SOUTH AFRICAN REVENUE SERVICE

DISCUSSION PAPER ON INTERPRETATION NOTE 6 PLACE OF EFFECTIVE MANAGEMENT

Section 1 of the Income Tax Act, 1962

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Abbreviations

DTA	Double taxation agreement
IN 6	Interpretation Note 6: Resident: Place of Effective Management (Persons other than Natural Persons) issued on 26 March 2002
Model Tax Convention	Model Tax Convention on Income and Capital
OECD	Organisation for Economic Development and Cooperation
Tax resident	"Resident" for purposes of the taxes imposed by the Act
TAG	The OECD's Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits
The Act	Income Tax Act 58 of 1962

1. Introduction

In 2010, National Treasury proposed a new "Gateway to Africa" initiative. This initiative is intended to make South Africa a more attractive base for investment into other African countries by both domestic and foreign investors.

One component of this initiative is the new headquarter company regime. Companies that meet the requirements for headquarter company status enjoy various tax benefits, including relief from South Africa's controlled foreign company rules found in section 9D of the Act.

Taxpayers and practitioners have raised concerns that foreign subsidiaries held by headquarter companies may be treated as South African tax residents under SARS's approach to determining a company's place of effective management, as outlined in Interpretation Note 6: Resident: Place of Effective Management (Persons other than Natural Persons) [IN 6], issued on 26 March 2002. Place of effective management is one of the two tests used to determine whether or not a company or other person other than a natural person (legal person) is a tax resident. In addition, the place of effective management test is also used as the "tie breaker" rule in many of the double taxation agreements (DTAs) that South Africa entered into with other countries, particularly those DTAs which are based on the Model Tax Convention on Income and Capital of the Organisation for Economic Cooperation and Development (OECD).[1] This "tie breaker" rule applies to determine the tax residency of a legal person where that legal person could otherwise be considered a tax resident of both contracting states under their domestic laws.

2. Purpose

This discussion document is intended to invite comments from taxpayers and practitioners regarding their concerns in this area and to provide a framework for discussion of possible revisions to IN 6.

Like IN 6, the scope of this discussion document is limited to issues involving domestic and foreign companies. Legal persons other than companies, such as foreign hybrid entities and trusts, present separate and distinct issues and will be addressed in a subsequent project.

Comments should be submitted to **policycomments@sars.gov.za** no later than 30 October 2011.

3. Problem statement

From a practical perspective, a determination that a foreign operating subsidiary of a head quarter company has its place of effective management in South Africa would negate many of the benefits offered by the new regime. In particular, that foreign

[1] South Africa currently has DTAs with 70 other countries. Of those, 55 use place of effective management for the "tie breaker" rule. 12 leave disputes to be resolved by the competent authority through the mutual agreement procedure. The DTA with the United States looks to the place of incorporation of a company or other legal person, while the DTA with Iran looks to the location of the registered office of a company or other legal person. The DTA with Canada looks to the place of incorporation of a company, if the company is organised under the laws of either laws of either contracting state. If the company is not – for example, where a company is organised under the laws of a third country, but operates in both South Africa and Canada – place of effective management is used as the tie-breaker.

operating subsidiary would have to recompute its income each year as if it were a South African resident, determine its tax liability under the Income Tax Act 58 of 1962 (the Act), and then claim a rebate for any foreign income taxes proved to be payable to the country in which it operates. The foreign operating subsidiary would also be subject to secondary tax on companies and the new dividend withholding tax, which is scheduled to come into effect in April, 2012.

4. General

South Africa adopted a "residence-based" income tax system in 2001. Residency is therefore one of the most fundamental and important concepts in the Act.

In general, the goals of a residency test are to ensure certainty and predictability on the one hand and to prevent manipulation on the other.[2] Unfortunately, there is considerable tension between these two goals.

In order to balance these competing considerations, South Africa has adopted two tests for determining the tax residency of a legal person. Under the first test, a legal person is regarded as a tax resident if it is incorporated, established or formed in South Africa. This is a formal test and is generally straightforward in its application. However, it is also open to manipulation, particularly in the modern global environment, and may have "little or no connection with the entity's actual economic and business links".[3]

The second test looks to a legal person's "place of effective management". This test has been recognised as a "less artificial measure" that looks to "substance over form."[4] For these reasons, it is generally considered less easy to manipulate, but has presented difficult issues of general interpretation and practical application, both in South Africa and elsewhere.

5. SARS's current approach to the term "place of effective management"

IN 6 was issued by SARS in 2002. The general approach taken by IN 6 is that a company's place of effective management is "the place where the company is managed on a regular or day-to-day basis by directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets". The focus is therefore on the location where policy and strategic decisions *are executed and implemented* by a company's senior management, rather than the place where the ultimate authority over the company is exercised by its board of directors or similar body. As noted above, IN 6 does not explicitly address issues related to persons other than companies.

In terms of practical application, IN 6 adopts a three-stage inquiry. First, if the relevant management functions are exercised at a single location, that location will be the place of effective management. Second, if those functions are exercised at multiple locations (for example, where those functions are exercised through distance communications such as videoconferencing or the internet), the place of effective management "would best be reflected where the day-to-day operational management and commercial decisions taken by senior managers are actually implemented, in

[2] BA van der Merwe, *The Phrase 'place of effective management': Effectively Explained?*, 18 SA Merc LJ, 121 at p. 124-125 (2006) (hereinafter, "Van der Merwe")
[3] Van der Merwe, at p.121.
[4] Van der Merwe, at p.122.

other words, the place where business operations/activities are actually conducted from/carried out." Finally, if those business operations or activities are conducted from various locations, the place of effective management would be "the place with the strongest economic nexus".

IN 6 emphasises that the determination of a company's place of effective management is an intensely factual question for which no definitive 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.

In this regard, IN 6 also provides the following list of factors to be considered in making place of effective management determinations:

- Where the centre of top level management is located;
- Location of and functions performed at the headquarters;
- Where the business operations are actually conducted;
- Where controlling shareholders make key management and commercial decisions in relation to the company;
- Legal factors such as the place of incorporation, formation or establishment, the location of registered office and public officer;
- Where the directors or senior managers or designated manager, who are responsible for day-to-day management, reside;
- The frequency of meetings of the entity's directors or senior managers and where they take place;
- The experience and skills of the directors or senior managers who purport to manage 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, the manner in which [those] powers are exercised by the representatives and the purpose of conferring the powers to the representatives.

This list serves only as a guideline and is not intended to be exhaustive or specific.

6. Criticism of IN 6

In general, IN 6 has been subject to four main areas of criticism. The first relates to the focus of the general approach on the place where strategic decisions and policies are executed and implemented, rather than the place where those decisions and polices are taken or adopted. This concern has been particularly acute in situations involving the interpretation and application of the place of effective management test under those DTAs which are modelled on the Model Tax Convention. In many cases, taxpayers and practitioners have pushed for an approach that would focus exclusively, or almost exclusively, on the place where a company's board of directors or similar body meets.[5]

The second relates to the inconsistent use of terminology in IN 6. In this regard, commentators have drawn attention to discrepancies between the language used in section 3, which discusses the general approach, and section 4, which discusses practical applications. Related concerns have been raised regarding the statutory basis for the use of an "economic nexus" test to determine the place of effective management in situations in which the primary or predominant locus of the "second level" management cannot be identified.

The third relates to the apparent inconsistency between some of the facts and circumstances outlined in the guideline and the general approach. Two items have been especially controversial in this regard. The first item refers to "where controlling shareholders make key management and commercial decisions in relation to the company". The second refers to "legal factors such as the place of incorporation, formation or establishment, the location of registered office and public officer".

The fourth area of criticism concerns the failure by IN 6 to provide any specific guidance for cases involving passive or intermediate holding companies.

7. International benchmarking

Despite its widespread use, the term "place of effective management" has never had a universally accepted meaning. There is, however, a broad consensus that the term "place of effective management has at least two main interpretations, namely the place where the board of directors meets or the place where the senior management operates."[6] These interpretations are typically labelled the "Anglo-American" and the "Continental" approach, respectively.

The history of nuances of these differing approaches have been exhaustively discussed by both South African and international authorities. Under the circumstances, there would be little benefit in covering that same ground again here. However, because much of the criticism of the general approach of IN 6 has focused on the extent to which it deviates from the traditional Anglo-American or "board-centric" approach, particularly in the treaty context insofar as that board-centric approach was reflected in the 2000 Commentary on Article 4 of the Model Tax

[5] The perceived tension between the general approach of IN 6 and international precedents and guidelines has also led to some speculation as to whether or not the courts would accept the general approach of IN 6 in a treaty context or whether the term might effectively be given different interpretations in treaty and domestic or non-treaty contexts.
[6] Russo, *European Tax* 459 (2008).

Convention,[7] it is critical to developments in that area since 2002, when IN 6 was issued.

7.1 Criticism of a "board-centric" approach

As various commentators have observed, the traditional Anglo-American approach, with its focus upon decision-making by an entity's board of directors or similar body, has failed to keep pace with changes in telecommunications, international travel and modern business practices. For example, two UK authorities have noted:[8]

> "[W]e might ask whether concepts developed before the age of international telephone and even before the wireless telegraph . . . are still appropriate in today's world. . . The contrast with the current availability of international communications by telephone, e-mail, videophone, video conferencing and the ubiquity of air travel is sharp."

Closer to home, BA van der Merwe has expanded on these same issues:[9]

> "The adequacy of effective management as a tie-breaker rule based upon [the location of superior management decision making] has been questioned. This interpretation of the phrase was coined when companies were generally organised in a hierarchical structure and management could be located at a specific point within a certain period of time. However, modern companies are increasingly run and managed divisionally rather than through the legal entities in which the divisions are formed. This has resulted in an organisational network spread across different countries. Also, due to modern technology, management has become much more mobile and traditional places of effective management may rotate. Technology has furthermore made it possible to manage without the need for a group of persons to be physically located or to meet in one place, for instance at the company's headquarters. Because of these changed management structures and technology, effective management based on where the directors meet becomes a matter of choice and manipulation. Even when based on a wider interpretation of key management and decision making, it is evident that technology makes it difficult to pin effective management down to one constant location, and double or multiple residences or even non-residence may be the result."

7.2 The OECD and the Commentary on Article 4 of the Model Tax Convention

The OECD has also been mindful of the concerns raised. In February, 2001, the OECD's Technical Advisory Group (TAG) issued a draft discussion paper, entitled *The Impact of the Communications Revolution on the Application of "Place of*

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[7] The Model Tax Convention does not define the term "place of effective management". The OECD has provided guidance from time to time, however, through its Commentary. The 2000 Commentary, which was in effect when IN 6 was issued, provided the following explanation of the term:

> "The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. 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."
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> (Para 24 of the 2000 Commentary on Article 4 of the Model Tax Covention.)

[8] Anglehard Miller & Lynne Oates, *Principles of International Taxation*, para 4.16 (Tottel publishing Ltd: 2006).

[9] Van der Merwe, at p. 124-125.

Effective Management" as a Tie Breaker Rule" (Draft Discussion Paper). The Draft Discussion Paper summarised the issues of concern as follows:[10]

> "33. In the past, in an environment where the most senior manager or managers tended to operate from and meet in a single location such as a head office, determination of the place where key management and commercial decisions were made was not too difficult. The place where the top level management activities occurred would mainly coincide with the place where the company was incorporated and had its registered office, where the business activities were conducted and where the directors or senior managers resided. It was therefore, as the Commentary states 'rare in practice for a company, etc. to be subject to tax as a resident in more than one State.'
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> "34. However, the communications and technological revolution is fundamentally changing the way people run their business. Due to sophisticated telecommunication technology and fast, efficient and relatively cheap transportation, it is no longer necessary for a person or a group of persons to be physically located or meet in any one particular place to run a business. This increased mobility and functional decentralisation may have a significant impact on the incidence of dual resident companies, and the application of the place of effective management tie-breaker rules."

Given this situation, the Draft Discussion Paper noted that "the application of the [traditional] factors may not result in a clear determination of which State should be given preference as the State of residence, or may result in an outcome which does not appear to accord with the policy intentions of the [tie-breaker] provision."[11] It further noted that "given that the 'place of effective management' is one of substance over form, in theory, it should always produce results which reflect the true policy intention of the tie breaker rule."[12]

The Draft Discussion Paper put forward a number of alternatives for addressing these concerns, including refinements to the existing Commentary on the place of effective management test:

> "62. In refining the existing place of effective management test, two options have been suggested. Either, making a determination on the basis of predominant factor(s) or giving a weighting to various factors.
>
> "63. The construction of paragraph 24 of the 2000 Commentary presupposes that the determination is on the basis of the following predominant factors; where the key management and commercial decisions are made in substance; where the most senior person or group of persons makes its decisions and where the actions to be taken by the enterprise as a whole are determined. It may be that, for the majority of cases involving the company residence tie-breaker, these three factors readily deliver a decision which reflects the underlying policy intent. This may be considered the norm.
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> "64. However, where analysis of these predominant factors does not produce a single place of effective management, it may be necessary to consider other additional

[10] See **www.oecd.org/dataoecd/46/27/1923328.pdf**.
[11] Draft Discussion Paper, at para 35.
[12] Draft Discussion Paper, at para 36. More specifically, "the availability of advanced and evolving communications technology such as videoconferencing or electronic discussion group applications via the Internet means that it is no longer necessary for a group of persons to be physically located or meet in one place to hold discussions and make decisions. In a modern environment, application of the traditional approach can produce results which do not reflect the intention of the tie-breaker rule." Id. At para 37.

factors, as is suggested in paragraph 24 of the Commentary where it states that *'however, no definitive rule can be given and all the relevant facts and circumstances must be examined to determine the place of effective management'.* Other facts which may be considered in association with the dominant factors could include:

- Location of and functions performed at the headquarters.
- Information on where central management and control of the company is to be located contained within company formation documents (articles of association etc).
- Place of incorporation or registration.
- Relative importance of the functions performed within the two States; and
- Where the majority of directors reside."

In 2003, TAG issued a follow-up discussion paper, entitled *Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention* (2003 Discussion Paper). The 2003 Discussion Paper focused on two alternative proposals: one involving an expanded explanation of "place of effective management" in the Commentary; the other being an alternative version of the "tie breaker" rule consisting of a "Hierarchy of tests".[13]

Amongst other things, the expanded explanation discussed the need to consider additional factors to be taken into account "where the key management and commercial decisions necessary for the conduct of an entity's business are in substance made in one place by a person or group of persons but are formally finalised somewhere else by it or by another group of persons."[14]

"Depending on the circumstances, these other factors could include:

- Where a board of directors formally finalizes key management and commercial decisions necessary for the conduct of the entity's business at meetings held in one State but these decisions are in substance made in another State, the place of management will be in the other state.
- If there is a person such as a controlling interest holder (e.g. a parent company or associated enterprise) that effectively makes the key management and commercial decisions that are necessary for the conduct of the entity's business, the place of effective management will be where that person makes these key decisions. For that to be the case, however, the key decisions 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 expected to take as regards the direction, co-ordination and supervision of the activities of each part of the group).
- Where a board of directors routinely approves the commercial and strategic decisions made by the executive officers, the place where the executive officers perform their functions would be important in determining the place of effective management of the entity. In distinguishing between a place where a decision is made as opposed to where it is merely approved, one should consider the place where advice on recommendations or options relating to the decisions were considered and where the decisions were ultimately developed."[15]

[13] 2003 Discussion Paper, at para 3.
[14] 2003 Discussion paper, at para 7 (Proposed Para 24.3 of the Official Commentary)
[15] Id.

Based on comments received, the OECD revised its Commentary on place of management in 2008. In particular, the revised Commentary omits any reference to an entity's board or directors or similar body. The OECD noted that even the more expansive explanation put forward by the TAG "would not be in line with the views of the majority of its member countries as to the meaning of the concept of place of effective management."[16] In particular, "many countries . . . considered that the TAG's proposed interpretation gave undue priority to the place where the board of director's of a company would meet over the place where the senior executives of that company would make key management decisions."[17]

7.3 Recent developments in the UK

Two recent cases in the United Kingdom illustrate the problems with a formalistic, "board-centric" approach. In *HMRC v Smallwood*,[18] the court was confronted with a "round the world" trust scheme.[19] Writing for a majority of the Court of Appeals, Patten LJ rejected a "snapshot" approach which would focus solely on the residence of the trustees at the time of disposal and held instead that one should take a holistic approach to the determination of the trust's place of effective management and consider where, in the words of the 2000 Commentary: "key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made". Under this holistic approach, the court concluded that the trust's place of effective management was in fact in the UK.

In *Laerstate BV v HMRC*,[20] the First-Tier Tribunal (Tax) concluded that the Appellant, a Dutch holding company, was a UK resident for UK tax purposes and for purposes of the UK/Netherlands DTA. At issue was whether a capital gain realised by the Appellant from its disposal of shares in another company was subject to UK corporation tax. In determining that the Appellant was a UK tax resident under domestic law, the Tribunal stated that "there is no assumption that CMC [central management and control] must be found where the directors meet."[21] Rather, "it is entirely a question of fact."[22] Regarding the relevance of board meetings in general, the Tribunal observed:

> "Where a company is managed by its directors in board meetings it will normally be where the board meetings are held. But if the management is carried out outside board meetings one needs to ask who was managing the company by making high level decisions and where, and even where this is contrary to the company's constitution."[23]

In the case at hand, the Tribunal concluded that the Appellant was actually managed and controlled by its sole shareholder, Mr Bock, a UK resident, and that Appellant's central management and control was therefore in the UK, rather than in the

[16] OECD, Centre for Tax Policy and Administration, "Draft Contents of the 2008 Update to the Model Tax Convention", at p. 7 (2008).
[17] Id.
[18] [2010] EWCA Civ 778.
[19] These schemes were devised to allow the assets to be repatriated without a gain becoming chargeable on the settlor. They operated by moving the residence of the trustees to (effectively, by changing the trustees to a body resident in) a jurisdiction with a favourable double taxation treaty, typically Mauritius. The trustees would then realise the gain but, before the end of the relevant tax year, they would then retire and a UK-resident body would be appointed in their place.
[20] [2009] UKFIT 209 (TC).
[21] Id. At para 27.
[22] Id.
[23] Id.

Netherlands, where its sole director at the time of the disposal, Mr Trapman, a Dutch citizen, was located. In dismissing the actions taken by that director, the Tribunal emphasised that "it is clear that the mere physical acts of signing resolutions or documents do not suffice for actual management."[24]

The Tribunal noted that "[t]here is nothing to prevent a majority shareholder, whether a parent company or an individual majority shareholder, indicating how the directors of the company should act. . . . The borderline is between the directors making the decision and not making any decision at all."[25] The Tribunal noted that directors who mindlessly sign resolutions or who sign them "without considering whether it would be better to sign [them] or not" would not be seen as engaged in the requisite level of decision-making, even if it could be shown that they had "the absolute minimum amount of information that a person would need to have in order to make a decision at all on whether to agree to follow the shareholder's wishes or to decide not to sign . . ."[26] Rather, it must be shown: (1) that the directors had that absolute minimum amount of information" and (2) that they actually considered whether or not to follow the wishes of the majority shareholder or similar person (and, *a priori*, had the actual authority to take a contrary decision if, in their discretion, they believed the proposed course of action to be "improper or unwise"[27]).

Turning to the UK/Netherlands DTA, the Tribunal also concluded that that Appellant's place of effective management was in the UK.

> "We have found that Mr Bock's activities were concerned with policy, strategic and management matters throughout the time when he was a director of the Appellant and also after he ceased to be a director. We find that his activities constituted the real top level management (or realistic positive management) of the Appellant and Mr Trapman's activities were limited were limited to signing documents when told to do so and dealing with routine matters such as the accounts. As such the place of effective management was in the UK."[28]
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> "Thus, the Appellant was resident in the UK both in domestic law and under the double taxation agreement . . ."[29]

[24] Id. At para 33.
[25] Id. At para 34.
[26] Id. At para 35.
[27] See *Untelrab Ltd v McGregor* [1996] STC (SCD) 1 at para 74, quoted in *Laerstate BV v HMRC*, at para 37.
[28] *Laerstate BV v HMRC*, at para 50.
[29] Id at para 51. In general, the Tribunal adopted the approach of the Special Commissioner's in *Smallwood*, *supra*, regarding the interpretation of place of effective management. In *Smallwood*, the Special Commissioners had noted that the debate over "whether, or to what extent [place of effective management] differed from CMC" essentially "missed the point." Id, at para 111. In particular, "the two concepts serve entirely different purposes. Central management and control determines whether a company is resident in the United Kingdom or not; place of effective management is a tie-breaker the purpose of which is to resolve cases of dual residence by determining in which of two states it is to be found." Id. Accordingly, in the view of the Special Commissioners, one must, in determining place of effective management, "necessarily weigh up what happens in both states and according to the ordinary meaning to be given to the terms of the treaty in their context . . . decide in which state the place of effective management is found." Id. at para 112.

8. Tentative proposals

Any revisions to IN 6 must balance multiple and sometimes competing goals. First, they must help to ensure that the place of effective management provision fulfils its purpose as a substantive test that is not open to "simple, formalistic manipulation."[30] As both international and local authorities have recognised, a board-centric approach can no longer meet this challenge in today's world, to the extent that it ever could, a fact recognised by the OECD in 2008, when it deleted any reference to an entity's "board of directors" or similar body in the Commentary on Article 4 of the Model Tax Convention.

Second, the revisions should seek to reduce uncertainty wherever possible. As discussed above, IN 6 appears to have caused uncertainty in at least three ways: first, by adopting an approach that appears to conflict with the weight of international authority insofar as the general approach focuses on the place where strategic decisions are "executed and implemented", rather than on the place where the decision-making, in substance, takes place; second, by appearing at times to blur the lines between what have 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 IN 6.

The revisions need to accommodate the broad variety of factual situations that may arise. It may not be uncommon for a company's board of directors to retain control over major actions, such as, decision to enter an entirely new line of business or to sell all or substantially all of the company's assets,[31] while nonetheless giving its senior management a free-hand in the day-to-day running of the business as a whole. Similarly, in many cases, senior management is not only responsible for the highest level of running the day-to-day business, but for the actual development and formation of the company's key commercial strategies and policies, with the board's role largely limited to ratifying or formally approving those strategies and policies. The members of senior management may not all be located in one place, while the place where formal meetings of a board of directors or similar body meets may have little or no connection with where decisions are really made. Passive and intermediate holding companies in turn present issues of their own, as numerous commentators have noted. Thus, the revisions cannot eliminate the need for "all the relevant facts to be examined" in determining a company's place of effective management; nor can they provide a "definitive rule" or bright-line test. What they can do is help to resolve any apparent conflicts or inconsistencies that may exist in the current guideline.

Finally, the revisions should provide sufficient guidance to address the legitimate concerns in this area that have been expressed by potential investors in head quarter companies. In particular, to the extent possible, the revisions should seek to relieve needless anxiety over situations involving foreign operating subsidiaries with *bona fide* foreign operations and "on the ground" top level managers responsible for the high level day-to-day running of those operations.

[30] Katz Commission, Fifth Interim Report, para 6.1.2.1; Van der Merwe, at p.124.

[31] Indeed, in some cases, such decision might even be reserved to the company's shareholders, either under the company's articles or under the laws of the jurisdiction in which it is incorporated.

8.1 Refinement of the general focus

The first proposal is to refine, without abandoning, the general approach of IN 6. In particular, the general approach would continue to focus on the "second level of management." In this regard, however, it would be clarified that the primary emphasis is upon those "top" personnel who "call the shots" and exercise "realistic positive management."[32] In general, these individuals would be the senior officers or executives who are responsible for: (1) actually developing or formulating key operational or commercial strategies and policies for, or taking decisions 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 generally would 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 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.[33]

In addition, in order to more closely align this approach with international norms and to avoid blurring the lines between the second and third (operational) levels of management, current references to the "implementation" of strategy and policy would be deleted. Thus, for example, a manufacturing company may have a head office in Johannesburg, where all of its senior management is based (including the managing director, finance director, sales director, and human resources director, as well as their immediate subordinates) and a main plant in Botswana, where the manufacturing takes place under the supervision of local management. In this situation, the company's place of effective management would be its head office in Johannesburg. The result would be the same if the company's board of directors met in Gaborone, where it routinely approved proposals formulated by senior management or, if and when necessary, took decisions on extraordinary matters.

Given the wide variety of corporate practices, and the intensely factual nature of the enquiry, IN 6 would continue to take the position that no definitive rules can be given and that all relevant facts and circumstances must be examined to determine the place of effective management of a company.[34]

8.2 Terminology

In order to address the perceived problem with the inconsistent use of terminology, it is proposed that definitions be provided for basic terms that would be used throughout IN 6. These terms would include –

- senior management;

[32] *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241.

[33] While the distinctions between these three levels of management are likely to be relatively clear in the vast majority of cases involving operating subsidiaries, difficult cases and special situations will no doubt arise in practice where the specific facts either blur these lines between these levels or render them less meaningful. Situations involving *bona fide* intermediate holding companies of multinational enterprises might be one such area, since there is likely to be little need, if any, for "operational management", while the board of directors or similar body may well be responsible for both "executive" level management (to the extent relevant) and "extraordinary" decision-making.

[34] See *Oceanic Trust*, *supra*, at para 54.

- operational management;
- executive/inside directors;
- non-executive/outside directors;
- head office;
- base of operations; and
- passive holding company.

8.3 Relevant facts and circumstances

It is proposed that the following changes be made to the relevant facts and circumstances in the current guideline:

- The deletion of the reference to legal factors, such as the place of incorporation, formation or establishment, the location of registered office and public officer.
- A clarification of the reference to where controlling shareholders make key management and commercial decisions in relation to the company. In particular, the application of this factor would generally be limited to situations in which controlling shareholders in fact "call the shots" and/or the board of directors or similar body is not the true decision-maker. In particular, this factor would be relevant in determining the place of effective management of passive holding companies;
- The addition of the following factors:
  - Delegations of authority by the board of directors or similar body, for example, to an executive committee.
  - 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).

The guideline would also be expanded to include examples illustrating the application of the factors.

8.4 Mutual agreement procedure

While it is believed that the proposed changes to IN 6 will bring SARS's approach in line with the 2008 Commentary and the positions taken by many of SARS's treaty partners, occasions may still arise in which there is a disagreement between SARS and a treaty partner regarding the application of the place of effective management "tie-breaker" rule. In such a situation, the revised IN would explicitly provide for the dispute to be resolved by the competent authorities of the two states through the applicable mutual agreement procedures.

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