 countries who have opted into updating CTAs in line with Article 4(1) and the 12 countries which contain existing MAP tie-breakers. Here, it is important to note that the balance of South Africa's 18 CTAs have not yet been signed, or no notification has yet been received.

The actual effect on the implementation of the updated wording by using MAP in determining residency in South Africa may not yet be determined, however it must be raised that there may be an expected increase in tax disputes. Especially in the case where the 24 treaty partners who have changed their determination criteria from POEM to be in line with Article 4(1) MLI. The result which companies should expect is not being able to assess their own corporate residency. Further, the application of Article 4(1) of the MLI to all dual residency scenarios and not limited to merely tax abuse scenarios. Therefore, the existence of any dual residency scenario for companies can only be resolved in a MAP process and not by the taxpayers determination alone (Oguttu, 2017).

### **3.4. CONCLUSION**

From the understanding of South Africa's domestic definition of residency there is no clear criteria of which factors are considered to be of more importance. From SARS' interpretation of POEM, it can be understood that there are various factors that must be considered in determining POEM with the emphasis being placed on the economic substance over legal form of a company. These factors may be used by SARS as criterion which are taken into account when determining the residency of a company in the case of a MAP. This interpretation may therefore give a taxpayer more insight into SARS' view on this matter however, considering that this is merely SARS' interpretation and is not binding on SARS, a taxpayer may not fully rely on this.

SARS or National Treasury in South Africa has not provided any guidance or interpretation on how the resolution of a MAP would take place in an instance of determining residence for companies, despite the existing IN6 regarding POEM. This makes considering a hierarchy to determine the factors to be considered by SARS and any relevant competent authority difficult.

The interpretation of POEM in other countries may be used as insight for factors which may be considered by competent authorities to determine the residency under a MAP procedure.

Chapter 4 will further consider whether there are any factors in the domestic laws of interpretations of the UK and Mauritius, together with its treaty with South Africa that may assist determining factors for the competent authorities when carrying out a MAP procedure.

## **CHAPTER 4**

### **ANALYSIS ON THE DETERMINATION OF TAX RESIDENCY FOR COMPANIES IN THE UK AND MAURITIUS AND IN TREATY CONTEXT WITH SOUTH AFRICA**

#### **4.1. INTRODUCTION**

The fundamental understanding of a foreign legal system which is included in the interpretation of a DTA is indispensable (Janiszewska, 2019). It is important to understand the domestic tax law of a jurisdiction and its interpretation of terms included in a DTA, overlaid by the terms specifically agreed to in its DTAs or CTAs.

This can make a significant contribution to legal certainty for taxpayers, if reciprocity is reached between tax authorities in a domestic and treaty sense in its interpretation of terms included in DTAs and CTAs (Janiszewska, 2019). This is specifically emphasised in the case of the tie-breaker rule, where the varying interpretation by tax authorities causes uncertainty for taxpayers.

An analysis is set out below of the domestic tax law in determining residency of the UK and Mauritius. Which is overlaid by the interpretation of the concept of residency or the tie-breaker rule in specific relation to their tax treaty with South Africa.

#### **4.2. UK TAX RESIDENCY**

##### **4.2.1. Domestic tax law and case law**

A company is considered to be a resident in the UK for tax purposes if it is either incorporated in the UK (being England, Wales, Scotland and Ireland) in terms of section 14 of the Corporation Tax Act of 2009 ("UK Corporation Tax Act") or in the case where they are not incorporated in the UK, if the business is centrally managed and controlled ("CMC") in the UK.

The reasoning and inclusion of the CMC rule in determining tax residency is of importance to help understand how such rule is applied. The basis for the CMC test arose from the *'De Beers Consolidated Mines Limited v Howe'*

(1906) case in which a company was incorporated in South Africa and His Majesty's Revenue and Customs ("HMRC") noted that the company should be taxed in the UK on the basis that the activities of the business must be considered beyond its incorporation. The court considered several factors when looking at the activities of such company's directors in the UK. The court ultimately decided in favour of the HMRC specifically with the below judgement:

'a company resides, for purposes of income-tax, where its real business is carried on. Those decisions have been acted upon ever since. I regard that as the true rule, and the real business is carried on where the central management and control actually abides. It remains to be considered whether the present case falls within that rule. This is a pure question of fact, to be determined not according to the construction of this or that regulation or by-law, but upon a scrutiny of the course of business and trading.' (*De Beers Consolidated Mines, Ltd v. Howe (Surveyor of Taxes)*, 1906).

The 1906 *De Beers* case was the first judgement which applied the CMC test which then subsequently applied to various cases with instances of dual residency for the courts to consider beyond place of incorporation. In the case '*New Zealand Shipping Co. Ltd v Thew*' (1922), a company which was incorporated in New Zealand and had a board of directors in both New Zealand and the UK. The Court decided that the company is a UK tax resident considering the fact that the board based in the UK had overall control of the company as the UK board decided on the financial business and overall business functions such as administrative functions and company policies (Cerioni and Eden, 2017: 3).

The application of the CMC test resulted in opposing decisions of the Courts in instances of a board based in the UK making decisions for its Group companies or subsidiaries. In '*The Unit Construction Co., Ltd. v Bullock*' (1959), the Courts decided in favour of being tax resident in the UK, where a UK parent company which had subsidiaries based in Kenya and the UK board assumed the functions of its subsidiary's boards. Therefore, such subsidiaries were managed and controlled from the UK (*The Unit Construction Co., Ltd. v. Bullock (H.M. Inspector of Taxes)*, 1959). In the case of '*Untelrab Ltd and*

*Others v McGregor* (1995), the Courts decided the subsidiaries of the UK parent company were not tax residents in the UK when applying the CMC rule. Specifically, this case related to a UK parent company whose board formulated its group policies while its subsidiaries held its own board meetings, and its day-to-day management takes place in country (*Untelrab Ltd and Others v. McGregor (Inspector of Taxes)*, 1995). These cases illustrated the importance in distinguishing where the decisions are made relating to the top management strategic decisions for the overall group and those that relate to day-to-day decisions and operations of the company.

Amidst the cases which assisted in the interpretation of CMC, the HMRC issued a Statement of Practice 1/90 in 1990 to provide guidance on the approach to determine residency in the case of applying CMC. The Statement of Practice stated the HMRC's adoption of the following approach:

- i. 'they first try to ascertain whether the directors of the company in fact exercise central management and control
- ii. If so, they seek to determine where the directors exercise this central management and control (which is not necessarily where they meet)
- iii. in cases where the directors apparently do not exercise central management and control of the company, HMRC then look to establish where and by whom it is exercised' (His Majesty's Revenue and Customs, 1990).

When determining the CMC of a company, case law refers to the importance of understanding whether the board is the "controlling brain" of a company. In the *'Mr and Mrs R J Wood v. Mrs L M Holden'* (2006) case, it was established that in determining whether the board is the "controlling brain of the company" the powers available to the board and the decisions made by the board in relation to the day-to-day business of the company must also be considered. In this case, a subsidiary of a British Virgin Islands ("BVI") company of a UK parent company received advice from UK tax advisors on restructuring its operations and the BVI board decided to carry out such restructuring. The Courts decided that the taxpayer was not a resident in the UK on the basis that although the advice was provided by advisors in the UK, the BVI board ultimately exercised their powers to decide to carry out such transaction (*Mr*

*and Mrs R J Wood v. Mrs L M Holden*, 2006). Another notable comment made Chadwick LJ in this judgment is that there was no clear distinction between the concept of POEM and CMC and in whether the two tests are not, in substance, the same (Hawkes, 2014).

Interestingly in the case '*Laerstate BV v Commissioners for Her Majesty's Revenue and Customs*' (2009) it was raised that all directors and/or shareholders of a company and the powers which they exercise must be considered, and not only the board. In this case, a Netherlands incorporated company who had board meetings which took place within the Netherlands were considered to be tax resident in the UK. This was on the basis that the UK resident company shareholder and director made strategic business decisions for the company. Therefore, although the board itself did carry out its meetings in the Netherlands, the UK resident shareholder and director which actually made the strategic business decisions. Therefore, the strategic business decisions did not take place in the board meetings. This highlights the importance of not only understanding where the board is located and where the meetings take place, but also the substance of the decisions made by the board as it relates to the company (*Laerstate BV v. Commissioners for Her Majesty's Revenue and Customs*, 2009).

Understanding the domestic tax law in the UK together with the interpretation of HMRC and the UK Courts is of importance when considering the "determining factors" which may be taken into account by the tax authorities seeking to resolve a case of dual residency for companies. Such domestic interpretation must be overlaid with its application in an international context, for which the UK's tax treaty network must be considered.

Determining residency for companies in a UK treaty context may turnout interesting results as the UK generally follows the OECD Model principles which applies the POEM rule in the case of a tie-breaker. Whereas, when determining residency for companies the UK applies the CMC concept.

#### 4.2.2. Tax treaty context

The UK has a treaty network of 137 DTA's, of which 16 were entered into before consideration was made for the tie-breaker clause and the OECD Model was drafted. It was the view of HMRC that for these treaties, where the case of dual residency exists for companies, such company would not be a resident of either jurisdiction and subsequently cannot avail itself to treaty benefits. These DTAs have not since been updated to take into account the inclusion of POEM as a tie-breaker or the updated wording of Article 4(3) of the OECD Model prior to 2017 (Cerioni and Eden, 2017: 8).

It is further noted that 12 of the UK's DTAs which have been entered into and renegotiated (some of which are not yet in force) do not include the use of POEM as a tie-breaker rule. Instead, these treaties include wording aligned to the 2017 wording of Article 4(3) of the OECD Model and Article 4(1) of the MLI (Cerioni and Eden, 2017: 9). These DTAs assisted in the updated wording of Article 4(3) of the OECD Model. The wording in some of these DTAs and the updated Models did not specifically remove the POEM criteria in determining residency in its entirety therefore, implying that it is still a factor to be considered (Cerioni and Eden, 2017: 9).

Considering that the balance of the above treaties may include POEM as a tie-breaker it is then necessary for a company to first consider whether its CMC may be CMC in the UK. In the case where the treaty uses POEM as the tie-breaker, it must consider where it may be effectively managed. From the UK case law the difference between POEM and CMC may not be clearly distinguished. However, the interpretation of CMC can be used, for instance, the "controlling brain" test from *Wood v Holden* can be applied where CMC can be where the overall operational business decisions are made whereas the POEM can be considered to be where the strategic management decisions are made (Cerioni and Eden, 2017: 10).

From a taxpayer's perspective it is important to note that the view of HMRC is that where the tie-breaker is POEM in terms of a DTA, each company must self-assess its POEM jurisdiction. In the case of the tie-breaker being a MAP in terms of the DTA, the company must still perform a self-assessment on the

criteria which may be considered in terms of the DTA. Such self-assessment will then be subject to the decision of the HMRC and relevant tax authorities of the other jurisdiction (Cerioni and Eden, 2017: 10).

In the context of the tax treaty between South Africa and the UK, although the synthesised text for the CTA has not yet been published by SARS or HMRC, both countries have opted to apply Article 4(1) of the MLI. The implementation of the MLI would update the wording in Article 4(3) of the CTA between South Africa and the UK. This would result in the update of the tie-breaker from the DTA from being POEM to MAP.

It can be viewed that this change may broaden the scope of the HMRCs interpretation to tax residency for companies i.e., that the HMRC may consider that CMC is a relevant factor in determining residency and not solely POEM. Whereas SARS, who may use POEM as a relevant factor, may challenge the HMRC on the factors that they could consider relevant such as CMC. Although this leads for interesting interpretation from the tax authorities, such opposing views on what is considered to be relevant factors may create further tax uncertainty for corporate taxpayers who are in a MAP procedure for dual residency.

### **4.3. MAURITIUS TAX RESIDENCY**

#### **4.3.1. Domestic tax law**

In terms of section 73 of the Mauritian Income Tax Act 1995 (“Mauritian ITA”) a company is considered to be resident if its place of incorporation is in Mauritius or its central management and control is exercised in Mauritius.

The concept of central management and control in Mauritius is made considering all relevant facts and circumstances which relate to a company’s business activities, including use of information and communication technologies in the decision-making process. Generally, the below criteria will determine as to whether a company is centrally managed and controlled in Mauritius:

- There are at least two resident directors in Mauritius with sufficient calibre to exercise independence of mind and judgement;
- The company maintains its principal bank account in Mauritius at all times;
- The company keeps and maintains its accounting records at a registered office in Mauritius at all times;
- The company prepares its statutory financial statements and where necessary, such financial statements are audited; and
- There is provision made for meetings of the directors which includes at least two Mauritian directors (Ramloll, 2024).

The Mauritian Tax Authority (“MRA”) released its Statement of Practice (SP 17/18) in 2018 which clarified that generally a company is deemed to have its POEM in Mauritius if:

‘(a) the strategic decisions relating to the company’s core income generating activities are taken in, or from, Mauritius; and

(b) any one of the following conditions is met:

i. The majority of the Board of directors’ meetings are held in Mauritius;  
or

ii. The executive management of the company is regularly exercised in Mauritius;’ (Mauritian Revenue Authority, 2018)

From the above it can be noted that although the MRA state that all facts and circumstances must be considered when determining residency, there is also guidance provided to the specific instances where a company may be considered to be centrally managed and controlled and where it may be considered to have a POEM in Mauritius. The listing of such factors is helpful in instances where a dual resident company must solve for which factors the MRA would take into account it to be a resident in Mauritius.

#### **4.3.2. Tax treaty context**

SARS and the Mauritian Ministry of Finance have concluded a MoU in 2015 which sets out the criteria that the South African and Mauritian authorities shall take into account when determining the residency of dual resident companies

through a MAP procedure (Hattingh and West, 2021). Guidance is provided on the interpretation of determining tax residency for companies of both the MRA and SARS' approach in the MoU.

Article 1 of the MoU the wording is similar to that of Article 4(3) of the OECD Model and Article 4(1) of the MLI stating that the Competent Authorities must determine the residency of a company through a MAP having regard to its POEM, place of incorporation or otherwise constituted and other factors (Mauritian Tax Authority and South African Revenue Services, 2015). The MoU provides further guidance on the relevant factors that the competent authorities will take into account, as follows:

- a) ' where the meetings of the person's board of directors or equivalent body are usually held;
  - b) where the Chief Executive Officer and other senior executives usually carry on their activities;
  - c) where the senior day to day management of the person is carried on;
  - d) where the person's headquarters are located;
  - e) which country's laws govern the legal status of the person;
  - f) where its accounting records are kept;
  - g) 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 final report; and
  - h) any such other factors that may be identified and agreed upon by the Competent Authorities in determining the residency of the person.'
- (Mauritian Tax Authority and South African Revenue Services, 2015).

The above listed factors, interestingly list factors which were not included in the IN6 published by SARS or Statement of Practice (SP 17/18) by the MRA. It does, however, provide guidance on specifically what these two competent authorities would consider if it were to enter into a MAP to determine the tax residency of a dual resident company.

Further, the reference to the OECD Commentary included on the basis that it may be amended, in essence, aligns the MoU to any subsequent commentary made or guidance provided by the OECD as relevant factors in determining

tax residency. It therefore leaves the list of relevant factors open to any updated interpretations by the OECD without the competent authorities explicitly agreeing to include such factors.

In a South African treaty context, both Mauritius and South Africa have opted into implementing the MLI and have published synthesised text to reflect the updated CTA. Specifically for residency, Mauritius did not opt to apply the updated wording in terms of Article 4(1) of the MLI. Which, considering the wording already included in the MoU, is an understandable position for Mauritius to take. The CTA would therefore apply on the same basis and take the MoU into account which is a similar practice to if the MLI would apply. However, in this case there is some certainty for taxpayers of what specific factors the tax authorities would take into consideration to reach agreement in a MAP procedure.

#### **4.4. CONCLUSION**

When analysing the local legislation and interpretation of factors considered to determine residency, it provides guidance into what the relevant tax authorities would take into account during a MAP procedure. Although this does bring a form of certainty for a taxpayer, it may also bring further uncertainty in the case that two tax authorities have opposing views on the factors which they deem relevant.

This can be evidenced in the case of the UK where CMC is applied by both the courts and the HMRC extensively to determine residency. This provides the HMRC with various cases to rely on for factors to support its view to apply CMC as relevance to a case. On the other hand, in the case of Mauritius, the MoU may assist taxpayers to broaden and understand which factors tax authorities have agreed upon if a taxpayer were to be in the case of considering which factors may be relevant for the MRA.

Although these factors may provide a broader and further understanding into which factors tax authorities considered in determining residency, legal uncertainty does not cease to exist for the taxpayer as it is not certain on

precisely which factors would be considered and the hierocracy of such factors.

Considering the above analysis, chapter five will consider solutions which may be presented for the challenges faced in determining residency for a company through a MAP procedure.

## **CHAPTER 5**

### **SOLUTIONS FOR THE CHALLENGES ENCOUNTERED IN SOLVING FOR A COMPANY'S DUAL RESIDENCY UNDER MAP FROM THE IMPLEMENTATION OF THE MLI**

#### **5.1. INTRODUCTION**

There is a wide range of challenges which may be expected to be encountered in the implementation of Article 4(1) of the MLI. The author, through the analysis of interpretation of South Africa, UK and Mauritian domestic law together with its interaction in a treaty context, proposes solutions to some of these challenges.

The challenges which the author specifically addresses is the entitlement to benefits of the treaty and the timing concerns for MAP to be resolved. The author also proposes a suggested hierarchy of relevant factors for tax authorities and taxpayers to make use of when solving for cases of dual residency under MAP.

#### **5.2. ENTITLEMENT TO BENEFITS AND TIMING CONCERNS FOR MAP**

As part of BEPS: Action 14, the OECD carried out a MAP Peer Review Report on making dispute resolution more effective for various countries including South Africa. The report entailed two stages with stage two being reported in 2021. The outline of stage two covered various matters such as: preventing disputes, availability and access to MAP, resolution of MAP cases and the implementation of MAP agreements. The report addressed two of the concerns raised with the implementation of Article 4(1) of MAP namely the entitlement to benefits for taxpayers and the timing concerns for reaching a resolution for a MAP.

In the case of the timing for MAP cases to be resolved, South Africa's competent authorities provided the OECD with statistics regarding the 2016-2019 period, specifically including the time period (in months) it took to close MAP cases. It was reported that South Africa took 26.50 months to close MAP cases. This statistic exceeded the 24 month ideal timeline for a MAP to be

resolved. Although this was the case in stage two of the OECD's report, it was noted that in comparison to stage one of the report, South Africa was able to close 65% of its cases prior to 2016. This illustrates that current and future MAP cases were resolved in a timely, efficient and effective manner (OECD, 2021).

The OECD nonetheless did suggest for South Africa to devote additional resources to its competent authority to handle pending and future MAP cases in a timely manner. South Africa noted that the devotion of additional resources may be possible in the medium term and is dependent on budgetary constraints (OECD, 2021). The measurement as to whether this recommendation has since been met by SARS cannot be determined as part of the scope of this paper.

With regards to the entitlement of treaty benefits and the entitlement to apply for a MAP, South Africa reported that it would not deny access to a taxpayer for a MAP where a treaty anti-abuse provision applies (OECD, 2021). This resolves the concern raised, of taxpayers not being entitled to apply for a MAP in the case of anti-abuse provisions such as Article 4(1) of the MLI. Therefore, South Africa's competent authorities confirmed that if using the strict reading of the wording of the MLI, a taxpayer would still be entitled to apply for a MAP.

Further to the position noted by South Africa, the suggestion of the HMRC for taxpayers to perform a self-assessment to determine their residency can be drawn upon. Such self-assessment would be subject to the assessment of the competent authorities. The criteria for taxpayers to use to perform such self-assessment, however, may not be provided by the competent authorities in certain terms or a hierarchical order.

### **5.3. CRITERIA TO DETERMINE CORPORATE RESIDENCY**

The consideration as to which criteria should be used in determining residency is uncertain for taxpayers. Although there is guidance provided by competent authorities in various countries, there is no defined criteria as to what the authorities would consider and in which order. Without providing a hierarchy to the application of the criteria to be applied, a contracting State may then

choose any factor it wishes to consider (even those not listed in the wording of the MLI) (Olika, 2023).

The importance of the purpose of Article 4(1) of the MLI must again be looked at when considering the criteria to determine residency. The introduction of the Article was as an anti-abuse provision for taxpayers who are structuring their tax matters in such a way as to take advantage of tax benefits such as a lower tax rate or even non-taxation. The Article would bring for unintentional consequences for taxpayers who are not structuring their business and tax affairs for the purposes of abusing tax treaties.

The purpose of the introduction of Article 4(1) of the MLI may then guide the application of it by the competent authorities, who opt to apply the Article to their CTAs. When considering that the mind of the authorities may be one of considering tax treaty abuse, the actual substance of what a taxpayer is carrying is of most importance.

To begin the authors suggested hierarchy of criteria, the first and highest criteria proposed is the factual circumstances and facts provided by the taxpayer, specifically in relation to the activities carried out by its senior management and board of directors. The facts will need to be understood and gathered by taxpayers and provided to the competent authorities. These facts would be explaining the nature of the business of the taxpayer, what its day-to-day activities entail and what role both their senior management and board of directors play in such day-to-day activities.

The recording of such information can be demonstrated from the financial information such as audited financial statements as well as provision of board minutes, board resolutions, agreements that the taxpayers enters into as part of carrying on its business. This may also include tax advice or opinions which the taxpayer may have received concerning its tax residency, tax residency confirmation of the taxpayer (if possible).

It is the authors view that the next consideration is where the residency of the members of senior management and the board of directors are. Further, where the day-to-day decision making and strategic decision making is made when carrying on the business of the company or taxpayer.

The author highlights importance here to note the difference between the level of strategic business decision making and the overall decision making which leads to the taxpayer carrying on its daily trade. Here it is suggested by the author that taxpayers do not confine themselves to the narrow interpretation of 'POEM' or 'CMC' but consider the underlying purpose of the use of these tests, being that the central and day-to-day business decision making of the taxpayer. This suggestion by the author provides a taxpayer with a further understanding, guidance and possible leverage in the form of case law from a UK perspective on what factors may apply to their own facts and how the Courts may apply such tests. In the alternative, for POEM, the interpretation of both SARS and the OECD can be drawn from apply such tests to its facts. The taxpayer can make use of these tests, especially the interpretation by the tax authorities, to understand the thinking and factors of importance which tax authorities would look to when determining residency.

With regard to the senior management and board of directors it is suggested by the author for the taxpayer to be upfront of the tax residency of such individuals and provide the residency information of such individuals to the tax authorities. It must be noted that the taxpayer and authorities may need to conduct a further analysis in determining the individual tax residency if it considers that these individuals are not tax residents of one jurisdiction.

A factor, which is not specifically mentioned in the POEM criteria, but was mentioned in the UK '*Laerstate BV v Commissioners for Her Majesty's Revenue and Customs*' (2009) case where the authority and decision-making power of the shareholder must be considered. It is suggested by the author to include the position of the shareholder in relation to the taxpayer as a criterion to consider in determining residency. This is emphasised in cases where neither the board nor the senior management are making the principal business function decisions as the shareholder has the authority for such decisions. This occurrence may be common with shareholders who were founders of the business and were initially both senior management and shareholders of the business then moved to being the shareholder of the business and maintained their senior management authority.

This leads to the next factor in the hierarchy suggested by the author which is establishing the authority held by the decision makers of the business (being senior management, board of directors and shareholders). The authority held must consider what such persons have the authority to carry out and decide on regarding the business and specifically which business functions these relate to. It will also include the signing powers of such persons and where such signing powers are limited. Here is it equally important to consider whether there is any delegation of authority in place by the taxpayer granted from the shareholders or board of directors. How far such delegation of authority extends and what such authority is limited to must also be considered. This can be documented by a taxpayer in the form of a delegation of authority policy and supported by the relevant board meeting minutes or board resolutions.

The last suggested factor or criteria in determining residency by the author is the legal form such as place of incorporation or domicile of the entity. Noting that the legal form of the corporate is in contrast to the above-mentioned criterion of consideration, which are notably substance based. The reasoning for the suggestion is that instances of dual residency arise mostly as a result of the legal form of a corporate due to their local tax legislation. Secondly, it must be considered whether the taxpayer would be entitled to treaty relief in such circumstance. The inclusion of the legal form may not be as important a factor for the competent authorities; however, it is a factor which cannot be disregarded in its entirety.

#### **5.4. CONCLUSION**

Resolving the issues which may arise from implementing the MLI may be an area that taxpayers, tax authorities and the OECD will be required to monitor and unpack over time. As the OECD has its MAP peer review report in place, the efforts in making more effective MAP cases is an ongoing effort is currently being monitored and effecting change by tax authorities.

From a corporate residency perspective and Article 4(1) of the MLI, the uncertainty of the taxpayer cannot be resolved without certainty provided by the tax treaties, legislation or tax authorities. The above analysis does provide

for the suggested criteria by the author to be considered by tax authorities such as SARS when determining corporate residency and the hierarchy for factors to be considered. The list is however, in no means exhaustive and is limited to the analysis performed in this study.

Nonetheless, it may be beneficial for tax authorities to broaden the base of their resources. Consideration can be given to the academic positions and research performed to further support resolving of disputes such as MAP cases. This could assist in solving for instances where additional resources (such as staffing and technical expertise) may not be provided to authorities to resolve such matters.

## CHAPTER 6

### CONCLUSION

There are many challenges that are expected to be faced when applying Article 4(1) of MLI in determining residence in cases of dual residency for corporate entities. Some of which include the lack of treaty benefits, double taxation for taxpayers' while tax authorities resolve MAP cases, timing for which it will take tax authorities to reach agreement on through a MAP, whether the tax authorities will in fact reach agreement in the MAP cases and what factors would tax authorities take into account when resolving MAP cases relating to corporate dual residency.

This paper sought to answer the question to, in a tax treaty context, what are the challenges to solve for a case of a company's dual residency where MAP is the tie-breaker clause, as set out in Article 4(1) of the MLI? Further, what are the solutions to the challenges in solving for a case of a company's dual residency where MAP is the tie-breaker clause, as set out in Article 4(1) applies to a Covered Tax Agreement? What factors should be considered as relevant to the South African tax authority and taxpayers and in what hierarchical order?

Throughout the analysis carried out in this paper, the legal uncertainty provided to taxpayers from the implementation of the MLI is the overarching challenge and concern. For this concern, it was analysed as to whether there is any solution that could be provided specifically for the factors which tax authorities may use as determining factors in solving for dual residency MAP cases. This analysis was carried out by considering the South African local legislation, SARS' interpretation and the treaty context which the MLI would apply to South Africa. This was further developed with an analysis of the local tax law Mauritius and the UK and their treaty context with South Africa in solving for dual residence cases in.

The suggested solution and hierarchy provided by the author is for tax authorities to consider firstly the substance of the decision making performed by the senior management, board of directors and shareholders of a taxpayer.

This suggestion is based on aligning to the purpose of BEPS Action 6 and the introduction of Article 4(1) of the MLI being an anti-abuse provision. It is also suggested specifically to integrate the interpretation and application from other jurisdictions such as the UK and not to consider the concepts of POEM and CMC as mutually exclusive.

The second factor that is suggested by the author, in order of hierarchy, is the authority of the senior management, board of directors and shareholders of a taxpayer and how such authority is exercised. Consideration here must be had to the delegation of authority and how such delegation is extended, where such policy exists. The importance of this factor lies in the fact that the legal authority for the business to function or make strategic decisions would be granted to certain individuals in the taxpayer's business. Understanding such authority would assist tax authorities with a better understanding of a taxpayer's business. Also, to distinguish where the authority for overall day-to-day or business function decisions are made and where the authority for the strategic decisions are made.

The last factor suggested by the author to be considered by tax authorities and taxpayers is the legal form of the taxpayer. This in terms of its corporate residency i.e., place of incorporation, domicile or the relevant corporate law recognition of registration and residence. It is a factor which may be disputed, however, it is still an essential factor in enabling the tax authorities with a holistic understanding of a taxpayers' business and to reach agreement in determining its residency.

The suggested list of factors by the author for tax authorities and taxpayers to determine residency in a MAP case is non-exhaustive. There may be a variety of factors such as outlying factors which need to be considered on a case-by-case basis. This, however, is suggested on the basis that tax authorities grant taxpayers a framework to apply to dual residency MAP cases. This would provide a form of legal certainty to taxpayers. It may also provide the tax authorities a form of efficiency in the way in which information is received and collated. It is suggested that for such a framework to be applied, it must still be noted that the list of factors are non-exhaustive.

The analysis performed in this study was limited to the consideration of factors in determining residency of 3 countries (South Africa, Mauritius and the UK). Such limitation results in limited results and suggested solutions. It is suggested for further research to take place to understand the determining factors of countries which opt to apply Article 4(1) of the MLI. This may broaden or even narrow the factors used by tax authorities when solving its MAP cases. The basis for this suggestion is that such research may be available to both taxpayers and tax authorities. The benefit to tax authorities would be that the focus spent on resources resolving MAP cases may resolve cases in a timelier manner (creating further certainty for a taxpayer).

For a taxpayer, it would provide further insight into the relevant factors that may be considered by tax authorities and how they may apply such factors to their cases of dual residency. This is especially important as the decisions made by tax authorities from a MAP case are not shared with taxpayers, in the same way in which a court case would be. A taxpayer may have no basis to understand what information would be of importance to the tax authorities, what information may be in support of its position and how different tax authorities' approach and resolve such cases.

The provision of these factors, other than creating certainty for a taxpayer, may in itself allow taxpayers to structure their businesses in a way which supports the anti-abuse measures. Where a taxpayer is granted a framework of compliance, it may then structure its business to be in accordance with such compliance. This may then eliminate instances where the application of Article 4(1) of the MLI unintentionally includes taxpayers with a determined residency who have legitimate business operations and reasons for the way in which it functions.

It is lastly suggested for tax authorities to consider the approach of the HMRC in tasking taxpayers to perform a self-assessment and determine their respective corporate residencies. In the interest of the time and resources of both the taxpayer and tax authorities, cases of dual residency must be resolved through a MAP procedure on an exception basis and not as a baseline approach.



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## APPENDIX A

## ANALYSIS OF SOUTH AFRICAN DOUBLE TAX AGREEMENTS TIE-BREAKER CRITERIA FOR DUAL RESIDENCE COMPANIES OVERLAYING THE APPLICATION OF THE MLI

<b>Contracting State</b>	<b>DTA status</b>	<b>Tie-breaker criteria for dual residence for companies in terms of the DTA</b>	<b>Opt in to apply Article 4(1) of MLI</b>	<b>Does the DTA contain the updated OECD Model wording with aligns to the updated MLI wording</b>
<b>Algeria</b>	Not signed	POEM	N/A	N/A
<b>Australia</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Austria</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Belarus</b>	Not signed	MAP	N/A	N/A
<b>Belgium</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Botswana</b>	Not signed	MAP	N/A	N/A
<b>Brazil</b>	Not signed	POEM	N/A	N/A
<b>Bulgaria</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Cameroon</b>	Signed	MAP	Not apply Article 4(1)	Yes
<b>Canada</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Chile</b>	Signed	MAP	Not apply Article 4(1)	Yes

<b>China</b>	Signed	POEM & MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Croatia</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Cyprus</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Czech Republic</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Democratic Republic of Congo</b>	Not signed	POEM	N/A	N/A
<b>Denmark</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Egypt</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Ethiopia</b>	Not signed	POEM	N/A	N/A
<b>Finland</b>	Signed	MAP	Not apply Article 4(1)	No
<b>France</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Gabon</b>	No notification	N/A	N/A	N/A
<b>Ghana</b>	Not signed	POEM	N/A	N/A
<b>Greece</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Hong Kong</b>	Signed	MAP	Not apply Article 4(1)	Yes
<b>Hungary</b>	Signed	POEM	Not apply Article 4(1)	No
<b>India</b>	Signed	POEM & MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Indonesia</b>	Signed	MAP	Opt into Article 4(1)	Article 4(1) of MLI applies

<b>Iran</b>	Not signed	Registered office	N/A	N/A
<b>Ireland</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Israel</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Italy</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Japan</b>	Signed	MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Kenya</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Korea</b>	Signed	POEM & MAP	Not apply Article 4(1)	No
<b>Kuwait</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Lesotho</b>	Signed	MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Luxembourg</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Malaysia</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Malta</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Mauritius</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Mexico</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Mozambique</b>	Not signed	POEM	N/A	N/A
<b>Namibia</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Netherlands</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies

<b>New Zealand</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Nigeria</b>	Signed	MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Norway</b>	Signed	MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Oman</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Pakistan</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Poland</b>	Signed	POEM & MAP	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Portugal</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Qatar</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Romania</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Russia</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Rwanda</b>	Not signed	POEM	N/A	N/A
<b>Saudi Arabia</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Seychelles</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Singapore</b>	Signed	MAP	Not apply Article 4(1)	Yes
<b>Slovak Republic</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Spain</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Sudan</b>	Not signed	N/A	N/A	N/A

<b>eSwatini</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>Sweden</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Switzerland</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Taiwan</b>	Not signed	POEM	N/A	N/A
<b>Tanzania</b>	Not signed	POEM	N/A	N/A
<b>Thailand</b>	Signed	MAP	Not apply Article 4(1)	No
<b>Tunisia</b>	Signed	POEM	Not apply Article 4(1)	No
<b>Turkey</b>	Not signed	POEM & MAP	N/A	N/A
<b>Uganda</b>	Not signed	MAP	N/A	N/A
<b>Ukraine</b>	Signed	POEM	Not apply Article 4(1)	No
<b>United Arab Emirates</b>	Signed	POEM	Not apply Article 4(1)	No
<b>United Kingdom</b>	Signed	POEM	Opt into Article 4(1)	Article 4(1) of MLI applies
<b>United States of America</b>	Not signed	MAP	N/A	N/A
<b>Zimbabwe</b>	Not signed	MAP	N/A	Yes