



SOUTH AFRICAN REVENUE SERVICE

INCOME TAX INTERPRETATION NOTE NO. 6

DATE: 26 MARCH 2002

ACT : INCOME TAX ACT, 1962 (“the Act”)
SECTION : SECTION 1
**SUBJECT : RESIDENT: PLACE OF EFFECTIVE MANAGEMENT
(PERSONS OTHER THAN NATURAL PERSONS)**

1. Background

The Revenue Laws Amendment Act, 2000 (Act No. 59 of 2000) introduced a definition of “resident” in section 1 of the Act, which includes the term “place of effective management” as one of the tests to determine the residence of a person other than a natural person.

The inconsistent use of the concepts “managed and controlled”, “managed or controlled” and “effectively managed” was addressed simultaneously and a more uniform approach is now followed in the Act. The reference to “managed or controlled” in Practice Note No. 7 dated 6 August 1999, paragraph 1.1.3, is therefore no longer applicable.

As a result of this definition a person, other than a natural person, which has its place of effective management in the Republic will be regarded as a “resident” as defined. The effect hereof is that such person will be subject to income tax on its worldwide income, i.e. income derived within and outside the Republic. It is, however, important to note that a person other than a natural person is also a resident if it is incorporated, established or formed in the Republic. This note, therefore, only deals with the “place of effective manage-

ment” test to determine the residence of a person, other than a natural person.

2. The Law

In terms of paragraph (b) of the definition of “resident” in section 1 of the Act, the word “resident” is defined 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.

An international headquarter company is, however, excluded.

The term “place of effective management” is not defined in the Act and the ordinary meaning of the words, taking into account international precedent and interpretation, will assist in ascribing a meaning to it.

The term “effective management” or “effectively managed” is used by various countries throughout the world, as well as by the Organisation for Economic Co-operation and Development (OECD) in its publications and documentation. However, the term does not have a universal meaning, and the various countries and the members of the OECD have attached different meanings to it.

3. Application of the Law

3.1 Introduction to the meaning of place of effective management

The concept of effective management is not the same as shareholder-control or control by the board of directors. Management focuses on the company’s purpose and business and not on the shareholder-function.

In order to determine the meaning of “place of effective management”, one should keep in mind that it is possible to distinguish between-

- the place where central management and control is 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.

3.2 General approach

The place of effective management is the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets.

Management by these directors or senior managers refer to the execution and implementation of policy and strategy decisions made by the board of directors. It can also be referred to as the place of implementation of the entity's overall group vision and objectives.

Management structures, reporting lines and responsibilities vary from entity to entity, depending on the requirements of the entity, and no hard and fast rules exist. It is therefore not possible to lay down absolute guidelines in this regard.

3.3 Practical application

If these management functions are executed at a single location, that location will be the place of effective management. This location might or might not correspond with the place from where the day-to-day business operations/activities are actually conducted from/carried out.

If these management functions are not executed at a single location due to the fact that directors or senior managers manage via distance communication (e.g. telephone, internet, video conferencing, etc.) the view is held that the place of effective management would best be reflected where the day-to-day operational management and commercial decisions taken by the senior managers are actually implemented, in other words, the place where the business operations/activities are actually carried out or conducted.

If the nature of the person, other than a natural person, is such that the business operations/activities are conducted from various locations, one needs to determine the place with the strongest economic *nexus*.

3.4 Relevant facts and circumstances

No definitive rule can be laid down in determining the place of effective management and all the relevant facts and circumstances such as those listed below must be examined on a case-by-case analysis.

- 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 the registered office and public officer:
- Where the directors or senior managers or the designated manager, who are responsible for the day-to-day management, reside;
- The frequency of the meetings of the entity's directors or senior managers and where they take place;
- The experience and skills of the directors, managers, trustees or designated 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 that powers are exercised by the representatives and the purpose of conferring the powers to the representatives.

The above list is not intended to be exhaustive or specific, but serves merely as a guideline.

4. Controlled foreign entity

An entity that has its place of effective management in the Republic is regarded as a "resident" as defined in section 1 of the Act and is, therefore, subject to income tax in its own right. Such entity will, therefore, not be regarded to be a "controlled foreign entity" as defined in section 9D of the Act in relation to another resident.