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School of Accountancy

The research was submitted to the Faculty of Commerce, Law, and Management in partial fulfilment of the requirements for the degree of Master of Commerce (Taxation).

The Tax Residency of a Legal Person During the World Health Pandemic.

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DECLARATION

I hereby declare this research report to be my unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand. It has not been submitted before for any other degree or examination in any other country.

Nomsa Patience Mhlongo

30 June 2022

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Abstract

It is common for directors to travel from their home jurisdiction to another jurisdiction to attend board meetings. At these Board meetings, the company's tactical and operational decisions are made, resulting in the latter jurisdiction being the Place of Effective Management. Due to the Covid-19 pandemic, there is a lack of certainty regarding the possible changes in the Place of Effective Management of a company due to the incapacity of the board members or senior executives to travel abroad given stringent travel restrictions. Numerous countries around the world have reacted to the Covid-19 pandemic with exceptional lockdowns, extremely limiting economic activity and the personal movement of their citizens. The concern may affect the company's residence under domestic laws and influence the company's tax jurisdictions.

It is not out of the ordinary for foreign companies to have one or more board members who reside in South Africa, particularly if the foreign companies are subsidiaries of a group headquartered in South Africa. In case SARS were to require the eye that managerial decisions taken in South Africa during the lockdown by a CEO or other Board members of a foreign company have caused the foreign company to become a South African tax resident, at that point it be at risk of being taxed here as well as in the country where it is normally tax resident.¹

Keywords: Place of effective management, interpretation note 6, the Organization for Economic Co-operation and Development "OECD", Model Tax Convention, central management and control

¹ The Tax Faculty : Covid-19 how to manage "place of effective management" tax risks lockdown [webber wentzel, place of effective management, covid-19, lockdown, coronavirus, pandemic, social distancing \(taxfaculty.ac.za\)](https://taxfaculty.ac.za/webber-wentzel-place-of-effective-management-covid-19-lockdown-coronavirus-pandemic-social-distancing) (accessed 16 June 2022).

1 Introduction

South Africa acquired a “residency-based” income tax principle in 2001.² This means that the persons who are inhabitants of South Africa for tax reasons residents are subject to income tax in South Africa on their worldwide income.³ Persons who are not inhabitants of South Africa for tax reasons are only subject to income tax on the amounts that they derive from a source in South Africa.⁴ Tax residence is one of the fundamental concepts in South African tax law. The natural person residency is based on meeting all the prerequisites of the physical presence test,⁵ however, is more difficult to decide for companies. The residency of the company is generally determined by identifying the company’s “Place of Effective Management” (“POEM”).⁶

South Africa has embraced two tests for deciding the tax residency of a legal person. Under the first test, a legal person is regarded as a tax resident if is incorporated, established, or formed in South Africa.⁷ There is no definition in the Income Tax Act of the term “incorporated” or “formed”.⁸ The second test looks at a legal person’s POEM. This test has been recognized as a “less artificial measure” that looks to “substance” over form.⁹ POEM is a familiar concept used in South Africa and internationally.

The POEM principle is applied to decide the tax residency of a company other than an individual. The influence of the Covid-19 pandemic on the application of the POEM test must be taken into consideration in companies with several offshore subsidiaries. A company that is incorporated in a foreign country will have dual residence status if it is effectively managed in South Africa, leading to the potential for juridical double taxation.¹⁰ When two states treat the same legal person as a resident for tax purposes under their domestic law, that legal person is said to be a “dual resident” and thus fully

² Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 754).

³ Ibid.

⁴ Ibid.

⁵ SARS Interpretation note 3 issue 2 [LAPD-IntR-IN-2012-03-Resident-definition-natural-person-ordinarily-resident.pdf \(sars.gov.za\)](#) (accessed on 12 June 2022).

⁶ Olivier and Honiball(2011:24).

⁷ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 754).

⁸ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 33).

⁹ Ibid.

¹⁰ De Koker and Williams §5.2G (2021:589).

liable for tax in both jurisdictions.¹¹ The Organisation for Economic Cooperation and Development Model Tax Convention contains tie-breaker rules that state that a non-individual should be considered to be an inhabitant as it is where the state in which POEM is situated. All relevant facts and circumstances must be looked at to determine the POEM.¹² A company may have more than one place of management, but it can only have one POEM at any one time.¹³ Different countries have diverse methods of deciding tax residency, for example, Australia and the United Kingdom have adopted the central management and control test to decide the tax residence of companies.

A situation may emerge where key commercial decisions of a legal person are made outside the tax jurisdiction, this may influence POEM. Covid-19 pandemic has resulted in travel limitations, resulting in South African directors of foreign companies, being unable to attend board meetings, or conduct business in the country where that company is a tax resident. Will these companies be taxed in South Africa by its POEM?

The OECD Secretariat Analysis of Tax Treaties and the impact of the Covid-19 crisis issued guidance from several jurisdictions such as Australia, Canada, Greece, Ireland, New Zealand, and the UK on whether temporary work and company management practices prompted by the Covid-19 pandemic can result in changes in corporate residence.¹⁴ The guidance represents the Secretariat's "view on the interpretation of the provisions of the tax treaties and expects to supply more certainty to taxpayers".

The determination of the POEM will be more difficult as Covid-19 prevented travel and the new norm is to host electronic meetings from any jurisdiction. For example, South African directors of a foreign company based in country A, cannot travel to country B to host meetings or conduct business due to the unprecedented lockdowns, which has resulted in hosting these meetings electronically.

¹¹ Oguttu, AW (2008) "Resolving double taxation: the concept "place of effective management" analysed from a South

African perspective", Comparative and International Law Journal of South Africa, vol. 41, pp. 80-104.

¹²Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 34).

¹³Ibid.

¹⁴ The OECD Secretariat Analysis of Tax Treaties and the impact of the Covid-19 [OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis - OECD \(oecd-ilibrary.org\)](https://www.oecd-ilibrary.org/tax-treaties/analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis) (accessed on 16 June 2022).

1.1 The Research Problem

The statement of the problem.

The impact of Covid-19 has been critical, resulting in the travel restrictions imposed by the government where some board members or other senior executives of foreign companies could not travel from South Africa to run a business in the country where that company is the tax resident. A situation may arise where the key commercial decisions of a foreign company are made in South Africa, this may have a negative and unplanned impact on the POEM of the foreign company.

1.2 Research Questions

1.2.1 The main Research question is

Will the inability to host meetings in a foreign country result in a change of POEM for foreign companies?

This has been split into four sub-questions below

How could companies maintain their legal personal tax residency during the world health pandemic COVID-19?

Is there a risk of an international company being regarded as a South African Company by POEM during the pandemic COVID-19?

What is the application of the POEM tie-breaker rules?

What is the international interpretation of the POEM?

1.3 Scope and Limitations

This research report will only examine the residence principles of persons other than natural persons (companies). The research report will be based on whether there are any risks of a foreign company being a tax resident in South Africa. This will include the investigation of the POEM. The residency of a natural person will not be covered in this research.

This thesis will cover the SARS interpretation note 6 and the international law aspects of how COVID-19 may or may not affect the POEM.

1.4 Research Methodology

To undertake the proposed qualitative research, SARS Interpretation Note 6 will be dissected with guidance provided by the OECD MTC 2017 and 2014. This paper endeavors to examine different practical issues encompassing the determination of the POEM of a company by way of case studies and the residential status is determined under the Income Tax Act 58 of 1962. Other sources of information will include publications, e-books, books, journals, statutes, reports, and guidelines that will be utilized as the basis of this research.

2 Literature review

2.1 Taxation in South Africa, Residency concept.

The term “residence” has a specific meaning in the tax law. It ought not to be confused with nationality, citizenship, and domicile. It also does not necessarily coincide with exchange control regulations.¹⁵ A wide test is applied in South Africa to decide the residence of companies and taxpayers other than individuals.¹⁶ These companies are South African residents if incorporated, established, and formed in South Africa, or if have their POEM in South Africa.¹⁷ POEM is where the corporate entity is effectively managed, and the interpretation and application differ from jurisdiction to jurisdiction.

The Katz Commission Report also made references in South Africa to the term POEM. The report states the following in paragraph 6.1.2.1.

“The current definition of a domestic (read ‘resident’) company is a company incorporated in South Africa, or a company “managed and controlled” in South Africa. The main criticism of this definition is that it has proven subject to relatively simple, formalistic manipulation. This concept is also out of line with the commonly used, and much more substantial, tax treaty expression of ‘effective management’. The Commission recommends that the concept of effective management as referred to in Article 4(3) of the OECD Model Tax Convention be used consistently to designate the tax residence of persons other than natural persons. This may perhaps be best achieved through an appropriate definition in s 1 of the Income Tax Act. Again, the change will have the benefit of employing international and, therefore, commonly understood terminology”.¹⁸

By suggestion, the Katz Commission Report connects meaning to POEM which is diverse from the term managed and controlled.¹⁹ The Katz Commission Report is of the view that South African tax legislation should utilize the terminology that is globally recognized. The POEM concept also seems to indicate a similar meaning to the tax

¹⁵ Olivier and Honiball (2011:19).

¹⁶ Olivier and Honiball(2011:24).

¹⁷ Ibid.

¹⁸ *Katz Commission the 5th report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa* “basing the South Africa Income Tax system on the Source or Residence principle – Options and recommendation”. [5_1.PDF \(treasury.gov.za\)](#) (accessed on 05 January 2022).

¹⁹ Olivier and Haniball (2011:27).

treaty.²⁰ The South African author's "view" is that POEM is the place where a higher level of the day-to-day running of the business takes place.²¹

The briefing note released by the National Treasury and SARS regarding the Residence Basis of Taxation pointed out the following

"As was announced in the Budget Review, a 'residence minus' system will be adopted with effect from years of assessment commencing from 1 January 2001.

Residents will be taxed on their worldwide income, but certain categories of income and activities undertaken outside South Africa will be exempt from South African tax".

Foreign taxes paid by these residents will, however, be allowed as a credit against the South African tax liability".²²

The briefing note also pointed to the following reasons for the change to the new basis of taxation :²³

- To place the income tax system on a sounder balance in this manner ensuring the South African Tax base from exploitation;
- To bring the South African tax system more in line with international tax principles;
- The relation of exchange control and the greater involvement of South African companies offshore;
- To more effectively cater to the taxation of e-commerce.

The most vital change made in the briefing note was re-defining the tax base whereby:²⁴

- All residents will be taxable on their South African and foreign income;
- All non-residents will be taxable on their South African-sourced income.

²⁰ Ibid.

²¹ Olivier and Honiball(2011:28).

²² National Treasury and South African Revenue Services: Briefing Note on the Residence Basis of Taxation [Residence Basis of Taxation.PDF \(sars.gov.za\)](#) (accessed on 14 January 2022

²³ Ibid. Par 3.

²⁴ Ibid. Par 4.

Also, the briefing note was refining a resident as a worldwide tax system.²⁵ A company is a resident if it is incorporated or has a POEM in South Africa.

2.2 The concepts of DTA

Double Taxation Agreements ("DTA") are internationally agreed legislation between two countries. South Africa holds a handful of such agreements with different countries, the most reason for a DTA is to guarantee that each country subject to the agreement knows what taxing rights they hold against taxpayers.²⁶ These agreements are referred to as tax treaties or DTA's.

A DTA guarantees that a taxpayer is not unjustifiably taxed in both South Africa and the corresponding country dealt with in a DTA.²⁷ It provides a defence to double taxation and sets out different prerequisites that a taxpayer must meet to comprehend where that taxpayer falls as a tax resident.²⁸ Dependent on where a taxpayer falls as a tax resident, taking into consideration, that the DTA will determine where the taxpayer must pay certain types of taxes on income received.²⁹

Article 2 of the Vienna Convention on the Law of Treaties 1969 reads as follows:

“treaty” means an “international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or two or more related instruments and whatever its particular designation”.³⁰

In essence, tax treaties create an individualistic voice to avoid double taxation through the restriction of Contracting States.³¹ This individualistic voice is made by either one of the Contracting States undertaking not to levy a tax or to levy tax only to a restricted extent or where it does levy tax to give credit for foreign taxes payable.³² Tax treaty rules do not lead to the application of domestic tax law in respect of both contracting

²⁵ Ibid.

²⁶ <https://www.taxconsulting.co.za/double-taxation-agreements/> (accessed on 25 September 2020).

²⁷ Par 2. [Double Taxation Agreement Assistance | Tax Consulting South Africa](#) (accessed on 26 January 2022).

²⁸ Ibid.

²⁹ Ibid.

³⁰ Par 1. Vienna Convention on the Law of Treaties 1969 [Vienna Convention on the Law of Treaties \(1969\) \(un.org\)](#) (accessed on 26 January 2022).

³¹ Olivier and Honiball (2011:269).

³² Ibid.

states.³³ *Russo 2008 European Tax 459* indicates that the term POEM has at least two interpretations in a treaty context, namely the place where the board of directors meets and where the senior management operates.³⁴

2.2.1 The Position of Tax Treaties in South Africa

South African laws, which incorporate statute law, common law, international customary law, and international law, are subject to the provisions of the Constitution of the Republic of South Africa, 1996.³⁵ As a tax treaty is classified as an international agreement, it should be connected, and the context of s 231 of the Constitution.³⁶ Under s 231 of the Constitution, all international agreements, i.e. including tax treaties, must be received by certain customs to be consolidated as portions of the South African Law.³⁷

The requirements for an international agreement to bind South Africa are set out in s 231(2) of the constitution.³⁸ Section 231(4) provides that all other pertinent sanctioning domestic legislation laid down for incorporation has to be complied with.³⁹ The domestic procedures for recognition of tax treaties into South African law are set out in s 108(2) of the Income Tax Act.⁴⁰ Tax treaties aim to prevent economic and juridical double taxation, although tax treaties generally only remove juridical double taxation.⁴¹

2.2.2 Interpretation of Tax Treaties in South Africa

Tax treaties don't have extraordinary or favored status in South Africa.⁴² Based on the method of incorporating a treaty into law, a treaty positions similarly with South African domestic law.⁴³ Further, a treaty itself does not form part of international customary law.⁴⁴ Article 31 of the VCLT 1969 sets out the rules of interpretation in respect of the tax treaties "a treaty shall be interpreted in great confidence by the conventional

³³ Vogel (1997:20).

³⁴ *Ibid.*

³⁵ Olivier and Honiball (2011:303).

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ *Ibid.*

⁴¹ Olivier and Honiball (2011:305).

⁴² Olivier and Honiball (2011:303).

⁴³ *Ibid.*

⁴⁴ *Ibid.*

meaning to be given to the text of the treaty in their context and the light of its objects and purpose”.⁴⁵

“Section 231 of the Constitution states that an international agreement of a technical, administrative, or executive nature or an agreement does not require either approval or promotion, entered into by the national executive, binds the Republic of South Africa without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within the reasonable time”.⁴⁶

In the *Commissioner for South African Revenue Services, v Tradehold Ltd* (132/11) [2012] ZASCA 61 (8 MAY 2012) stated the following with regards to the interpretation of tax treaties:

“Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. They achieve the objective of s 108, generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state or, in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances”.⁴⁷ A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict”.⁴⁸

From the analysis above under the South African Constitution, a treaty treated similarly with domestic law even if a provision thereof is not compatible with domestic laws, and its provision would need to be interpreted like domestic statutory provisions to create a sense of any struggle or irregularity.⁴⁹

⁴⁵ Art 31(1) of the VCLT 1969 [Vienna Convention on the Law of Treaties \(1969\) \(un.org\)](#) (accessed on 30 May 2022).

⁴⁶ Section 231 of the Constitution [Office of the Chief State Law Advisor \(IL\) \(dirco.gov.za\)](#) (assessed on 30 May 2022).

⁴⁷ Ibid.

⁴⁸ *Commissioner for the South African Revenue Service v Tradehold Ltd* (132/11) [2012] ZASCA 61 (8 MAY 2012) [LAPD-DRJ-SCA-2012-02-Tradehold-8-May-2012.pdf \(sars.gov.za\)](#) (accessed on 30 May 2022).

⁴⁹ Olivier and Honiball (2011:306).

2.2.3 Rules of Interpretation

The Strict literal approach

In terms of this rule, the interpreter primarily concentrates on the exacting meaning of the words of the provision that must be translated to determine the purpose of the legislature.⁵⁰

The purposive approach

The purposive or contextual approach determines the purpose of the legislation by taking into consideration all surrounding circumstances and resources.⁵¹

An objective approach

In a more recent decision (Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA)) the judge (Willis JA) warned against the utilization of an expression such as “the intention of the legislature” if the sole purpose is an inquiry into the mind of the legislature.⁵² Paragraph 18 of the judgment is as follows;

“The present state of the law can be expressed as follows. Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or a contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence”.⁵³ Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed, and the material known to those responsible for its production”.⁵⁴ Where more than one meaning is possible each possibility must be weighed in the light of all these factors”.⁵⁵ A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to and guard against, the temptation to

⁵⁰ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 20).

⁵¹ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 20).

⁵² Ibid,

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ Ibid.

substitute what they regard as reasonable, sensible, or business-like for the words used. To do so regarding a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context, it is to make a contract for the parties other than the one they made. The “inevitable point of departure is the language of the provision itself, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document”.⁵⁶

The contra fiscum rule

The contra fiscal rule is also in agreement with the spirit and purport of the Bill of Rights and this rule means that where a provision of the Act is open to more than one meaning, the court must take after the interpretation that favors the taxpayer (and therefore goes against the fiscus).⁵⁷

Substance over form rule

If problems of interpretation arise about the genuine meaning of an agreement or a transaction, the courts will be concerned with the substance rather than the form of the agreement or transaction.⁵⁸

2.3 The meaning of POEM

There is no single, internationally recognized meaning of POEM, nor does the Act define it.⁵⁹ A company formed and incorporated in South Africa in terms of s 13 of the Companies Act 71 of 2008 is a resident of South Africa because of its formation and incorporation in the Republic of South Africa, disregarding where it is managed or where it is carried out its business.⁶⁰ As a result of being an inhabitant of South Africa,

⁵⁶ Par 18 of the judgement [Natal Joint Municipal Pension Fund v Endumeni Municipality \(920/2010\) \[2012\] ZASCA 13; \[2012\] 2 All SA 262 \(SCA\); 2012 \(4\) SA 593 \(SCA\) \(16 March 2012\) \(saflii.org\) \(accessed 31 May 2022\)](#).

⁵⁷ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 20).

⁵⁸ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 20).

⁵⁹ De Koker and Williams. § 14.42 (2021: 1857).

⁶⁰ Stiglingh, Koekoemoer, Van Heerden, Wilcocks and Van der Zwan (2018: 33).

the company is at risk of tax in South Africa on its worldwide receipts.⁶¹ The term POEM is utilized to decide the residency of a company in South Africa.⁶²

The Income Tax Act 1962 defines the term “resident” to mean the following about the company:⁶³

“(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, 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 Republic and that other country for the avoidance of double taxation;...”⁶⁴

In the tax treaties, the term POEM is used as a so-called “tie-breaker” where an individual is considered for a tax treaty to be an inhabitant in both contracting states.⁶⁴ A tie-breaker clause, as a rule, provides that a dual-resident person other than an individual is resident for the tax treaty in the country in which it has its POEME even though the term is utilized ought to therefore prima facie have the same meaning, the intention or purpose varies in the context and different meanings may be ascribed to POEM in this context.⁶⁵

South African Revenue Services (“SARS”) has adopted Interpretation note 6 on the POEM’s view, which is in line with the OECD guidelines.⁶⁶ The term POEM it’s not defined in the Income Tax Act.⁶⁷

Article 4(3) of the OECD Model Tax Convention provides that:

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 endeavour to determine by mutual agreement the Contracting State of

⁶¹ Ibid.

⁶² Section 1 of the Income Tax Act 1962.

⁶³ Ibid.

⁶⁴ Olivier and Honiball (2011:25).

⁶⁵ Guduza T “Has recent United Kingdom case law affected the interplay between “Place of Effective Management”

and “Controlled Foreign Companies”?” *South African Mercantile Law Journal* (2012) vol. 24, p. 426.

⁶⁶ Par 4.1 Page 4 [1 \(sars.gov.za\)](http://sars.gov.za) (accessed on 16 April 2022).

⁶⁷ Olivier and Honiball (2011:24).

which such person shall be deemed to be a resident for the Convention, having regard to its place of effective management”.⁶⁸

The meaning of “POEM” is not defined in article 4(3) but paragraph 24 of the OECD Commentary on Article 4(3) offers some guidance on the meaning of the concept.⁶⁹

The paragraph states that:

Effective management is the “place where key management and commercial decisions necessary for the entity’s business are in substance, the place of effective management will ordinarily be the place where the most senior person or group of persons for example a board of directors makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time”.⁷⁰

Apart from this provision, there is no further guidance in the Commentary on the meaning of POEM.⁷¹ The purpose of the POEM is effectively to decide between two rival claims to tax based on residence.⁷²

The concept of effective management differs from shareholder control or control by the board of directors. Management centres on the company’s purpose and business, not shareholder function.⁷³

The Income Tax Act is probably the most complex legislation in the statute book. This is largely because many words or phrases in the Act can be interpreted in more than one way.⁷⁴ Language is inherently ambiguous and many a reader of the tax laws grapple daily with the complex text of fiscal legislation and tries to attach the correct interpretation to a word or phrase, which is in line with what the legislature had in mind amidst a maze of meanings and constant amendments.⁷⁵ Therefore, when

⁶⁸ Par 3 Page 7 [untitled \(oecd.org\)](#) (accessed on 01 May 2022).

⁶⁹ Oguttu Page.82

⁷⁰ Par 24 Page 82 [Model Tax Convention on Income and Capital: Model Tax Convention on Income and on Capital \(oecd.org\)](#) (accessed on 01 May 2022).

⁷¹ Oguttu Page 83

⁷²De Koker and Williams § 14.42 (2021: 1857).

⁷³ Par 3 Page 2 [Interpretation Note 6 - Resident Place of effective management - 26 March 2002 \(sars.gov.za\)](#) (accessed on 21 April 2022).

⁷⁴ Goosen (2006:9).

⁷⁵ Ibid.

determining and interpreting the ordinary meaning of the word POEM it could be supportive to see the definitions joined in different words within the dictionary.⁷⁶

2.3.1 Dictionary meaning of POEM

The word “effective” is a subjective content, and its interpretation can differ depending on the particular circumstance of a case.⁷⁷ The conventional syntactic meaning of the word can hence be exceptionally to reveal its meaning.

The Oxford online dictionary defines “effective” as follows :⁷⁸

“Successful in producing a desired or intended results; Existing in fact, though not formally acknowledged as such; Assessed according to actual rather than face value”,

And defines the word “management” to mean the following:

“The process of dealing with or controlling things or people; The responsibility for and control of a company or organization”.

2.3.2 SARS’s current approach to the term “Place of effective management

In the year 2002, SARS issued Interpretation note 6 (“IN6”) which stated the following regarding the POEM.

The Interpretation note clearly states that one should keep in mind distinguishing the following places:⁷⁹

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

The general approach taken by IN6 is that a company’s POEM is “the place where the company is managed on a regular or day-to-day basis by directors or senior managers

⁷⁶ Ibid.

⁷⁷ See Klaus Vogel (2006) *United States Income Tax Treaties* (March Update) (“Vogel US Treaties”)

⁷⁸ Available at [EFFECTIVE | Meaning & Definition for UK English | Lexico.com](https://www.lexico.com/define/effective) (accessed on 28 May 2022)

⁷⁹ Par 1. Page 3 [Interpretation Note 6 - Resident Place of effective management - 26 March 2002 \(sars.gov.za\)](https://www.sars.gov.za/interpretation-note-6-resident-place-of-effective-management-26-march-2002) (accessed on 26 April 2022).

of the company, irrespective of where the overriding control is exercised, or where the board of directors meets’.⁸⁰

In other words, “the POEM refers to the place where policy and strategy decisions made by the board of directors are implemented and not where they are taken”.⁸¹ “It would also be important that these decisions were implemented outside of South Africa to ensure the SARS interpretation of effective management”.⁸² “The foremost self-evident way to advert any question in this respect would be for all these choices and activities to be taken and implemented internationally and for all relevant documentation(for example, board of resolution) to reflect this”.⁸³

The IN6 has adopted practical application guidelines to achieve a single place in the POEM:⁸⁴

- Management capabilities are executed at a single location, that location will be POEM;
- If these management functions are not executed at a single location due to the distance communication such as telephone, and video conferencing, the POEM would be reflected where the day-to-day operational management and commercial decisions are taken by senior managers and are implemented, in other words, the place where business operations/activities are carried out or conducted;
- If the business operations/activities are carried from different locations, the POEM would be a place with the strongest economic nexus.

Van der Merwe indicated certain observations with regard to the practical application adopted, and there are as follows:⁸⁵

- “The Interpretation Note elucidates the second ‘rule’ by providing that the deemed POEM in terms of this ‘rule’(where the day-to-day operational

⁸⁰ Par 5. Page 3 [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf](https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf) (sars.gov.za) [https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2011-02 - Discussion Paper POEM on IN6.pdf](https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf) (accessed on 07 January 2022).

⁸¹ Olivier and Honiball (2011:25).

⁸² Olivier and Honiball (2011:26).

⁸³ Ibid.

⁸⁴ Par 3. Page 4 [Interpretation Note 6 - Resident Place of effective management - 26 March 2002](https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf) (sars.gov.za) (accessed on 27 April 2022).

⁸⁵ Van der Merwe BA (2006) p.128

management and commercial choices taken by senior managers are implemented) is, in other words, the place where the company operations/activities are carried out or conducted by senior managers. Van der Merwe further points out that it is evident that this application will not essentially result in a single place of residence as a taxpayer may have few places over the world where operational and commercial decisions are implemented, and where the business activities, or parts of phases of such business activities, are carried out or conducted”.⁸⁶

- “The possibility is acknowledged in the ‘third rule’ which provides that the business operations or activities are conducted from different places, one must decide the place with the strongest ‘nexus’. Van der Merwe points out that, unlike the two previous rules, the third rule is not expressly linked to effective management. This leaves one with the impression that it is not offered as a means to locate the POEM, but as a different rule to determine residence”.⁸⁷

The POEM, SARS explains, “is not the place where the extreme control of the company is located or the place where the board of directors normally meets to manage and control the company’s operations as an entirety, even though they may coincide”.⁸⁸ “Thus, a South African company, conducting its business in South Africa but controlled by foreign shareholders ordinarily resident outside South Africa, will have its POEM in South Africa”.⁸⁹

IN6 emphasizes that the determination of a company’s POEM is an intensely factual question for which no conclusive rule or bright-line test can be laid down. Consequently, SARS’s view is that the “issue requires a case-by-case analysis of the relevant facts and circumstances”.⁹⁰

In this regard, IN6 also provides the following list of factors to be considered in creating the POEM:⁹¹

⁸⁶ Ibid

⁸⁷ Ibid.

⁸⁸ De Koker and Williams. § 14.42 (2021: 1857).

⁸⁹ Ibid.

⁹⁰ Par 5. Page 4 [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf \(sars.gov.za\)](#) (accessed on 07 January 2022).

⁹¹ Ibid.

- Where the center of top-level management is located;
- Place of and functions performed at the headquarters;
- Where the business operations are carried;
- Where controlling shareholders make key management and commercial decisions about the company;
- Legal factors such as the place of incorporation, formation or establishment, the location of its registered office, and public officer;
- Where the directors or senior managers or designated managers, who are responsible for day-to-day management, reside;
- The recurrence of meetings of the company's directors or senior managers and where they take place;
- The experience and skills of the directors or senior managers who imply to oversee the entity;
- The actual activities and physical location of senior employees; the scale of onshore as opposed to offshore operations;
- The nature of powers conferred upon representatives of the entity, how [those] powers are exercised by the representatives, and the purpose of conferring the powers to the representatives.

The list of identified facts and circumstances, since, all in it, it is questionable whether they are particularly conclusive or informing, maybe they amount to a list of potentially competing factors or criteria that may be encountered in practice, but seemingly fail to come to grasp with the issue itself.⁹²

It is not unexpected, therefore, that SARS Interpretation Note 6 in its first version was the subject of significant criticism.⁹³ SARS has reacted with a discussion paper whose reason is to welcome comments from taxpayers and practitioners and to give a framework for “possible revisions” to that Note.⁹⁴ The main criticism is that the concept

⁹² De Koker and Williams. § 14.42 (2021: 1858).

⁹³ Ibid.

⁹⁴ Ibid.

is out of line with the foremost International commonly used concepts of effective management and it can be easily manipulated.

IN6 in its first version has been much dissolved by the choices of the Western Cape High Court in *Oceanic Trust Co Ltd NO v C: SARS*, discussed, below, in that the criteria connected in that judgment to decide the POEM of the trust in question deviates markedly from the criteria propounded in the Interpretation Note.⁹⁵

SARS IN6 (issue 1) received criticism in the past which is summarized as follows⁹⁶

- “The first relates to the focus of the general approach on the place where strategic decisions and policies are executed and implemented, rather than a place where those decisions and policies are taken or adopted”;
- “The second relates to the inconsistent use of terminology IN6, where commentators have drawn attention to discrepancies in the language used. Furthermore the concerns regarding the statutory basis of the use of the “economic nexus” to determine the POEM”;
- “The third relates to the apparent inconsistency between some facts and circumstances outlined in the guidance and the general approach”;
- “The fourth relates to no guidance for cases involving passing or intermediate holding companies”.

There was also criticism of a “board-centric” approach with its focus on the decision-making by an entity’s board of directors or comparative body that has been unsuccessful to keep pace with developments in telecommunication, international travel, and advanced business practice.⁹⁷

It is clear from SARS’s General Approach that the area of the primary level of management activity, central management and control as worked out by the board of directors, does not play an unequivocal in deciding the South African entity resident.⁹⁸

⁹⁵ Ibid.

⁹⁶ Par 5. Page 5. [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf \(sars.gov.za\)](#) (accessed on 07 January 2022).

⁹⁷ Par 7.1 Page 6 [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf \(sars.gov.za\)](#) (accessed on 04 May 2022).

⁹⁸ Van der Merwe BA (2006) Pg 2

Agreeing with the note, the place that is conclusive in “deciding the POEM is the place where the company is managed on a regular day-to-day basis by the directors or senior managers of the company, irrespective of where the superseding control is utilized or where the board of directors meets”.⁹⁹ In other words, the POEM refers to “the place where policy and strategy decisions made by the board of directors are *implemented* not where they are *taken*”.¹⁰⁰

SARS has not as yet withdrawn IN6 (Issue 1), but a draft second version (Issue 2) was released on 31 July 2015.¹⁰¹ No date has been reported yet to replace issue 1 of the note. SARS issued the Discussion Paper inviting taxpayers and practitioners regarding their concerns in this area and to provide a framework for discussion of possible revisions to IN6 discussed below.

The overview of the Draft Interpretation Note (issue 2)

In terms of this draft interpretation note, “the key measure in deciding a company’s POEM is the location at which the key management and commercial decisions that are necessary for the conduct of the company’s business as a whole are made”.¹⁰² In this inquiry, it is unimportant where those decisions are implemented.¹⁰³

2.3.3 SARS Discussion Paper on Interpretation Note 6

The discussion paper takes recognition of the concerns raised by the OECD MTC since 2002, the Technical Advisory Group (TAG) discussion papers released in 2001 and 2003 as well as the developments raised in UK case law such as the Laerstate, Smallwood, and Wensleydale’s Settlement Trustees cases. The concept or principles raised in the TAG discussion will be discussed below.

The Discussion Paper sets out the goals it aims to achieve in determining the POEM:¹⁰⁴

- “First, they must help to ensure that the POEM provision fulfills its reason as a substantive test that is not open to ‘simple’, formalistic manipulation”;

⁹⁹ Olivier and Honiball (2011:25).

¹⁰⁰ Ibid.

¹⁰¹ De Koker and Williams. § 14.42 (2021: 1858).

¹⁰² De Koker and Williams. § 14.42 (2021: 1856).

¹⁰³ Ibid.

¹⁰⁴ Par 8 Page 11 [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf](#) ([sars.gov.za](#)) (accessed on 04 may 2022).

- “Second, the revisions should seek to diminish vulnerability wherever conceivable, IN6 shows up to have caused instability in at least three ways first, by adopting an approach that shows up to struggle with the weight of international authority insofar as the general approach focuses on the place where strategic decisions are ‘executed’ and ‘implemented’, instead than on the place where the decision-making, in substance, takes place; second, by appearing at times to blur the lines between what has been called the ‘second’ and ‘third’ levels of management; and third, by including certain factors in the “guideline” that appear to conflict with the general approach taken by IN6”;
- “Finally, the modification ought to give adequate direction to address the legitimate concerns in this area that have been expressed by potential investors in headquarter companies”.

Then the Discussion paper establishes the areas discussed below:¹⁰⁵

A. Refinement of the general focus of IN6

The first proposal should not be abandoned in the general approach in IN6. The general approach should proceed to the second level of management “who calls the shots” and exercise realistic positive management.

The senior officers and executives are capable for:

- (1) “developing or formulating key operational or commercial strategies and policies for, or taking choice on key operational or commercial actions by the company (regardless of whether those strategies, policies, and decisions are subject to formal approval by a board or similar body) and (2) ensuring that those strategies and policies are carried out. Areas of decision-making involving extraordinary matters (such as major acquisitions, disposals, mergers, or new borrowing) that are commonly reserved to a company’s board or its shareholders, for the most part, will not be considered part of this ‘second level of management’ for a foreign operating subsidiary and therefore generally would not affect the determination of a foreign operating subsidiary’s place of

¹⁰⁵ Ibid

effective management. Similarly, day-to-day operational decision-making by junior and middle management would also generally fall outside of the second level of management, as would the performance of routine administrative or support functions”.¹⁰⁶

In addition, to align the approach with international principles and avoid misrepresentation between the second, and third levels of management, current references to the implementation of strategy and policy would be deleted and the focus will be on where the choices are made.

B. Terminology

Definitions will provide for basis terms that would be used throughout IN6. These decisions would include:

- Senior Management;
- Operational Management;
- Executive/ inside directors;
- Non-executive/ outside directors
- Head office;
- The base of operations; and
- Passive holding company.

C. Relevant facts and circumstances

Proposed the following changes to be made to relevant facts and circumstances in the current guidelines as set in IN6: The deletion of the reference legal factors, such as place of incorporation, formation or establishment, the location of the registered office, and the public officer. Clarification of the references where controlling shareholders make key management and commercial decisions about the company.

The addition of the following factors

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

¹⁰⁶ Par 8.1 Page 66 [LAPD-LPrep-DP-2011-02-Discussion-Paper-POEM-on-IN6.pdf \(sars.gov.za\)](#) (accessed on 05 May 2022).

- Consideration of differing board structures, for example, distinctions between commercial and non-commercial or supervisory boards.
- The identification of various factors that will generally be given little weight, for example, the place where administrative activities, such as the opening of a bank account, take place.
- Refinement of the distinctions between various levels of management. For example, “in companies operating on a divisional basis, individual divisions are often run by an executive vice president or operational manager who reports to a higher level of management that is responsible for the company as a whole. In such a situation, the place of effective management would be the place where that top level of management is primarily or predominantly based”.
- Criteria for determining the base of operations for senior management in situations where senior management travels frequently or operates from multiple locations (with meetings held, for example, via video conferencing).

D. Mutual agreement procedure

On occasions where there are still disagreements between SARS and the treaty partner regarding the application of POEM. The revised IN will explicitly provide to resolve disputes through the application of mutual agreement procedures.

2.3.3 Issues relating to the meaning of POEM

The meaning of POEM in domestic legislation versus the DTA

A company is regarded as a dual resident if it is incorporated or formed in one country but has POEM in another country. The POEM concept is used in South African domestic legislation as one of the two tests to determine the tax residency of the company. Oguttu thus points out that article 3(2) of the OECD Model Convention grants countries the to apply the domestic meaning to the term that is not defined in the Convention, the article also makes it clear that this has to be done in the context of the intentions of the OECD Model Convention.¹⁰⁷

¹⁰⁷ Oguttu Page 87

More than one POEM

Article 4(3) of the OECD Model Tax Convention states that there can only be one POEM, and there could be more than one place of management in the OECD's interpretation of the term POEM. By inserting the word "only" after the second word "resident" in paragraph 3 the OECD confirms the function of determining a sole state of treaty residence for companies.¹⁰⁸ Dual residence is not an option under the treaty law, as it is specifically designed to provide clarity in cases of dual attachment.¹⁰⁹

This is understood by the fact that the POEM test is one of substance over form, where it is compared to, for example, the incorporation test, and that it is supposed to allow to reflect the policy intention of the tie-breaker rule.¹¹⁰

¹⁰⁸ Goosen (2006:34).

¹⁰⁹ Van der Merwe(2002:89).

¹¹⁰ Ibid.

3 Oceanic Trust Co Ltd NO v SARS

South Africa does not have a lot of cases in the concepts of POEM, determining the Tax residency or the tiebreaker concept under the DTA. The following will point out the decision of the Western Cape High Court in Ocean Trust Co Ltd No V SARS and the criteria applied in the judgment to determine the POEM.

3.1 Background on the case

The Ocean Trust Co. Ltd N.O (hereinafter referred to as the SISM) “was formed and registered on 23 November 2000 in Mauritius, and was the sole trustee of the Specialized Insurance Solutions (Mauritius) Trust SISM, carrying on the business of captive re-insurance. Both the Oceanic Trust Company and SISM were registered in Mauritius. SISM provided re-insurance to MCubed Life Limited, a company registered in South Africa and SISM appointed MCubed Life Limited’s fellow subsidiary, Corporate Money Managers, as the asset manager and investment advisor”. “SISM was registered for tax in Mauritius”.

“The premiums of the policies of reinsurance by MCubed life with SISM were transferred to SISM and constituted assets invested by SISM in South Africa. SISM utilized an asset manager in South Africa to manage the assets invested in South Africa. Amid the period of its business operations, SISM prepared financial accounts and rendered tax returns to the revenue authorities in Mauritius”. “ SISM considered throughout that it only had tax obligations in Mauritius and that did not have any tax obligations in South Africa”.

On 4 March 2008, SISM received a notice of audit from SARS informing it that SARS intended to conduct an audit/inspection of SISM and require certain information from SISM. “The Ocean Trust as the sole trustee of SISM responded and corresponded to SARS. SARS thereupon issued a letter stating that it believed that it had had a tax claim against SISM and asked for reasons why SISM should not be taxed in South Africa”.

“On 20 July 2009, SARS issued an assessment letter wherein it raised an assessment of income tax, additional tax, and interest of the years 2000 to 2007 for ZAR1,5 billion. One of the bases for the assessment was that SISM was a resident of South Africa because it had its place of effective management in South Africa”. “The assessment

also continued that SISM derived income from the South African source and that it carried on business through a permanent establishment in South Africa”.

On 28 August 2009, SISM filed a detailed objection.

“On 23 July 2009 before the objection filed by SISM, SARS appointed Standard Bank of South Africa to remit ZAR1,5 billion to SARS”. “The standard bank paid an amount of ZAR20 million out of the SISM account to SARS”.

“On 16 September 2009 SARS gave a written notice to SISM that it was continuing with legal action against SISM which included the liquidation of SISM to recover the tax debt”.

“On 29 October 2009, the matter was heard in the Western Cape High Court of South Africa, and the applicant brought forward the matter in two parts”. “In Part A an urgent interim order was sought pending the determination of the relief sought in Part B”. In Part B the applicant seeks declaration orders declaring that”:

- SISM is not a resident of South Africa;
- SISM has not carried on business through a permanent establishment ;
- SARS is liable to repay the amount of ZAR20 million removed from the SISM Standard Bank account.

3.2 Statements of Facts

The court held that, on the facts, at least some key management decisions and at the very least commercial decisions necessary for the conduct of the trustee’s business were in substance made in South Africa, which signifies its doubt that the test for locating effective management was conclusively inclined towards Mauritius, as the applicant had urged.¹¹¹

Reasons for the assessment (Oceanic Trust, Para 22):

- “SISM is registered as an offshore trust by section 29 of the Mauritius Offshore Business Activities Act, 1992. SISM is licensed in Mauritius to conduct business

¹¹¹ De Koker and Williams. § 14.42 (2021: 1861).

as a provider of long-term insurance”. “It holds a category 1 Global Business License”.¹¹²

- “SISM is registered as a trust under the South African Trust Property Control Act”.
- “The fundamental activity of SISM is carrying out the captive reinsurance business”.
- “SISM derived all its business from MCubed Life Limited, a South African registered company”.
- “In 2000, SISM entered into a reinsurance agreement with MCubed Life Limited”.
- “MCubed Life Limited made decisions by the re-insurance agreement on how premiums were to be handled by SISM”.
- “SISM appointed Corporate Money Managers (hereinafter referred to as CMM), then a wholly-owned subsidiary of MCubed Holdings Limited, to be its asset manager and investment advisor for its South African investments. CMM received instructions regularly from MCubed Holdings Limited and its operating division Asset management Outsourcing (hereinafter referred to as AMOS) on the SISM investments”. SARS has names of individuals from MCubed Holdings who were giving such instructions”.¹¹³
- MCubed Life Limited and CMM were wholly-owned subsidiaries of MCubed Holdings Limited, listed in JSE.
- All investments in SISM were made in South Africa.
- “During the period under review, SISM generated its entire income from business activities conducted in South Africa”.
- “SISM held its bank account with Standard Bank in South Africa. A review of SISM bank statements showed that SISM did not transfer money to Mauritius from the bank in South Africa, and vice versa, throughout the period that SISM was conducting business in South Africa”.¹¹⁴
- “The reason for the formation of SISM was that MCubed Life Limited had a smaller balance sheet than most of its competitors. Many potential policyholders

¹¹² Ibid.

¹¹³ Ibid.

¹¹⁴ Par 57 - 58

found MCubed life policies attractive but would not take up the policies for fear of MCubed Life not being able to discharge its obligations on the maturity date. Furthermore, section 34 of the Long Term Insurance Act prohibited MCubed Life from encumbering any of its assets”.¹¹⁵

- MCubed Holdings Limited is a beneficiary of International Investment Trust, a beneficiary of SISM.
- “SISM did not provide to SARS, as requested, minutes of trustee’s meetings of SISM in Mauritius or any documentation to substantiate the claim of SISM’s business run in Mauritius by its trustees, the Ocean Trust”.¹¹⁶
- SISM did not pay taxes in South Africa.

3.3 Conclusion

The court stated that “it would show up to me that at the slightest few key management decisions and the very least, key commercial decisions necessary for the conduct of SISM’s business were in substance made in South Africa”. “Therefore applying the Smallwood test, the facts to the extent that they have been established, do not, in my view establish that the POEM of SISM was in Mauritius, and not in South Africa”.¹¹⁷

That Court did not distinguish between POEM in the two different contexts.¹¹⁸ Where the term POEM is used to determine the residency of a company in South Africa and the use of the tie-breaker rule in double taxation agreements where companies have dual tax residency.¹¹⁹

SARS’s approach of following a “case-by-case determination appears in line with the international standard, but the broad amount of facts and circumstances that have to be considered will involve some subjective comparisons and creates vulnerability as there is no single technical requirement that can be used as guidance for the taxpayer”.¹²⁰

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Par 57 - 58

¹¹⁸ Gutuza (2012:426)

¹¹⁹ Ibid

¹²⁰ Du Toit (2015:75).

“The Oceanic trust has moreover generally ruined the guidance issued by SARS and it is appropriately questionable what weight, if any, a court will trait to it in the future”.¹²¹

¹²¹ Ibid

4 The international Interpretation of the Residency Concept

4.1 Introduction

A place of effective management will normally be “where key management and commercial decisions necessary for the conduct of a business are in substance made and given. This will commonly be where the directors meet to form choices relating to the management of the company, but the determination of a POEM is a question of fact and other relevant factors taken into account by the courts have been included”.¹²²

- Where the center of top-level management is located,
- Where the business operations are conducted,
- Legal factors such as the place of incorporation, the location of the registered office, public officer, etc.

Even though it is evident that the OECD uses the POEM test as a tie-breaker where persons other than individuals are dually residents, it is vague what is precisely implied by POEM.¹²³

4.2 The OECD approach

The meaning of the term POEM is not defined in Article 4 of the OECD Model Tax Convention. However, the following new paragraph 24 in the Commentary on Article 4 which was included in the 2000 Update to the Model, offers a few directions on the meaning of this term.

24. ... Effective management “is the place where key management and commercial decisions necessary for the enterprise’s business are in substance. The place of effective management will ordinarily be where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the enterprise as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management”. “A venture may have more than one

¹²² Par 31. Page 7 [1923328.pdf \(oecd.org\)](#) (accessed on 09 April 2022).

¹²³ Olivier and Honiball (2011:37).

place of management, but it can have only one place of effective management at any one time’.¹²⁴

Separate from this provision, there is no further direction within the Commentary on the meaning of POEM. From the reading of paragraph 24 of the OECD Commentary, it is clear that the OECD presupposes that the determination of POEM is based on the following overwhelming components: “where the key management and commercial decisions are made in substance; where the most senior person, or group of persons (for example board of directors), makes its decisions; and where the steps to be taken by the entity as a whole are determined”.¹²⁵

4.2.1 Commentary on OECD Model Tax Convention

The existence of the Model Convention has encouraged bilateral arrangements between OECD member countries and made possible alluring harmonization between their bilateral conventions for the advantage of both taxpayers and national administrations.¹²⁶

“Most of South Africa’s treaties follow the OECD Model Tax Convention on Income and Capital to a large extent, even though South Africa is not a member of the OECD.¹²⁷ In *CIR v Dowing*, the court held that South Africa is bound to take cognizance of the guidelines for interpretation issued by the OECD in its commentaries on the concept used in the OECD Model Tax Convention”.¹²⁸

“The OECD Model Tax Convention Commentary likely forms part of South Africa’s customary international law based on its acceptance in South African case law and the general use of an interpretative aid for treaties, and would therefore be applicable in interpreting treaty provisions in South Africa”.¹²⁹

¹²⁴ Ibid.

¹²⁵ Oguttu Page 83

¹²⁶ Par 13 Page 12 [mtc_cond-2017-en.pdf \(wits.ac.za\)](https://wits.ac.za/mtc-cond-2017-en.pdf) (accessed on 08 May 2022).

¹²⁷Oguttu, AW (2008) “Resolving double taxation: the concept “place of effective management” analyzed from a South

African perspective”, *Comparative and International Law Journal of South Africa*, vol. 41, pp. 80-104.

¹²⁸ Ibid.

¹²⁹ Olivier and Honiball (2011:312).

“the effect of the Model Convention has expanded a long way beyond the OECD area. It has been utilized as a basic document of reference in negotiations between the member and non-member countries and even between non-member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems”.¹³⁰

“The OECD Model Tax Convention deals with residence-residence conflicts through tie-breaker rules in Article 4 which allocate residence of the ‘dual resident’ person to one of those States, so that person is treated as a resident solely of that State for the Convention”.¹³¹

4.2.2 OECD Commentary on Article 4 of the OECD Model Tax Convention

Article 4 of the OECD Model Tax Convention is aiming to characterize the meaning of the term “resident of a Contracting State” and answer double residence cases.¹³² Article 4(1) establishes the definition of the “resident” concept and article 4(3) set out the tie-breaker test in instances where there is a dual residency.

Article 4 – Resident

1. Paragraph 1 defines the expression “resident of a Contracting State” for the Convention, the definition alludes to the concept of residence adopted in the domestic laws, where the state is liable to tax by domicile, residence, place of management, or any other measure of a comparable nature

Article 3

1. Paragraph 3 relates to companies and other bodies of persons, irrespective of whether they are or not legal persons to be subject to tax as a resident in more than one State, for instance, one State attaches importance to the registration, and the other State to the POEM.

When paragraph 3 was first drafted, it was “considered that it would not be a satisfactory solution to join significance to a purely formal criterion like registration,

¹³⁰ Par 14 page 12 [mtc_cond-2017-en.pdf \(wits.ac.za\)](#) (accessed on 05 May 2022).

¹³¹ Par 9. Page 3. <http://www.oecd.org/tax/treaties/1923328.pdf> (accessed on 22 September 2020).

¹³² Par 2 Page 105 [mtc_cond-2017-en.pdf \(wits.ac.za\)](#) (accessed on 08 May 2022).

and greater liking was given to a rule based on the POEM, which was intended to be based on the place where the company, etc. was managed".¹³³

4.3 Recognizing the concept POEM from other concepts utilized in domestic legislation.

OECD does not give a particular definition of the concept of POEM, some countries have deciphered the term by utilizing the concept that is utilized in domestic tax law residence rules. Countries that have turned to use the domestic meaning of the term, have equated the concept of POEM with a concept such as “place of management” and the concept “central management and control which are used to determine the residence of companies in some jurisdictions.¹³⁴

4.3.1 Place of Management

The concept “place of management” is used in Germany to decide the residency of a company.¹³⁵ Vogel portrays the term POEM as indistinguishable from the term “place of management” as used in German domestic law as both concepts refer to factual conditions. Vogel states that what is conclusive is not the place where the management’s important directives take place, but rather the place where they are given. ¹³⁶ Oguttu¹³⁷ contends that if the controlling shareholder is authorized to represent the company and convey the company’s management activities, then that shareholder may be considered as being in control of the top-level management.

4.3.2 Central Management and Control

CM&C is one of the residence tests adopted in several distinctive countries such as the UK, Canada, and Australia for non-individuals.¹³⁸ For example, under Section 6(1)

¹³³ Par 2 Page 112 [mtc_cond-2017-en.pdf \(wits.ac.za\)](http://www.mtc.ac.za/cond-2017-en.pdf) (accessed on 31 may 2022).

¹³⁴ BA van der Merwe’s Residence of a company – the meaning of “effective management” (2002) 14 *SA Mercantile Law Journal* at 91 (Van der Merwe (2002)).

¹³⁵ Oguttu page 84

¹³⁶ Ibid.

¹³⁷ Oguttu page 84

¹³⁸ Par 17. Page5. <http://www.oecd.org/tax/treaties/1923328.pdf> (accessed on 22 September 2020).

of Australia's Income Tax Assessment Act 1936, a company is a resident of Australia if:¹³⁹

- It is incorporated in Australia; or
- It carries on business in Australia and is centrally managed and controlled in Australia; or

It carries on business in Australia and its voting power is controlled by shareholders resident in Australia. The concept of "central management and control" was described in the UK case *De Beers Consolidated Mines Ltd v Howe*. Where it was held that a company's central management and control would regularly be exercised by its directors who make the essential policy commitment that accounts for the exercise of central management and control of the company.¹⁴⁰

Oguttu states, "the reason why the concept POEM and the concept "central management and control" are regularly translated as synonymous, is because both concepts refer to the place where the superior policy and strategic decisions are made by the board of directors of a company".¹⁴¹

The principle stated in *Wood v Holden* that the term POEM is comparable to that of the term central management and control was confirmed. In this regard, it was held as follows:

"A company cannot eat and sleep, but it can keep house and do business. Therefore, we ought to see where it keeps house and do business...I regard...as the true rule that business is carried on where the central management and control abides".¹⁴²

Internationally, conflicting views exist on whether the term POEM is the same as the term "central management and control", it is obvious that the former term was essentially affected by the latter term.¹⁴³ The last-mentioned term was, to begin with, laid down as a test to determine the residency of a company in *De Beers Consolidated Mines Limited v Howe*.¹⁴⁴

¹³⁹ Ibid.

¹⁴⁰ Oguttu page 85

¹⁴¹ Ibid.

¹⁴² Olivier and Honiball (2011:37).

¹⁴³ Ibid (2011:38).

¹⁴⁴ Ibid.

Goosen¹⁴⁵ made instances where the POEM will be found to be in a place distinct from the place of central management and control. This could happen, for example, where a company is run by executives based abroad in Country A, but the final directing powers rest with non-executive directors who meet locally in Country B.¹⁴⁶ In such circumstances the company's POEM might well be in Country A but, depending on the precise powers of the non-executives directors, it might be centrally managed and controlled in Country B.¹⁴⁷ Below are two foreign case laws as discussed above.

4.4 Foreign Case law

4.4.1 Wood and Another v Holden (Inspector of Taxes) [2006] EWCA Civ 26; [2006] 1 WLR 1393

Facts of the case

The central issue, in this case, was whether CIL made a chargeable gain when it sold its 49.99% shareholding in Holdings to Eulalia on 23 July 1996.

“Section 14 TCGA 1992 provides, for s 13 TCGA 1992, that no gain arises on the disposal by one company to another provided that both companies are in a non-resident group of companies (defined by s.14(4)(a) TCGA 1992)”. There is no issue that Eulalia and CIL were members of a group: CIL held more than 75% of Eulalia. However, the issue is whether they were both non-residents at the date of the disposal by CIL to Eulalia of CIL's holding in Holdings

Park J: judgment

“Both companies were established and acquired abroad to implement particular parts of the wider tax scheme of which the architects were Price Waterhouse. Both were managed in the offices of overseas financial organizations: CIL in the Geneva offices of Barclay Trust and Eulalia in the Amsterdam offices of 2 AA Trust. [Counsel for the taxpayer's] point is that, if CIL was resident outside the United Kingdom (which the Revenue not merely accepts but asserts as an essential ingredient in the claim

¹⁴⁵ Goosen (2006:34).

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

for tax which they advance against Mr. & Mrs. Wood), then there is no credible basis on which it can be said that Eulalia was resident in the United Kingdom”.¹⁴⁸

Comments by the author:

“This case is important for several reasons. First, it exemplifies the fact that all situations must be looked at realistically. It is unrealistic to say that a tax scheme created by a UK adviser will necessarily affect the residence of all the companies that participate in that scheme. Additional evidence is required to the effect that the directors of the companies that take part in such a tax scheme have abdicated all control and management over their respective subsidiaries and have allowed the parent or another person to usurp central management and control”.¹⁴⁹

“Secondly, a Board of Directors may act under the influence of another person or persons but that does not necessarily mean that the Board of Directors has ceased to exercise central management and control”.¹⁵⁰

“Thirdly, The Revenue seemed to suggest in this case that the absence of intense activity by the sole director of Eulalia meant that Eulalia could not possibly be a resident where the sole director took its decisions. Park J. rejected this argument. The absence of intense activity is irrelevant. Provided that what a company must conduct its business where the directors meet, and that company is resident in the territory in which the directors meet”.¹⁵¹

“ Company, the subsidiary does not, as a result of such complaisance, cease to be resident in the territory in which its directors meet. It is required that the directors of that subsidiary give up all control and management duties and allow their role to be usurped by the directors of the parent company”.¹⁵²

“Finally, if the directors of overseas company documents without thinking about them, it is difficult to say that the jurisdiction in which those directors meet is the jurisdiction of the residence of the company. However, if such directors do apply their minds and do think about the documents that they are asked to sign and make a decision about

¹⁴⁸ Para 39.

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

¹⁵¹ Para 39

¹⁵² Ibid.

whether or not to sign them, the company is resident in the place where the directors take such decisions".¹⁵³ The Revenue has appealed Park J's judgment. The case will be heard in the latter part of November of that year. See the appeal below.

Wood v Holden (Inspector of Taxes), [2006] 1 W.L.R. 1393

Facts

A complex scheme was devised under which a sale of the shares would take place between two members of a non-resident group of companies so that any gains would not be attributed to the taxpayers as settlors, by sections 14(2) and 171(1) of the Taxation of Chargeable Gains Act 1992. Thus the taxpayers set up a number of entitlements with non-resident trustees. Those trustees incorporated CIL, a company registered in the British Virgin Islands, and all the shares which were issued to the trustees of the family settlements. Subsequently, a holding company, H Ltd, was formed, all the shares being allotted to the taxpayers.

Three months later E sold its shares in H Ltd to an outside purchaser. The revenue assessed the taxpayers to capital gains tax on the disposal of 23 July on the basis that although CIL was not resident in the United Kingdom, E was, so that the disposal had not been between two members of a non-resident group of companies, within the meaning of section 14(2) of the 1992 Act. On the taxpayers' appeal, the special commissioners upheld the assessment, finding that after 18 July 1996, the central management and control of E was exercised in the United Kingdom, either by the taxpayers or by their accountants acting on their behalf, so that E had to be regarded as resident in the United Kingdom. The judge allowed the taxpayers' appeal.

Appeal

Chadwick LJ – judgment 26 January 2006

"It is common ground that the question of whether or not Eulalia was resident in the United Kingdom on 23 July 1996 for the 1992 Act turns, in the first instance, on "where its real business [was] carried on... where the central management and control

¹⁵³ Ibid.

abides". That was the test adopted by the House of Lords in *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455,458".¹⁵⁴

The judge stated that In my view, "the judge was correct in his analysis of the law. In seeking to determine where 'central management and control' of a company incorporated outside the United Kingdom lies, it is essential to recognize the distinction between cases where management and control of the company are exercised through its constitutional organs (the board of directors or the general meeting) and cases where the functions of those 1411 constitutional organs are 'usurped' in the sense that management and control are exercised independently of, or without regard to, those constitutional organs. And, in cases that fall within the former class, it is essential to recognize the distinction (in concept, at least) between the role of an "outsider" in proposing, advising, and influencing the decisions which the constitutional organs take in fulfilling their functions and the role of an outsider who dictates the decisions which are to be taken. In that context, an "outsider" is a person who is not, himself, a participant in the formal process (a board meeting or a general meeting) through which the relevant constitutional organ fulfils its function".¹⁵⁵

The making of the board resolutions and the signing and execution of documents which the commissioners say were the only acts of management and control of Eulalia all took place in the Netherlands. A company is a resident where its central management and control are situated. How, therefore, can Eulalia have been resident in the United Kingdom? How can it have been resident anywhere other than the Netherlands?¹⁵⁶

"If directors of an overseas company sign documents mindlessly, without even thinking what the documents are, I accept that it would be difficult to say that the national jurisdiction in which the directors do that is the jurisdiction of residence of the company. But if they apply their minds to whether or not to sign the documents, the authorities indicate that it is a very different matter".¹⁵⁷

¹⁵⁴ Para 6.

¹⁵⁵ Para 27.

¹⁵⁶ Para 35.

¹⁵⁷ Para 36

The judge further stated that “In my view, the judge was correct to hold that the only conclusion open to the commissioners, on the facts which they had found, was that Eulalia was resident in the Netherlands. The commissioners made two findings of fact which, as it seems to me, lead necessarily to that conclusion. The first, at para 119 of their decision, was that the directors of Eulalia... were not bypassed nor did they stand aside since their representatives signed or executed the documents. That finding takes this case outside the class exemplified by the facts in *Unit Construction Co Ltd v Bullock* [1960] AC 351. The second implicit in the finding that “their representatives signed or executed the documents”, but made explicit in the observation, at para 134 of the commissioner’s decision, that “From the viewpoint of Eulalia we find nothing surprising in the fact that its directors accepted the agreement prepared by [Price Waterhouse] was that ABN AMRO (the managing director of Eulalia), through Mr. Fricot and Mr. Schmitz, did sign and execute the documents (including the purchase agreement); and so must have decided to do so”.

The judge further stated “that those two facts make it impossible to treat this case as one in which ABN AMRO, as managing director of Eulalia, made no decision. There was no evidence that Price Waterhouse (or anyone else) dictated the decision which ABN AMRO was to make; although, as the commissioners and the judge pointed out, Price Waterhouse intended and expected that ABN AMRO would make the decisions that it did make. There was no basis for an inference that Price Waterhouse (or anyone else) dictated to ABN AMRO what decision it should take, and it is inherently improbable that a major bank (or its trust company) would allow its actions to be dictated by a client’s professional advisers (however eminent). On a true *1418 analysis the position was that there was no reason why ABN AMRO should not decide to accept (on behalf of Eulalia) the terms upon which the Holdings shares were offered for sale by CIL; and ample reason why it should do as it was expected it would”.¹⁵⁸

“A further flaw in the commissioners approach was to treat the decisions which were made by ABN AMRO as not effective decisions because they were reached without proper information or consideration. But a management decision does not cease to be a management decision because it might have been taken on fuller information; or even, as it seems to me, because it was taken in circumstances that might put the

¹⁵⁸ Para 41.

director at risk of an allegation of breach of duty". "Ill-informed or ill-advised decisions taken in the management of a company remain management decisions. I should add (in fairness to ABN AMRO) that it is not said that, with fuller information, further consideration, or independent professional advice, the decisions in the present case as to the purchase and sale of the Holdings shares would have differed from the decisions taken; but nothing turns on that. The decisions which were taken would have been no less 'effective decisions' if (on the facts) different decisions would have been reached if ABN AMRO had approached the decision-making process with greater circumspection".¹⁵⁹

For the above reasons, the judge upheld Park J's decision to reverse the commissioners' finding as to the residence of Eulalia based on the central management and control test.¹⁶⁰ The court dismissed the appeal

4.4.2 De Beers Consolidated Mines Ltd v Howe (1906) AC 455

Facts

The appellant company contended that it was not resident within the United Kingdom and that it did not exercise any trade within the United Kingdom, and was not subject to assessment to income tax under the Income Tax Acts.¹⁶¹ On behalf of the Revenue, it was contended that the operations of the company were controlled from London by the directors here; that London was the real seat of its business regarded as a whole; and that the company was resident here, and liable to assessment under s 2 of the Income Tax Act, 1853, on the whole profits wherever made.¹⁶²

Conclusions

The court stated that "I do not say that the locality of the head office would be conclusive to where the company is a resided; but, assuming it to be so since the article shows that the intention was that it might be shifted from the Cape Colony to another country, we are justified in looking to see what has been done in fact, before drawing any inference from the mere fact that the head office was by the article stated

¹⁵⁹ Para 43.

¹⁶⁰ Para 44.

¹⁶¹ Para 16.

¹⁶² Para 17.

in the first instance to be at Kimberley. We find that an office was established in London, and that, throughout the period in question, a majority of the directors resided in the United Kingdom; and, although certain directors had to reside in South Africa, a quorum must always reside in England. There are a series of findings of fact all tending to shew that the real business of the company was conducted in England, though in concert with the directors in Kimberley. As I have said, the majority of the directors resided in the United Kingdom, and they appear to have been the persons who exercised the effective control of the undertaking”.¹⁶³

Further, the court stated that it “seems to me that the more one looks into the facts, the more clear it becomes that the provisions of the articles were so framed, and so acted on, as really to enable the directors in London to manage the company. Now, when we come to look at what was done under the management of the directors, it appears clear that the real business of this company was that of diamond merchants carrying on business in London. The material which they dealt in, no doubt, was drawn from South Africa, and certain members of the governing body had to be in Kimberley to superintend operations there; but, though that was so, the real business of the company, the business operations to which skill, and intelligence, and experience were most essential, were carried on in London”.¹⁶⁴

“The head and brains of the company are, as it appears to me, to be found in London, and the real conduct of the adventure takes place there. It does not matter in my opinion whence the subject matter with which the business deals is drawn; the inference which I draw from the facts is that the real business of the company is carried on in London”.¹⁶⁵

“Dealing with the questions of residence and where the business was carried on together, I think that the business of the company was one business and that the essential parts of that business were conducted in London; and, having regard to the fact that the company had a local habitation in London, which, though not named the head office, really was in effect the head office, I think it resided in London. For these

¹⁶³ Para 638.

¹⁶⁴ Para 638.

¹⁶⁵ Para 639.

reasons, I think the decision of Phillimore J. was right and this appeal must be dismissed”.¹⁶⁶

Cozens-Hardy L.J. Agreed with the above judgment and added the following:

“In answering the question of whether a company resides in this country, which is a mixed question of law and fact, the place where it is incorporated forms no doubt one element for consideration, but all the circumstances must be considered. The question cannot depend on what the company chooses to call its head office. One must look at facts and not mere terms. I find in the present case that a clear majority of the directors reside in the United Kingdom, and all questions of policy appear to be dealt with by them in London. All-important contracts by the company would appear to be sealed in London”.¹⁶⁷

Mathew L.J. Agreed with the above judgment and added the following:

“The mining operations in Africa were superintended by a small number of the directors, and the majority of the directors resided and held their meetings in the United”.¹⁶⁸ The judge concluded that “It seems to be impossible on the facts to treat the company otherwise than as carrying on business in this country, and the inference which I draw is that the seat of authority over the affairs of the company was in England, there being a preponderance of directors here, who could and did control the operations of the company abroad”.¹⁶⁹

4.5 The OECD recommendation to clarify the POEM

In May 2003, the OECD Technical Advisory Group drafted a discussion paper suggesting changes to the concept of POEM as used in the OECD Model Tax Convention.¹⁷⁰ The drafted discussion paper is still a proposal, the public was invited to submit their recommendation.

¹⁶⁶ Para 640.

¹⁶⁷ Para 643.

¹⁶⁸ Para 641.

¹⁶⁹ Para 642.

¹⁷⁰ Place of effective management concept; suggestion for changes to the OECD Model Tax Convention [2956428.pdf \(oecd.org\)](https://www.oecd.org/tax/2956428.pdf) (accessed on 31 May 2022).

The OECD Technical Advisory Group created two proposals where the first proposal is the refinement of the concept of POEM by expanding the Commentary explanation as to how the test should be interpreted.

“The place of effective management is the place where the key management and commercial decisions that are necessary for the conduct of the entity’s business are in substance made, i.e. the place where the actions to be taken by the entity as a whole is, in fact, determined. All the relevant facts and circumstances must be examined to determine the POEM”.¹⁷¹

“The POEM is ordinarily the place where the most senior person or group of persons (for example a board of directors) makes its choices which ordinarily compares to where it meets. There are cases, however, where the key management and commercial decisions essential for the conduct of the entity’s business are in substance made in one place by a person or group of persons but are formally finalized someplace else by it or by another person or group of persons. Depending on the situation, these other factors could incorporate”:¹⁷²

- “Where a board of directors formally finalizes key management and commercial choices essential for the conduct of the entity’s business at meetings held in one State but these decisions are in substance made in another State, the place of effective management will be in the latter State”.¹⁷³
- “If there is an individual such as a controlling interest holder (e.g. a parent company or associated enterprise) that successfully makes the key management and commercial decisions that are necessary for the conduct of the entity’s business, the POEM will be where that individual makes these key decisions. For that to be the case, however, the key decisions made by that person must go beyond decisions related to the normal management and policy formulation of a group’s activities (e.g. the type of decisions that a parent company of a multinational group would be anticipated to take as regards the

¹⁷¹ Par 7 [2956428.pdf \(oecd.org\)](#) (accessed on 31 May 2022).

¹⁷² Par 7 [2956428.pdf \(oecd.org\)](#) (accessed 31 May 2022).

¹⁷³ Ibid.

direction, coordination, and supervision of the activities of each part of the group)".¹⁷⁴

- "Where a board of directors routinely favors the commercial and strategic decisions made by the executive officers, the place where the executive officers perform their capabilities would be important in determining the POEM of the company. In recognizing between a place where a decision is made as contradicted to where it is just approved, one ought to consider the place where direction on guidance or options relating to the decisions were considered and where the decisions were ultimately developed".¹⁷⁵

Van der Merwe points out that the recent OECD Discussion Draft makes "it clear that the inquiry centers around the 'making' of key management and commercial decision, which takes place "where the actions to be taken by the entity as a whole are determined".¹⁷⁶ The Draft does not include the "no definitive rule" phrase but states that all surrounding facts and circumstances should be examined in the determination of this indicated POEM.¹⁷⁷

The second proposal deals with the Hierarchy of tests where it is set to receive the new version of paragraph 3 of Article 4 of the Model Tax Convention (the tie-breaker rule for companies). Whereby reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then its status shall be determined as follows:¹⁷⁸

- it shall be deemed to be a resident only of the State in which its POEM is situated;
- "if the State in which its POEM is situated cannot be decided or if its POEM is in neither State, it shall be deemed to be a resident only of the State [OPTION A: with which its economic relations are closer] [OPTION B: in which its business activities are fundamentally carried on] [OPTION C: in which its senior executive decisions are fundamentally taken]".¹⁷⁹

¹⁷⁴ Ibid.

¹⁷⁵ Ibid.

¹⁷⁶ Van der Merwe (2006:124).

¹⁷⁷ Ibid.

¹⁷⁸ Par 8 [2956428.pdf \(oecd.org\)](#) (accessed on 31 May 2022).

¹⁷⁹ Ibid.

- “if the State [with which its economic relations are closer] [in which its business activities are fundamentally carried on] [in which its senior executive decisions are fundamentally taken] cannot be chosen, it shall be regarded to be a resident of the State from the laws of which it derives its legal status”;
- “if it derives its legal status from neither State or from both States, or if the State from the laws of which it derives its legal status cannot be decided, the competent authorities of the Contracting States shall settle the question by mutual agreement”.¹⁸⁰

¹⁸⁰ Ibid.

5 Dual Breaker: Tie-breaker

The domestic laws of both Contracting States may demonstrate that the person is a tax resident in both Contracting States, i.e. dual residency. Dual residency is often referred to as the “residency–residency” conflict.¹⁸¹ In the case of companies, this may happen where, for example, a company is incorporated in one State, but has its POEM in the other State.¹⁸² It should be borne in mind that foreign-incorporated or foreign-formed entities that have their POEM in South Africa are regarded as South African residents.¹⁸³ To alleviate the ensuing double taxation, if the two states have entered into a DTA, the OECD has a tie-breaker to resolve residence-residence conflicts.¹⁸⁴

The concept of “resident of a Contracting State” has various functions and is of importance in three cases.¹⁸⁵

- in determining a convention’s scope of application;
- in tackling cases where double taxation arises as a consequence of double residence;
- in tackling cases where double taxation arises as a result of taxation in the State of residence and the State of source or situs.

To break this deadlock, a provision is made for a tie-breaker clause.¹⁸⁶ “Under this tie-breaker clause, certain tests have to be applied to decide in which country a dual resident is respected to be a resident of the treaty”.¹⁸⁷ The OECD uses the POEM as a tie-breaker where companies are dually resident.¹⁸⁸

The potential change in the POEM of a company is due to the inability of the board members or senior executives to travel abroad due to the travel restriction imposed by the government. The potential change may trigger double taxation. In a situation where would be double taxation of an entity, tax treaties provide the tie-breaker rules

¹⁸¹ Olivier and Honiball (2011:32).

¹⁸² Ibid.

¹⁸³ Olivier and Haniball (2011:25).

¹⁸⁴ Oguttu Page 81

¹⁸⁵ Par 1. Page 103. Model Tax Convention on Income and Capital [OECD-Income-and-Capital-Model-Convention-and-Commentary-2017-1.pdf \(africataxjournal.com\)](#) (accessed on 26 January 2022).

¹⁸⁶ Olivier and Honiball (2011:32).

¹⁸⁷ Ibid.

¹⁸⁸ Ibid (2011:37).

ensuring an entity is a tax resident in only one of the states. Below are the treaty provision for the 2017 and 2014 OECD model tie-breaker rules.

5.1 The OECD MTC Commentary of 2017

The OECD MTC Commentary has been distributed and discharged on 21 November 2017. Paragraph 23 of the OECD Commentary states that the treaty contains a provision like the 2017 OECD model of the tie-breaker rule, competent authorities deal with the residency issue on a case by case by mutual agreement.¹⁸⁹

Para 24 of the Commentary currently states, “As a result of these considerations, the current version of paragraph 3 provides that the competent authorities of the Contracting States shall endeavor to resolve by mutual agreement cases of dual residence of a person other than an individual”.

Para 24.1 further states, “Competent authorities having to apply paragraph 3 would be expected to take account of different 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 Convention would carry the risk of improper use of the provisions of the Convention, etc. Countries that consider that the competent authorities ought not to be given the judgement to solve such cases of dual residence without a sign of the components to be utilized for that reason may want to supplement the provision to refer to these or other factors that they consider relevant”.¹⁹⁰

5.2 The OECD MTC Commentary 2014

The OECD MTC Commentary was distributed and discharged on 15 July 2014.

¹⁸⁹ Par 23. Page 112 The OECD MTC 2017: Commentary [mtc_cond-2017-en.pdf \(wits.ac.za\)](#) (accessed on 04 June 2022).

¹⁹⁰ Par 24 page 112 The OECD MTC 2017: commentary [mtc_cond-2017-en.pdf \(wits.ac.za\)](#) (accessed on 04 June 2022).

Para 24 of the Commentary currently states “the POEM has been adopted as the inclination criteria for companies. 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”. All relevant facts and circumstances must be examined to determine the POEM. An entity may have one place of management but it can only have one POEM at any one time.

Para 24.1 of the commentary further states that,¹⁹¹ “some countries consider cases of dual residence companies to be moderately uncommon and ought to be managed on a case-by-case basis. Some countries also consider that such a case-by-case approach is the best way to deal with the challenges in determining the POEM of the legal person that may arise from utilized of unused the use of new communication technologies”.

The Commentary recommends further that “in these circumstances where contracting states want to leave the decision POEM up to the competent authorities to resolve, the contracting states should replace the provision of their DTA with an enabling provision for determining residency by mutual agreement”.¹⁹² “Competent authorities having to apply such a provision to determine the residency of a legal person for purpose of the Convention would be anticipated to require an account of the different factors not constrained to”:¹⁹³

- The meetings of its board of directors or equivalent body are usually held;
- The chief executive officer and other senior executives usually carry on their activities;
- The senior day-to-day management of the legal person is carried on;
- The legal person’s headquarters are located;
- Which country’s law governs the legal status of the person;
- Where the accounting records are kept;

¹⁹¹ Ibid

¹⁹² Du Toit (2015:24).

¹⁹³ Par 24.1 page 90 The OECD MTC 2014: [Commentary on article 4: concerning the definition of resident | READ online \(OECD-ilibrary.org\)](#) (accessed on 08 June 2022).

- Whether determining that the legal person is a resident of one of the contracting states but not of the other for the Convention would carry the risk of improper use of the provisions of the convention.

Several jurisdictions such as Australia, Canada, Greece, Ireland, New Zealand, and the UK have issued guidance on whether short-term changes in work and company management applications prompted by the Covid-19 pandemic can result in changes in corporate residence.

Guidance issued by the Australian Tax Office

“The guidance on its domestic law residence test (central management and control) notes that If the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of the effects of COVID-19, then we will not apply compliance resources to decide if the central management and control is in Australia”.¹⁹⁴

Guidance issued by the Canadian Revenue Agency

The guidance on the application of the POEM tie-breaker noted the following: ¹⁹⁵

- “The COVID-19 crisis brought the burden of safety measures by the governments around the world, including the Canadian government, to ensure the wellbeing of their citizens. Same, businesses have imposed safety measures to protect their employees. These measures include travel restrictions. The travel restrictions have resulted in certain taxpayers and their representatives expressing concerns about several potential Canadian income tax issues. This record portrays each potential issue considered by the Canada Revenue Agency (the CRA) thus far and outlines the agency’s approach to addressing the matter”.¹⁹⁶
- “Some of these income tax matters will emerge from the travel restrictions introduced by another country and not those of Canada. As well, in some circumstances, specific travel restrictions seem to have an impact past the date

¹⁹⁴ Guidance on Covid-19 affects foreign incorporated companies [Working out your residency | Australian Taxation Office \(ato.gov.au\)](https://www.ato.gov.au/Working-out-your-residency/) (accessed on 05 June 2022).

¹⁹⁵ Guidance on Covid-19 affects foreign incorporated companies [International income tax issues - Canada.ca](https://www.cra.ca/International-income-tax-issues-Canada.ca) (accessed on 05 June 2022).

¹⁹⁶ Ibid.

on which the restrictions are authoritatively lifted. Therefore, the CRA will consider whether a specific tax issue has emerged as the result of the travel restrictions, on a case-by-case basis. Except for subsection III. D. (sending international waivers, and notifications for certificates of compliance), the alleviation measures depicted in sections I-VI of this guidance are applicable from March 16 until September 30, 2020 (the initial relief period). The extra alleviation relief measures contained in the supplemental guidance in section VII apply for the periods described in that section”.¹⁹⁷

- “The authoritative approach taken by the CRA in communicating these issues is expanding to assist citizens amid this time of crisis. The approach does not speak to any interpretive position or deliberate set of any broader policy by the CRA. Nor does it speak to any alteration in Canada’s progressing commitment to battling international tax evasion and avoidance. Any taxpayer that takes part in tax evasion or avoidance schemes that attempts to exploit the crisis or the temporary measures discussed below can expect the CRA to use all its compliance tools to protect the integrity of Canada’s tax system”.¹⁹⁸

Guidance issued by Greece’s Independent Authority for Public Revenue

The guidance¹⁹⁹ “states that for the application of the tie-breaker rule based on the POEM for the period 18 March-15 June 2020, the POEM of an entity will not be influenced exclusively since the individual of the group that makes the key management and commercial decisions of an entity are temporarily located in a jurisdiction other than the one where the decisions are usually made, provided that such change is temporary and due to extraordinary circumstances. In any case, companies ought to keep up a record of facts and circumstances of the bona fide presence in a different jurisdiction as evidence that such presence resulted from COVID-19-related measures. For periods preceding 18 March 2020 and following 15 June 2020, it shall be evaluated whether restrictions were in place”.

Guidance issued by Ireland’s Revenue

¹⁹⁷ Ibid.

¹⁹⁸ Ibid.

¹⁹⁹ Guidance on Covid-19 affects foreign incorporated companies [Updated guidance on tax treaties and the impact of the COVID-19 pandemic \(oecd.org\)](#) (accessed on 05 June 2022).

The guidance²⁰⁰ is “to ignore the existence of an individual in Ireland – and where significant, in another jurisdiction – for a company about which the individual is a director if such presence is shown to result from travel restrictions related to COVID-19”.

Guidance issued by New Zealand’s Inland Revenue

The guidance on the application Company Residence states the following:²⁰¹

- “The COVID-19 pandemic will not cause companies to be tax residents because directors of a company are confined or helpless in New Zealand. Consideration will be considered on how a company is managed. If directors are confined because of COVID-19, that will not alter where the genuine trade of a company is carried on. The occasional exercise of control by the directors from New Zealand, for example through a board meeting, will not make the company tax resident in New Zealand”.²⁰²
- “The COVID-19 pandemic will not cause companies to be tax residents because directors of a company exercise control of the company from New Zealand when that is not ordinarily the case, each case turns on its facts and circumstances, but in terms of the director control test, what is relevant is where control is ordinarily exercised”.²⁰³
- “The tax residence of a company will not alter because of directors exercising control from New Zealand when they would not ordinarily do so. This may be, for example, because they cannot enter the country they would ordinarily exercise their directorial control from, or if they can, some restrictions make that impractical such as quarantine requirements. Individual contemplations or liking are not components that affect whether an individual is essentially confined in traveling. The occasional exercise of control by the directors from New Zealand, for example, through a board meeting, will not make the company tax resident in New Zealand. Where directorial control is ordinarily exercised and can be

²⁰⁰ Guidance on Covid-19 affects foreign incorporated companies [Updated guidance on tax treaties and the impact of the COVID-19 pandemic \(oecd.org\)](#) (accessed on 05 June 2022).

²⁰¹ Guidance on Covid-19 affects foreign incorporated companies [COVID-19 Tax residency \(card.govt.nz\)](#) (accessed on 05 June 2022).

²⁰² Ibid.

²⁰³ Ibid.

viewed over a broader timeframe. Where there are some directors exercising control from New Zealand and others from another country, consideration can be given to where the majority ordinarily exercise control if the powers of the directors are the same”.²⁰⁴

- “Comparably, in terms of the center of management test, a broader thought of the regular overall management of the company is suitable. It is also necessary to look at the various levels of management of the company, not just management at the director level”.²⁰⁵
- “A DTA may also affect the residence of a company. If the company is also a resident of another jurisdiction with which New Zealand has a corporate residence tie-breaker provision, the tiebreaker may result in the company being treated as a non-New Zealand resident for DTA purposes on any occasion”.²⁰⁶

Guidance issued by the UK’s HM Revenue and Customs

The guidance of the application stipulates the following:²⁰⁷

- “Where the central management and control of a company abides could be a query of fact. HMRC take the view that whilst the site of board meetings may be important in determining where central management and control abides, it is not determinative. Each case turns on its facts and circumstances which makes it difficult for HMRC to provide definitive guidance as to where CMC may abide in cases where companies are constrained to create changes in reaction to the COVID-19 pandemic”.²⁰⁸
- “Nevertheless, published guidance as to when we would not ordinarily challenge a company’s perspective on its residence will be important within the current circumstances whilst the examples given in the latter are based on a few suspicions being made, this guidance sets out HMRC’s view that occasional UK board meetings, or participation in such meetings from the UK,

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ Ibid.

²⁰⁷ Guidance on Covid-19 affects foreign incorporated companies [INTM120185 - HMRC Approach to Company Residence in response to COVID-19 Pandemic - HMRC internal manual - GOV.UK \(www.gov.uk\)](#) (accessed 5 June 2022).

²⁰⁸ Ibid.

does not necessarily result in CMC abiding in the UK. This guidance makes it clear that HMRC's view will depend on the facts in particular situations".²⁰⁹

- "It is also worth noting that even if CMC does abide in the UK, this does not necessarily mean that the company will be a UK resident. If the company is also considered to be a resident of another jurisdiction with which the UK has a DTA, the corporate residence tie-breaker provisions of the DTA may result in the company being treated as a non-UK resident. Most of the UK's DTAs include a POEM or a competent authority-based tie-breaker".²¹⁰
- "POEM, like CMC, requires contemplation of all the facts and circumstances. Unlike CMC however, the POEM can only be in one place at any one time. As such, even if CMC started to abide in the UK to a sufficient enough degree to result in UK residence under UK domestic law, it may be that after consideration of the activity in both jurisdictions, the POEM may be found to be in the other jurisdiction, and the company will therefore be regarded as non-UK resident".²¹¹
- "In cases where the DTA includes a competent authority-based tie-breaker, the UK competent authority usually takes into account the factors as set out at Company residence: standard treaty tie-breaker. Whilst it is not conceivable to foresee the results of any talks between the two competent authorities, the UK competent authority would take into consideration a more extensive run of factors than just CMC and POEM, and these will all be seen within the circular".²¹²
- Similarly, HMRC does not believe that a company will fundamentally become a non-UK resident for UK tax purposes because a few board meetings are held, or some decisions are taken, outside the UK for a brief period.

²⁰⁹ Ibid.

²¹⁰ Ibid.

²¹¹ Ibid.

²¹² Ibid.

6 Conclusion

6.1 Residency status of persons other than individuals during the pandemic.

Under South African domestic law, a company will be tax resident in South Africa if it is incorporated or formed in South Africa or has its POEM in South Africa.

The OECD Model Tax Conventions 2017 leave it to the domestic tax laws of the respective contracting jurisdictions to ascertain the residency status of persons other than individuals. It continues to provide tie-breaker tests to ascertain the residential status of persons other than individuals, respective domestic tax laws of contracting jurisdictions, and obtain residency of both jurisdictions.

SARS has to date not discharged any official direction about the issue of Covid-19. It is considered highly unlikely, that SARS would delicately take the perspective that a foreign company could become a South African tax resident simply because an unexpected crisis has prevented certain board members from traveling to attend board meetings as they ordinarily would.²¹³ However, each circumstance will need to be considered in light of its facts. The risk will be higher where senior executives of the foreign company reside permanently in South Africa and normally rely on the argument that they travel to attend board meetings to protect the foreign company from being regarded as South Africa's tax residents.²¹⁴

In a situation where senior executives have become comfortable working from their home country, the convenience of technology (e-commerce), and innovation of post-pandemic workplace policies, there is a risk that POEM will be affected.

The company's status would not change because of the Covid-19 pandemic, the traveling restrictions were imposed by the Government. Based on this research senior executives of companies will need to keep all the traveling documentation, and minutes relating to the meetings held during the lockdown period imposed by the government kept safe.

²¹³ Webber Wentzel – how to manage POEM tax risks during lockdown [Covid-19: How to manage “place of effective management” tax risk during lockdown | Webber Wentzel](#) (accessed 11 June 2022).

²¹⁴ Ibid.

6.2 Dual Residency and the International interpretation of POEM

It is worth noting that historical UK courts considered the concept of “central management and control” where the company “sleeps and eats” as factors in determining POEM. Internationally POEM is not defined in domestic law, there is guidance to be considered in the application of POEM.

On 21 January 2021, the OECD issued updated guidance on the tax treaties and the impact of the Covid-19 pandemic.²¹⁵

The OECD suggests “that it is unlikely that the COVID-19 situation will create any changes to an entity’s residence status under a tax treaty. A temporary change in location of board members or other senior executives is an extraordinary and temporary situation due to the COVID-19 pandemic and such a change of location should not trigger a change in treaty residence”.²¹⁶ The OECD may turn the impact of the Covid-19 pandemic to develop binding guidelines to avoid such a predicament.

Currently, there are no changes in the international interpretation of POEM. Key facts in the OECD Commentary may assist in determining POEM and all relevant facts and circumstances must be examined on a case-by-case basis.

6.3 Application of the POEM Tie-Breaker Rules

Currently, and pending the implementation in South African tax treaties of the Base Erosion and Profit Shifting Multilateral Convention provisions relating to the tax residence tie-breaker test, most of South Africa’s DTA also look to the POEM of a company to decide the issue of which of the two countries which are party to the treaty will have primary taxing rights.²¹⁷ In this context, the OECD guidance states that all relevant facts and circumstances must be examined to determine the “ordinary” or “usual” POEM and not only those that pertain to an exceptional and temporary period such as the Covid-19 crisis.²¹⁸

²¹⁵ The OECD guideline [Updated guidance on tax treaties and the impact of the COVID-19 pandemic \(oecd.org\)](https://www.oecd.org/tax/treaties/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic/) (accessed 11 June 2022).

²¹⁶ Ibid.

²¹⁷ Webber Wentzel – how to manage POEM tax risks during lockdown [Covid-19: How to manage “place of effective management” tax risk during lockdown | Webber Wentzel](https://www.webberwentzel.com/insights/covid-19/how-to-manage-place-of-effective-management-tax-risk-during-lockdown/) (accessed 11 June 2022).

²¹⁸ Ibid.

“The POEM is used in paragraph 3 of Article 4 of the OECD’s Model Tax Convention on Income and on Capital as a tie-breaker when a person other than an individual is considered, before the application of the tie-breaker, to be a resident of both of the Contracting States to the tax treaty”.²¹⁹ The application of the tie-breaker results in the person being deemed to be a resident only of the State where its POEM is located.²²⁰

The POEM being conclusive for the determination of its tax residency status, shall not be influenced by the fact that executives or senior management making key management and commercial decisions are temporarily located in a country other than the one where the registered office is.

It has been noted above that there are clear applications for the term POEM as it is the most reliable tie-breaker test. These applications are well interpreted at both the South African level and international levels.

²¹⁹ Draft Interpretation note: no 6 issue 2 [1 \(sars.gov.za\)](https://www.sars.gov.za) (accessed 11 June 2022).

²²⁰ Ibid.

7 Abbreviations and Acronyms

| | |
|---------------|--|
| CM&C: | Central Management & Control |
| Constitution: | Constitution of the Republic of South Africa, 1996 |
| CRA: | Canada Revenue Agency |
| DTA: | Double Taxation Agreement |
| IN 6: | Interpretation note 6 |
| MTC: | Mutual Tax Convention |
| OECD: | Organisational for Economic Co-Operation and Development |
| Para(s): | paragraph(s) |
| POEM: | Place of Effective Management |
| SA: | South Africa |
| SARS: | South African Revenue Services |
| TAG: | Technical Advisory Group |
| UK: | United Kingdom |

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