

DETERMINING THE RESIDENCY OF COMPANIES: DIFFICULTIES IN INTERPRETING ‘PLACE OF EFFECTIVE MANAGEMENT’

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Abstract

Even South Africa’s Income Tax Act No. 58 of 1962 uses the terminology ‘place of effective management’ when determining the residency of companies. This term is not, however, defined in the said legislation and there is no South African case law specifically dealing with this matter. In contrast, the United Kingdom (UK) uses the term ‘central management and control’, and its courts have been called upon to hear numerous cases on the interpretation of this phrase. Given the increasing pressure on South Africa to align its tax treatment with international trends as well as increased levels of trade with the United Kingdom, this study examined the interpretation of ‘place of effective management’ in a South African context and juxtaposed this with the conclusions reached in seven cases in the United Kingdom dealing with the interpretation of ‘centre of management and control’. The findings show that ‘place of effective management’ from a South African perspective may depend heavily on where decisions are implemented and day-to-day operations occur. ‘Central management and control’, however, appears to vest almost exclusively in where primary decisions are made or strategic directions emanate from.

Keywords

Micro place of effective management, management and control, central management and control, key decisions, management decisions, day-to-day operations

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1. INTRODUCTION

The system of international corporate taxation is often based on the 'residence principle', with the vast majority of countries relying on the place of residence of a company to determine its tax liability (Greenleaf, 2003; Mult, Jacobs, Spengel & Schafer 2003). The Republic of South Africa (South Africa) has moved from a source-based to a residence-based system of taxation for years of assessment commencing on or after 1 January 2001 (Stiglingh, Koekemoer, Van Schalkwyk, Wilcocks, De Swardt & Jordaan, 2011). Part of the reason for the migration was the need to align the South African tax system with international trends following the end of apartheid and the growth in international trade with South Africa (Solomon, 2010; Maroun & Segal, 2011; Goosen, 2006; Stiglingh et al., 2011). This had profound implications for the determination of the taxation liability of both resident and non-resident taxpayers in South Africa, as the taxation liability became a function of the 'residency status' of a taxpayer, as opposed to 'loci' of the income earning functions (Stiglingh et al., 2011).

As a result of this change, the definition of 'gross income' in section 1 of the Income Tax Act No. 58 of 1962 of the Republic of South Africa (the South African Income Tax Act) was amended, and currently states that 'gross income',

... in relation to any year or period of assessment, means-

- in the case of any *resident*, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
- in the case of any person *other than a resident*, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic ... (s1 of the South African Income Tax Act; emphasis added)

The result is that, as a general rule, and barring the application of double tax treaties, if a company is resident in South Africa, it is subject to tax in South Africa on its worldwide income. In contrast, if a company is not resident in South Africa, it is subject to tax in South Africa only on receipts and accruals from a South African source. To determine a company's liability in terms of the South African Income Tax Act, it is therefore necessary first to determine whether or not it is a resident of South Africa (Stiglingh et al., 2011).

The South African Income Tax Act defines the term 'resident' in relation to a company as a:

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. (s1 of the South African Income Tax Act; emphasis added)

Where a company is 'incorporated', 'established' or 'formed' is a matter of fact that should be simple to establish and is one of the factors that needs to be considered to determine the country of residence of a taxpayer (Brincker, Honibal & Olivier, 2003; Mult et al., 2003; Van der Merwe, 2006). The second part of the definition, which refers to where a company is effectively managed, is a more complex question which is subject to interpretation, as no definition or explicit guidance is given in the South African Income Tax Act and there is an absence of South African case authority on the matter (Casey, 2001; Van der Merwe, 2006; Stiglingh et al., 2011).

By contrast, in the United Kingdom the tax authority refers to 'central management and control' to determine the country of residence. The rules on company residence are both statutory and non-statutory. The oldest of the company residence rules ("central management and control")

is based on case law. The central management and control test is generally considered to be best expressed in *De Beers Consolidated Mines v Howe* (1905), 5 TC 198 HC “A company resides, for the purposes of Income Tax, where its real business is carried on ... I regard that as the true rule; and the real business is carried on where the central management and control actually abides” (Her Majesty Revenue & Customs, 2011).

As with the South African Income Tax Act, the residence status of a taxpayer will be a critical determinant of the final tax liability (Van der Merwe, 2006; 2002). The relevance of determining the residency of a company is further demonstrated by the application of the New Convention Between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains (SARS double tax agreement) which refers to the residence status of a company when determining the taxation charge in the respective jurisdictions (OECD, 2000a; Stiglingh et al., 2011). Briefly, the Double Tax Treaty may allow tax to be charged by only one or both of the Contracting States, and ensures that the tax payable in one State can be recovered as a rebate from tax payable in the other State in order to avoid a taxpayer being subject to tax on the same income in both Contracting States (Stiglingh et al., 2011; The Double Tax Treaty between South Africa and the UK).

The crucial aspect of determining a company’s tax liability, both in terms of the relevant tax law and the Double Tax Treaty between South Africa and the UK, is therefore to establish the country of residence (PricewaterhouseCoopers, 2004). It is interesting to note that the first draft of a bilateral convention for the prevention of double taxation by the then League of Nations was issued in 1928, and that it was only in 1958 that the Organisation for Economic Cooperation and Development (OECD) first used the term ‘place of management’ or any similar criterion in its commentary (Kragen, 1964). In spite of the fact that the terms ‘place of management’ and ‘place of effective management’ have been in use for several decades, varying interpretations continue to arise. While not every dispute is taken before courts, uncertainty continues to result in disputes with SARS and promotes inconsistent application of the terms, resulting in dispute.

In view of the above, by performing a content analysis of key literature on the residence basis of taxation in South Africa, and related case authority from the UK, this research evaluates the differences in the interpretation of ‘place of effective management’ and ‘management and control’ as applied in South Africa and the UK respectively. It will also demonstrate that, in spite of efforts to harmonise international tax, key differences in determining the residence status of taxpayers in South Africa and the UK continue to apply. The research will also aggregate the views of the above literature and case authority to provide an overview of the similarities and differences in the interpretation of the meaning of ‘place of effective management’ and ‘central management and control’ in a fashion that is capable of being readily understood by the international accountant. It should be noted that the research explores only the phrases ‘place of effective management’ and ‘management and central control’ and thus deals with juristic taxpayers.

2. THE INTERPRETATION OF 'PLACE OF EFFECTIVE MANAGEMENT' IN SOUTH AFRICA

2.1 Interpretation Note 6

Interpretation Note 6 issued by SARS is very wide and can therefore lead to different interpretations of the term 'place of effective management'. This is not part of the Income Tax Act but serves as a guideline to assist with the interpretation and application of the definition within the Income Tax Act. Interpretation Note 6 (IN6) emphasises that no definitive rule can be laid down in determining 'the place of effective management'. It states that the relevant facts and circumstances of a particular case must be taken into account in this regard. The list of criteria given in IN6 for determining 'the place of effective management' is not intended to be exhaustive or specific, but serves merely as a guideline (SARS, 2002). The criteria listed in IN6 are as follows:

- the place where the centre of top-level management is located (A)
- the location of and functions performed at headquarters (B)
- the place where the business operations are actually conducted (C)
- the place where the controlling shareholders make key management and commercial decisions in relation to the company (D)
- legal factors such as the place of incorporation, formation or establishment and the location of the registered office and public officer (E)
- the place where the directors or senior managers or the designated manager, responsible for the day-to-day management, reside (F)
- the frequency of the meetings of the entity's directors or senior managers and where they take place (G)
- the experience and skills of the directors, managers, trustees or designated managers who purport to manage the entity (H)
- the actual activities and physical location of senior employees (I)
- the scale of onshore as opposed to offshore operations (J)
- the nature of the powers conferred upon representatives of the entity, the manner in which those powers are exercised by the representatives and the purpose of conferring the powers in question onto the representatives (K)
- (SARS, 2002; Goosen, 2006)

(Please note that these criteria have been labelled 'A' to 'K' and will be contrasted with indicators considered by the UK authorities when conclusions on the meaning of 'management and control' are drawn in section 3.2 and **TABLE 1.**)

It is conceivable that the application of IN6 could result in mixed indicators. For example, the location of physical operations may not coincide with the placing of top-level management. On the other hand, the place where the day-to-day activities are carried out may not necessarily coincide with the place where the execution and implementation of policy decisions are made by the board of directors (Stiglingh et al., 2011).

This is compounded by the fact that IN6 is silent on whether or not qualitative or quantitative factors ought to carry the same weight, or on which of the above indicators should be treated as

primary ones (Van der Merwe, 2006). The practical application of IN6 has, however, yielded this result: that the place of effective management is where the board decisions are actually implemented, which would usually be where the day-to-day-business is conducted (Goosen, 2006; Van der Merwe, 2006). This view has not, however, gone unchallenged and remains disputed by Vogel (1996), who maintains that 'effective management' is synonymous with the issuance of directives and not their execution. A similar conclusion is advanced by Vogel (1996), and thus demonstrates the scope for differences in interpretation.

Adding to the complexity is the possible need to distinguish between the different levels of management involved in the decision-making process (SARS, 2002; Van der Merwe, 2006). Van der Merwe (2006) indicates that 'effective management' takes place where the 'most vital' management actions or decision making and implementation occur. This could, however, imply that the place of effective management is where the day-to-day running of the business takes place or where the board of directors normally meets. Where the business is controlled is not, however, necessarily where its daily activities take place, although these locations may be the same. The daily activities usually take place where the company carries on its business, whereas the board of directors can meet anywhere, and so the business can be controlled from any chosen location (Stiglingh et al., 2011). In this light, it may be necessary to identify the levels of management involved in the decision-making process and the nature of the decisions under review, including their implementation (SARS, 2002).

Ultimately, opinions tend to differ in South Africa with regard to the levels of management that should be used to determine the 'place of effective management'. Where the *key* management operates and makes decisions is a possible interpretation which has been adopted in a number of jurisdictions, including the United States of America (USA) and Germany, both of which place emphasis on a company's place of incorporation and the location of its statutory seat (Meyerowitz, 2003; Mult et al., 2003; Goosen, 2006). On the other hand, the place where the day-to-day activities are carried out by lower level managers could be an alternative approach to determining the place of effective management if more weight is assigned to the implementation of decisions at an operational level (Van der Merwe, 2006; Stiglingh et al., 2011).

In contrast, the 'central management and control' model in the UK and the 'place of effective management' model in the OECD appear to use the level of management where the key decisions are made. This is discussed in more detail in section 3 below.

2.2 The Organisation for Economic Co-operation and Development (OECD)

Owing to the fact that both South Africa and the UK are members of the OECD, and the OECD refers to a 'place of effective management', the guidance given by the OECD is relevant. Article 4 of the OECD Model Treaty states:

[where] ... a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its *place of effective management* is situated. (OECD, 2000a; *emphasis added*)

The term 'place of effective management' is not defined in the OECD Model Treaty; however, guidance is provided in the *Commentary on Article 4 Concerning the Definition of a Resident* (OECD, 2000b), which states that:

... the place of effective management is the place where *key management* and commercial decisions that are necessary for the conduct of the enterprise's business are in *substance* made. 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. An enterprise may have more than one place of management, but it can have only one place of effective management at any one time. (OECD, 2000a; emphasis added)

A discussion paper entitled *The impact of the communications revolution on the 'place of effective management' as a tie breaker rule* (OECD, 2001) offers additional insights into the meaning of 'place of effective management' by suggesting that the following factors should be considered:

- where the board of directors' meetings are held
- where the strategic decisions are taken
- where the managers' and directors' offices are located
- where relevant legal documents are kept
- where essential acts in the life of a company are conducted. (OECD, 2001; Burgstaller & Haslinger, 2004; Goosen, 2006)

The above indicators could still, however, result in mixed outcomes, as was the case with IN6. Nevertheless, these indicators are centred almost exclusively on the notion that the actions of senior management are of key importance, unlike those in IN6, which adopts the 'level of management' view (SARS, 2002; OECD, 2003; Goosen, 2006; Van der Merwe, 2006).

The OECD thus takes the making of key management decisions as the pivotal action indicative of 'effective management' (Greenleaf, 2003; Van der Merwe, 2006). In spite of similar wording in the OECD Model Treaty and IN6, this stands in stark contrast to the 'level of management approach' adopted by SARS (2002) and is more in line with the 'central management and control' model applied in the UK and elaborated on in section 3 below (Van der Merwe, 2006).

3. INTERPRETATIONS OF 'CENTRAL MANAGEMENT AND CONTROL' IN THE UNITED KINGDOM: EXAMINATION OF CERTAIN UK CASE LAW

3.1 Case Law in the UK (1876-2008)

The UK makes use of the notion of 'central management and control' for the purpose of determining a company's tax liability, in contrast to the South African principle of 'place of effective management'. Unlike in South Africa, there have been numerous instances where the courts have been called upon to offer a ruling on the interpretation of the 'central management and control' of certain taxpayers. The primary cases will be used to aggregate the views on the 'central management and control' model and compare this with the 'place of effective management' model used in South Africa.

3.1.1 De Beers Consolidated Mines Ltd v Howe (1906) 5 TC 198 (De Beers)

De Beers Consolidated Mines Ltd v Howe (1906) 5TC 198 dealt with De Beers Consolidated Mines

Limited (the Company), a company registered in South Africa, formerly the Colony of Cape of Good Hope, and involved in the operation and management of diamond mines. The facts of the case are as follows:

The Company's head office was situated in South Africa where the general meetings of the shareholders also occurred. The majority of its directors, however, resided in the UK. It was concluded that the directors' meetings would be conducted both in South Africa and in London, but that it was in the UK that the effective control of the key business of the Company would be exercised. In particular, the profits of the Company were made from the sale of diamonds from its mines to diamond merchants in terms of established sales contracts which had been negotiated in London. The evidence presented to the court showed that matters of policy were always discussed and approved at the meetings in London and then communicated to the operations in South Africa (*De Beers Consolidated Mines Ltd v Howe*).

The directors, meeting in London, appointed four committees, namely the finance, diamond, machinery and dynamite committee. Most of the financial decisions, particularly those related to the purchase or sale of other mining companies, were made at directors' meetings held in London. The directors in London had also unanimously appointed a new chairman and simply notified the South African operations after the fact (*De Beers Consolidated Mines Ltd v Howe*).

The Company contended that it was not resident of the UK and, hence, that it was not subject to assessment under the then Act of 1853. It was opinion of the UK's Inland Revenue that the Company was controlled by the directors in London; that London was the real seat of its business; and hence that the Company was liable to assessment under section 2 of the Act of 1853 on the whole of the profits, wherever made (*De Beers Consolidated Mines Ltd v Howe*).

The court held that the Company constituted one business that was conducted within the UK at its London office. It was also held that the head of the Company and substantive directing power ultimately resided in London, from where the chief operations of the Company, both in the UK and elsewhere, were controlled, managed and directed. That the Company's business was UK-based was further supported by the fact that the principal office was in the UK; the majority of directors met there; and although the diamonds sold came from Kimberley, the profits were realised within the UK. In the court's opinion, the Company therefore resided and conducted business in the UK (*De Beers Consolidated Mines Ltd v Howe*).

Many of the principles discussed in the case are addressed by IN6 and thus could be relevant in a South African context. For example, the location of senior management; the place where executive decisions are made; and the place where contracts are concluded are directly or indirectly referred to in IN6. (The mapping of the criteria in IN6 with the factors considered by the UK courts is presented in section 3.2.)

In the UK context, however, the principle of 'central management and control' resulted in the conclusion that decision making occurred in the UK and, although the Company's *daily* activities were executed in South Africa, the Company was thus a resident of the UK (*De Beers Consolidated Mines Ltd v Howe*). What is not clear is whether or not a similar conclusion would have been reached in South Africa. While the issue of the location of 'central management' is a reasonable indicator of the 'place of effective management', a level of management approach could lead to the conclusion that the 'place of effective management' is more consistent with the location of operational execution (Meyerowitz, 2003; Mult et al., 2003; Goosen, 2006, Van der Merwe, 2006; Stiglingh et al., 2011). In this way there may be relevant differences between the 'place of effective management' and the place of 'central management and control'. This possible source of ambiguity will undoubtedly continue to linger until such time as the matter is

taken before the South African courts.

3.1.2 Cesena Sulphur Company Ltd v Nicholson (1876) 1 TC 88 (Cesena)

In *Cesena Sulphur Company Ltd v Nicholson* (1876) 1 TC 88, Cesena Sulphur Company Limited (the Company) carried out its manufacturing and selling activities exclusively in Italy, where the Company's profits were earned. The Company was, however, registered in the UK, where the board meetings were also held. It was contended that the Company ought not to be regarded as a resident of the UK (*Cesena Sulphur Company Ltd v Nicholson*).

Although the board was controlled by its Italian members, the Company's registered office was in the UK and directors' meetings were held there. Accordingly, it was held that the Company was resident in the UK due to the fact that the directors' meetings were held in the UK and, hence, central control was maintained from there (*Cesena Sulphur Company Ltd v Nicholson*). This is consistent with Italian case law and tax literature, which states that the 'place of effective management' is where the Company's main decisions are made (Romano, 2001). Again, while IN6 makes provision for the fact that the place where the board meets is relevant, it is not clear whether this should be seen as the primary indicator and, hence, whether 'central control' is consistent with the 'place of effective management' from a South African perspective. It is thus uncertain what weights would have been applied to each of the indicators examined by the UK courts in a South African context.

3.1.3 Bullock (H.M. Inspector of Taxes) v The Unit Construction Company Ltd (1959) 38 TC 713 (Bullock)

Alfred Booth & Company Ltd (the Parent Company), resident in the UK, owned three subsidiaries (the Subsidiaries) which were formed, carried out their business and had their registered offices in East Africa. The Subsidiaries' directors neither held regular meetings nor had access to all of the records of and information concerning their companies. Although they did make day-to-day or operational decisions regarding their respective companies, the board of directors of the Parent Company met regularly in the UK to set the group's strategic direction. After losses were incurred at a subsidiary level, the board of the Parent Company began to intervene in the running of the Subsidiaries. This was in spite of the intention of the Parent Company that the Subsidiaries be viewed as non-residents (*Bullock (H.M. Inspector of Taxes) v The Unit Construction Company Ltd*).

In making its decision, the court noted that while certain operational decisions had been made at a subsidiary level, the directors of the Parent Company had always made key decisions in respect of the three Subsidiaries. It was thus held that the Subsidiaries were UK residents, as each was controlled and managed by the Parent Company (*Bullock (H.M. Inspector of Taxes) v The Unit Construction Company Ltd*).

The residence test was therefore 'management and control'. Contrary to IN6, the fact that day-to-day decisions had been made at a local level; that operations were in East Africa; that the directors likely had the skills to manage the Subsidiaries; and that they were based in East Africa caused the UK courts to conclude that the Subsidiaries were UK residents. This approach suggests that the 'levels of management' interpretation discussed by Meyerowitz (2003), Mult *et al.* (2003), Goosen (2006) and Stiglingh *et al.* (2011) and applied in a South African context may not be upheld in the UK. This could be pertinent for many multinationals where the strategic decisions are made from the parent company based in the UK while operational level subsidiaries in South Africa are run by lower levels of management.

3.1.4 The Egyptian Delta Land and Investment Company Ltd v Todd (1928) 14 TC 119 (Egyptian Delta)

In *The Egyptian Delta Land and Investment Company Ltd v Todd*, the company was incorporated in the UK for the purpose of dealing in and developing land in Egypt. The articles of association vested control in Egypt. In deciding on where the company was a resident the court concluded the following.

Firstly, the process of deciding on the residence of a company was one of seeing where it 'keeps house', and not of considering only the place or the form of its incorporation. Secondly, and related to the first point, the real business was carried on where the central management and control were situated. If a company has no place of trade in the UK, and does nothing at its head office except for minimum and occasional formalities, it cannot be a resident there. The company was therefore resident in Egypt (*The Egyptian Delta Land and Investment Company Ltd v Todd*).

The court's decision, that the place of incorporation alone would be inadequate to conclude on the residency of a taxpayer, is likely consistent with the South African approach (Stiglingh et al., 2011). Again, however, the key determinant was where central control was exercised, without regard being given to the levels of management engaged in the differing levels of decision making. This seems to be a far simpler approach to that envisaged by IN6.

3.1.5 The Swedish Central Railway Company Limited v. Thompson (1925) 9 TC 342 (Swedish Central Railway)

In *Swedish Central Railway Company Limited v Thompson*, the company was incorporated and had a registered office in the UK, although its business was conducted in Sweden. An amendment to the articles of association vested control of the business in Sweden, but its activities in the UK included performing certain primary 'organic operations' incidental to its existence as a company (*The Swedish Central Railway Company Limited v. Thompson*).

It was held that the company was resident in the UK, although Lord Atkinson has argued that this judgment could not be fully reconciled with previous judgments, for example, the De Beers Case, where management and control, and not incorporation, was used as the test for residence (*The Swedish Central Railway Company Limited v. Thompson*). Thus the central management and control concept is not one that is always simple to apply, and it may not always be consistently applied. Hence, the case demonstrated the importance of the prevailing facts and circumstances and the relevance of the subjectivity inherent in the application of the 'central management and control' concept.

3.1.6 American Thread Company v Joyce (1912) 6 TC 1/163 (American Thread)

The English Sewing Cotton Company Ltd (the English Company), registered and carrying on business in the UK, owned all of the American Thread Company's (the American Company) common stock. The American Company was incorporated and registered in the USA and its board met for ordinary and special meetings there. Extraordinary board meetings, however, were held in the UK (*American Thread Company v Joyce*).

The facts of the case are that the American Company owned and operated its plant and equipment in the USA and generated profits there. No profit was made in the UK, and the American Company did not embark on imports from or exports to the UK. Of the seven directors of the American Company, four, including the president, had resided in England and were also

directors of the English Company. In addition, there was evidence that the directors in the UK were in frequent communication with the executive committee in the USA. Moreover, the directors in the UK ultimately set the group's strategic path (*American Thread Company v Joyce*).

The UK tax authorities maintained that control of the management of the affairs of the American Company vested in the UK given that strategic decisions were made at a UK level and that the American Company's board was constantly dominated by the English Company, which owned all of the ordinary shares of the American Company (*American Thread Company v Joyce*).

The Appellant argued that, while the American Company was registered in the USA, conducted its business there, and had no UK registered office, 'real' control was vested in the directors in the UK. It was held that the executive committee, made up of the three directors attending to the detail of the business, played the role of managers only. Effective control at the strategic level was thus in the UK (*American Thread Company v Joyce*).

The findings in this case are consistent with those in *De Beers Consolidated Mines Ltd v Howe* advanced earlier: the levels of management – regarded as a potentially key feature under IN6 – may not be relevant at a UK level; the primary indicator is the place from which the strategic direction of a company is set.

3.1.7 Mr R.J. Wood and Mrs R.J. Wood v Mrs L.M. Holden (HM Inspector of Taxes) (2005) EWHC 547 (Ch) (Wood)

This case involved the restructuring of an existing shareholding by Mr and Mrs Wood (Woods) in Greetings Ltd. Part of this restructuring involved the sale by CIL Ltd (a second UK company involved in the scheme) of its shares in a third UK company (Holdings Ltd) to Eulalia Ltd (a company that was created under the scheme). The sale by CIL Ltd of its interest in Holdings Ltd to Eulalia Ltd constituted contended revenue in the UK.

This case reaffirmed the relevance of the 'central management and control' test cited in *De Beers Consolidated Mines Ltd v Howe*, with the court concluding that key management decisions were relevant in deciding on the residency status of a taxpayer. Where management decisions are superficial or purely administrative, this is not an indicator. As before, it is where the true 'head' of decision making is situated that determines where 'central management and control' is vested (*Mr R.J. Wood and Mrs R.J. Wood v Mrs L.M. Holden (HM Inspector of Taxes)*).

This approach is supported by *Untelrab Ltd v McGregor* [1996] STC (SCD) 1:

Although a board might do what it was told to do, it did not follow that the control and management lay with another, so long as the board exercised its discretion when coming to its decisions and would have refused to carry out an improper or unwise transaction ...

Again, it appears that the substance of decision making is relevant. Accordingly, it is where the primary act of decision making takes place, and not just where a procedural process is executed, that is relevant.

In concluding on the location of the place of 'management and central control', the court also referred to Article 4, in particular to its 'tie-breaker provision', in 'the double tax convention between the United Kingdom and [the country of incorporation of Eulalia Ltd]' which required the court to consider the 'place of effective management' as it is meant in the said convention. Here, too, the court resolved that the process of complying with formalities did not provide definitive evidence on the 'place of effective management' or 'control'. Hence, in the present

context, there is no difference between the ‘central management and control’ and the ‘place of effective management’.

In this light, the conclusion in *Mr R.J. Wood and Mrs R.J. Wood v Mrs L.M. Holden (HM Inspector of Taxes)* is consistent with the guidance given by the OECD (2000a). The ‘place of effective management’, while affected by the various facts and circumstances, is based largely on where key management decides on the primary path of a company (OECD, 2000a).

3.1.8 Smallwood (and Related Appeal) v Revenue and Customs Commissioners (2008) SpC 669 (Smallwood)

In this case the taxpayer had made use of trusts in order to minimise the taxpayer’s tax liability. Accordingly, the Court of Appeal was called on to review the decision made by the lower court regarding the residence status of a trust.

As in *Mr R.J. Wood and Mrs R.J. Wood v Mrs L.M. Holden (HM Inspector of Taxes)*, it was resolved that the ‘management and central control model’ would yield a result consistent with the OECD interpretation of ‘place of effective management’. Thus, it was reaffirmed that effective management implies realistic, positive management on a material level (*Smallwood (and Related Appeal) v Revenue and Customs Commissioners*).

In reaching its conclusion, the court noted that ‘central management and control’ differed from ‘place of effective management’, in part due to the fact that the former was a ‘one residence test’, while the latter would be applied as a ‘dual residence test’. In this light, the court made reference to *De Beers Consolidated Mines Ltd v Howe* (1906), noting that ‘effective’ management probably meant ‘real’ or substantive acts of management and that the need to take cognisance of the levels of management engaged in decision making would apply where the issue of dual residence was raised. Thus, the case mentions that, consistent with OECD (2000b), if dual residence was caused by different levels of management in each respective country then ‘place of effective management’ would be relevant for considering which level of management is engaged in different degrees of decision making (*Smallwood (and Related Appeal) v Revenue and Customs Commissioners*).

This conclusion was reaffirmed in *Revenue and Customs Commissioners v Smallwood and another* (2010) EWCA Civ 778; (2010) WRL (D) 177, where the Court of Appeal upheld the decision reached in the earlier 2008 case. Ultimately, the Court of Appeal confirmed the approach that ‘central management and control’ is consistent with the notion of decision making on the part of senior management (*Revenue and Customs Commissioners v Smallwood and another*, 2010).

While reiterating the view expressed in sections 3.1.1 to 3.1.7, that the IN6’s interpretation of ‘place of effective management’ could result in an inconsistent conclusion, the courts did not deal explicitly with the matter in either the 2010 or the 2008 cases. In particular, the notion that ‘place of effective management’ is considered only for resolving a dual residency issue is not an opinion voiced in IN6 (SARS, 2002). Further, the principle that levels of management would be relevant in solving dual residence problems would probably be reconciled with the notion of identifying the level of management that ultimately makes the most coordinated and entity-wide decisions on a relative scale from a UK perspective.

3.2 Summarising the cases

The following table highlights the considerations applied by the legal authorities in the UK in

deciding on the meaning of 'central management and control' in the De Beers, Cesena, Bullock, Egyptian Delta, Swedish Central Railway and American Thread cases. Whether the decisions reached in each of these cases is consistent with the approach followed by the courts in the UK in the later Wood and Smallwood cases is also considered. Finally, the considerations applied by the UK authorities in deciding on the meaning of 'central management and control' are contrasted with the indicators noted in IN6 which would probably have been considered by the South African tax and legal authorities in dealing with similar facts and circumstances.

As indicated in the table, the factors that one would be expected to consider in a South African context in deciding on the 'place of effective management' are largely consistent with the indicators considered in the UK context when concluding on the place of 'central management and control'. It thus appears, *prima facie*, that the 'place of effective management' in the South African context is consistent with the notion of 'central management and control' from a UK perspective. Detailed analysis of the rationale in the cases, however, has revealed that, firstly, the UK tends to focus almost exclusively on where strategic decision making takes place in defining the place of central management and control. Secondly, from a South African perspective, the levels of management are potentially relevant (Van der Merwe, 2006), while at the UK level, this would be relevant only where concerns over dual residence have resulted (*Smallwood (and Related Appeal) v Revenue and Customs Commissioners*).

As a result, while South Africa and the UK appear to consider similar factors when resolving where the 'place of effective management' or 'management and central control' respectively reside, the UK explicitly places great weight on the place where senior management effect key decisions. In South Africa, an absence of case authority and a lack of explicit guidance in the South African Income Tax Act and IN6 mean that the exact weighting of the factors has not been definitively decided upon.

4. CONCLUSION

The question whether 'central management and control' and the 'place of effective management' are interpreted in a consistent manner in the UK and South Africa respectively is a complex one. Moreover, whether 'place of effective management' has precisely the same meaning as envisaged by the OECD (2000a) is not clear. This is largely due to the absence of case authority in the South African context.

According to IN6, the place of effective management needs to be determined with reference to all of the fact and circumstances of each situation (SARS, 2002). One view advanced by the South African literature is that this is the place where decisions are implemented, rather than where operational management occurs (Meyerowitz, 2003; Mult *et al.*, 2003; Goosen, 2006, Stiglingh *et al.*, 2011). On the other hand, it is conceivable that the South African courts, when called upon to resolve the matter, may take the view that the place of implementation, or where primary operations occur, could be the decisive factor (Vogel, 1996; Stiglingh *et al.*, 2011). Also relevant is the level of management, which could alter the conclusion as to where the place of effective management is located, not only in situations where dual residency arguments arise (SARS, 2002).

TABLE 1: Cases and IN6 Provisions

<i>Facts/criteria</i>	<i>De Beers</i>	<i>Cesena</i>	<i>10.5</i>	<i>Bullock</i>	<i>IN6 Factors</i>	<i>Egyptian Delta</i>	<i>IN6 Factors</i>	<i>Swedish Central Railway</i>	<i>IN6 Factors</i>	<i>American Thread</i>	<i>IN6 Factors</i>
Place of registration	South Africa	UK	ε, β	East Africa	ε, β	UK	ε, β	UK	ε, β	USA	ε, β
Location of general and shareholder meetings	South Africa & UK, but at a strategic level in the UK	UK	A, B, D	East Africa and the UK, but at a strategic level in the UK	A, B, D, G	Egypt and UK, but at a substantive level in the Egypt	A, B, G	UK and Sweden, but with 'organic' activities at the Swedish Level	A, B, G	USA and UK, but at a more strategic or group-level in the UK	A, B, D, G
Place of primary operation	South Africa	Italy	C	East Africa	C	Egypt	C	Sweden	C, J	USA	C
Place of overall management and direction	UK	UK	I, K	UK	H, I, K	Egypt	I, K	UK	I, K	UK	I, K
Concluded country of residence	UK*	UK*		UK*	UK*	Egypt*		UK*		UK*	

Sources: Authors' deductions

* Interpretation of 'management and central control' is consistent with *Mr R.J. Wood and Mrs R.J. Wood v Mrs L.M. Holden (HM Inspector of Taxes)* (2005) EWHC 547 (Ch) and *Smallwood (and Related Appeal) v Revenue and Customs Commissioners* (2008) SpC 669
 A-K Considers, directly or indirectly, the criteria per IN6 as per section 2.1.
 β The factor in question per IN6 is considered immaterial

In contrast, the case authority from the UK suggests that 'central management and control' is synonymous with where senior management make the decisions. These decisions appear to be those that are at an entity-wide or strategic level and not simply those that are administrative or driven by legal formality alone. This approach is consistent with the interpretations of the OECD, of which both South Africa and the UK are members (OECD, 2000a). In this way, it would appear that the 'place of effective management' as per the OECD and the UK's notion of 'central management and control' are equivalent (Zollo, Kvalseth, Zuvich & Tao, 2007).

A key area of consistency, however, is the realisation that each case must be examined in detail according to the facts and circumstances owing to the inherent complexities that can arise in determining the residence status of a company. Unfortunately, as a result of the absence of case authority in South Africa and the fact that decisions of the UK courts provide only persuasive legal authority at a South African level, the exact resolution of the apparent inconsistency is not likely to be readily resolved.

Although each and every dispute between taxpayers and SARS over the precise meaning of the term 'place of effective management' does not culminate in court action, varying interpretations continue to arise and promote inconsistency in the application of the term. For this reason, it is recommended that SARS actively review how it practically applies the term 'place of effective management' providing additional and clear guidance where necessary. This can be complemented by future scholarly efforts that explore the costs and benefits of consistent tax terms as well as the legality of such in more detail.

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