

**INTERPRETATION NOTE 6 (Issue 3)**

DATE: 30 June 2023

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTION : SECTION 1(1)**  
**SUBJECT : RESIDENT – PLACE OF EFFECTIVE MANAGEMENT (COMPANIES)**

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***Preamble***

In this Note unless the context indicates otherwise –

- **“Article”** means an Article of the OECD Model Tax Convention 2017;
- **“board”** means the board of directors or similar body, however designated, that has the legal authority to exercise the powers and perform the functions of a company, except to the extent that Company Law or the company’s Memorandum provide otherwise;

- “**Companies Act**” means the Companies Act 71 of 2008;
- “**company**” means a company as defined in section 1(1) and includes companies incorporated under the Companies Act and companies incorporated, formed or established under the laws of a country other than South Africa;
- “**Company Law**” means the Companies Act or the laws of a country other than South Africa, as appropriate, under which a company is incorporated, formed or established;
- “**director**” means a member of the board or an alternate director and includes any person occupying the position of director or alternate director, by whatever name designated;
- “**head office**” means the place where a company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets;
- “**Memorandum**” means a company's memorandum of incorporation or similar document, as amended from time-to-time, that sets out the rights, duties and responsibilities of shareholders, directors and others within and in relation to a company;
- “**OECD**” means the Organisation for Economic Co-operation and Development;
- “**OECD Model Tax Convention**” means the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development, Condensed Version, 21 November 2017;
- “**South Africa**” means the Republic of South Africa;
- “**rules**” or “**by-laws**” mean any necessary or incidental rules adopted by the board or shareholders of a company relating to the governance of the company on matters that are not addressed in the company's Memorandum or Company Law
- “**section**” means a section of the Act;
- “**senior management**” means the level of employees of a company who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While terminology may vary, these employees may include –
  - Managing Director or Chief Executive Officer;
  - Financial Director or Chief Financial Officer;
  - Chief Operating Officer; and
  - the heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing);

- **“shareholder agreement”** means an agreement between a company's shareholders which may, amongst other things, set out the shareholders' rights and obligations and describe how the company should be operated. It may, for example, include information on the regulation of the shareholders' relationship, the management of the company, ownership of shares and privileges and protection of shareholders;
- **“tax treaty”** means an agreement (including a convention) entered into between the government of South Africa and another country for the avoidance of double taxation;
- **“the Act”** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

## 1. Purpose

This Note provides guidance on the interpretation and application of the term “place of effective management” in determining the tax residence of a company as one of the considerations under the tie-breaker rule in a tax treaty.

## 2. Background

The concept of residency is critical in determining a person's South African tax obligations. Generally, a resident is liable to income tax on gross income derived within and outside South Africa, while a non-resident is liable to income tax only on gross income from a source within South Africa.<sup>1</sup>

A person other than a natural person is a “resident” as defined in section 1(1) if such person –

- is incorporated, established or formed in South Africa; or
- has its place of effective management in South Africa.

The definition excludes any person that is deemed to be exclusively a resident of another country for purposes of the application of any tax treaty. In addition, special considerations apply to a “foreign investment entity” as defined in section 1(1).

A company incorporated in South Africa is a “resident” as defined before considering the implications of an applicable tax treaty. Accordingly, from a domestic law perspective, when determining tax residency, the place of effective management is relevant to companies *not* incorporated, established or formed in South Africa.

The term “place of effective management” is not defined in the Act and must be ascribed its ordinary meaning, taking into account international precedent and interpretation. It does, however, not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it.

An amendment to Article 4 in the 2017 version of the OECD Model Tax Convention provides that the place of effective management is no longer the only criterion in determining the residency of a person other than an individual if it was a resident of both contracting states. The issue of dual residency of persons other than individuals

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<sup>1</sup> Definition of “gross income” in section 1(1).

is now determined on a case-by-case basis and through mutual agreement<sup>2</sup> by the contracting states having regard to the person's place of effective management, the place where it is incorporated or otherwise constituted, and any other relevant factors.<sup>3</sup> In the absence of a mutual agreement, the person will not be entitled to any relief or exemption from tax purely based on the place of effective management, but in a manner as agreed upon by the competent authorities<sup>4</sup> of the states concerned.

Although this Note deals with the place of effective management in the context of companies, the underlying principles will generally apply to other entities and bodies of persons that are not natural persons. For example, with a trust the structures involved, and terminology used, may require some adaptation. The determination of the place of effective management would, however, take into account the same considerations as those discussed in this Note. Depending on the applicable facts, there may be additional considerations that need to be taken into account.

The place of effective management must be supported by the facts. Under section 102 of the Tax Administration Act 28 of 2011 a company bears the onus of proving its place of effective management and must, under section 29 of that Act, retain the necessary evidence to support the view taken.

### 3. The law

#### Section 1(1) – Resident

“resident” means any—

- (a) ...
- (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 the Republic and that other country for the avoidance of double taxation: Provided that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident: Provided further that in determining whether a person that is a foreign investment entity has its place of effective management in the Republic, no regard must be had to any activity that—

- (a) constitutes—
  - (i) a financial service as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002); or

<sup>2</sup> Mutual agreement refers to the Mutual Agreement Procedure (MAP) as referred to in Article 25 of the OECD Model Tax Convention. Information on MAP can be found on SARS website at [www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/mutual-agreement-procedure-map/](http://www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/mutual-agreement-procedure-map/) [Accessed 30 June 2023].

<sup>3</sup> Paragraph 23 of the Commentary to Article 4. Also see paragraph 2.11 “Dual residency” in the *Guide on Mutual Agreement Procedures*.

<sup>4</sup> The term “Competent Authority” is used in treaties to identify a position, a person or a body within a contracting state or jurisdiction to whom issues can be addressed. The Competent Authority in South Africa is the Commissioner for SARS. [www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/mutual-agreement-procedure-map/](http://www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/mutual-agreement-procedure-map/) [Accessed 30 June 2023].

- (ii) any service that is incidental to a financial service contemplated in subparagraph (i) where the incidental service is in respect of a financial product that is exempted from the provisions of that Act, as contemplated in section 1(2) of that Act; and
- (b) is carried on by a financial service provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), in terms of a licence issued to that financial service provider under section 8 of that Act;

#### 4. Application of the law

##### 4.1 General principle – the meaning of place of effective management

A company's place of effective management is the place where key management and commercial decisions necessary for the conduct of its business as a whole are in *substance* made. This approach is consistent with the OECD's commentary on "place of effective management".<sup>5</sup>

In *Oceanic Trust Co Ltd NO v C: SARS*,<sup>6</sup> Louw J held that the taxpayer had not made a case for declaratory relief declaring that it was not a resident of South Africa because the facts were not "fully found".<sup>7</sup> However, applying the approach adopted in *Smallwood*<sup>8</sup> (which is consistent with that set out in the preceding paragraph), Louw J noted that to the extent the facts were established, they did not establish that the place of effective management was in Mauritius and not South Africa.

Overseas court cases, in the context of tax treaty interpretation, have provided useful interpretations on the meaning of the "place of effective management". For example, in *Wensleydale's Settlement Trustees v Inland Revenue Commissioners*,<sup>9</sup> Special Commissioner David Shirley made the following comment on the ordinary meaning of place of effective management:

"I emphasise the adjective 'effective'. In my opinion it is not sufficient that some sort of management was carried on in the Republic of Ireland such as operating a bank account in the name of the trustees. 'Effective' implies *realistic, positive management*. The place of effective management is *where the shots are called*, to adopt a vivid transatlantic colloquialism."

(Emphasis added.)

<sup>5</sup> As it read in paragraph 24 of the Commentary on Article 4 in the OECD Model Tax Convention, dated 15 July 2014. The Commentary on Article 4 in the OECD Model Tax Convention dated 21 November 2017, does not repeat a discussion of the meaning of "place of effective management". The discussion in the 2014 version is, however, still relevant and used for purposes of this Note.

<sup>6</sup> [2012] JOL 28880 (WCC), 74 SATC 127.

<sup>7</sup> The High Court was not entitled to enquire into and make the required findings of fact.

<sup>8</sup> *Her Majesty's Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778.

<sup>9</sup> [1996] STC (SCD) 241 at 252.

In the *Smallwood's* case,<sup>10</sup> the court held that determining the place of effective management required the court to determine where, based on the facts presented, *the real top level of management or realistic, positive management* of the taxpayer, a trust, was exercised. Although this case dealt with the determination of the place of effective management in the context of a trust, the court's decision is considered useful because the principles and the type of facts that were considered are equally relevant in the context of companies. The court found that there was a distinction between the scheme of management (which constituted the key management and commercial decisions) and day-to-day management exercised by the trustees from time-to-time with the former determining the place of effective management.

If a company's key management and commercial decisions affecting its business as a whole are made at a single location, that location will be its place of effective management. However, if those decisions are made at more than one location, the company's place of effective management will be the location where those decisions are primarily or predominantly made.

Experience has shown that the application of these principles does not present serious problems in the majority of cases. For example, it is relatively easy to determine a company's place of effective management if that company operates in several countries through branches with local managers but has its head office in South Africa where most of its senior management are located and where most, if not all, of its board meetings take place. In contrast, it would be more complicated to determine a company's place of effective management if that company is part of a global group that operates on a divisional as opposed to a separate legal entity basis with senior management teams who are responsible for different aspects of the business being based in different locations, and whose senior management teams travel frequently. This complexity can be compounded when overlaid with modern technology such as video-conferencing and electronic mail. Despite the potential levels of complexity, the determination of the place of effective management still involves an application of the same core principles.

## 4.2 Key facts and circumstances

There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is necessary, as noted above, to determine a single dominant place where the place of effective management is located. The determination looks at where the key management and commercial decisions are regularly and predominantly made. It is not a snapshot requiring an assessment at a particular moment in time.

Although the determination of the place of effective management is not based on a snapshot at a particular moment in time, when a company changes its place of effective management, the change in residence<sup>11</sup> occurs on a particular date and is not in relation to a year of assessment.

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<sup>10</sup> *Trevor Smallwood Trust v Revenue and Customs* [2008] UKSPC SPC00669 in 112 & 114 at 30 and in 130 at 35 and the subsequent appeal in the Court of Appeal, *Her Majesty's Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778 in 48.

<sup>11</sup> Ignoring for the moment its place of incorporation, establishment or formation.

**Example 1 – Time period***Facts:*

Company A is a listed South African-incorporated multinational company with branches operating in Africa, United Kingdom and America. Its head office is based in South Africa and the quarterly board meetings are generally all held in Cape Town.

During the 2021 year of assessment, Company A held the third of its quarterly meetings in London to coincide with its secondary listing on the London Stock Exchange and the related interactions with financial advisors and media.

*Result:*

One meeting of the board of directors in London will not result in the effective management of the company temporarily moving to the United Kingdom. The senior management team and the board of directors regularly and predominantly make the key management and commercial decisions in South Africa and South Africa is accordingly Company A's place of effective management.

Definitive rules cannot be laid down in determining the place of effective management, and all relevant facts and circumstances must be examined on a case-by-case basis. Although it is not possible to provide a detailed list of all the factors that must be considered, some of the key facts and circumstances that must be examined in determining a company's place of effective management are discussed below. This list is not intended to be exhaustive but serves merely as a guideline.

The place of effective management test is one of *substance over form*, that is, ignoring the evident formalities and determining the real intention or substance.<sup>12</sup> It therefore requires the identification of those persons in a company who actually "call the shots" and exercise "realistic positive management". Stated differently, a company's place of effective management must be determined by ascertaining what are and who makes the key management and commercial decisions for the conduct of the company's business as a whole. Once this has been determined, it is necessary to determine where those decisions are in *substance* actually made.

**4.2.1 Head office**

The location of a company's head office, being the place where a company's senior management and their support staff are predominantly located, is generally a major factor in the determination of a company's place of effective management because it often represents the place where key company decisions are made. For example, it is likely that key management and commercial decisions of an operating company whose board meets only once a year will be made more frequently than once a year and that the place of effective management will not be where the board meeting is held. Conversely, board meetings could be held more frequently but key management and commercial decisions may nevertheless be made outside those board meetings. All the facts and circumstances must be considered.

<sup>12</sup> C:SARS v NWK Ltd (27/10) [2010] ZASCA 168; 2011 (2) SA 67 (SCA) ; [2011] 2 All SA 347 (SCA) (1 December 2010).

The following points apply in relation to head offices:

- A company's head office is easy to determine when all the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters.
- A company may be more decentralised. For example, various members of senior management may operate, from time-to-time, at offices located in the various countries where the company operates. In these situations, the company's head office would be the location where those senior managers are primarily or predominantly based or to where they normally return following travel to other locations or where they meet when formulating or deciding key strategies and policies for the company as a whole.
- Members of senior management may operate from different locations on a relatively permanent basis. In these situations, the members may participate in meetings via telephone or video-conferencing, that is, virtual meetings, rather than by being physically present in a principal location. In these situations, the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.
- Finally, there may be some situations in which senior management is so decentralised that it is not possible to determine the company's head office with a reasonable degree of certainty. Consequently, in these situations, the location of a company's head office would be of little relevance in determining that company's place of effective management.

### **Example 2 – Place of effective management**

*Facts:*

Bigco is a multinational company, incorporated under the laws of the United Kingdom, with substantial operations in South Africa, the United Kingdom and the United States. Its shares have a primary listing on the Johannesburg Stock Exchange (JSE), a secondary listing on the London Stock Exchange, and are also traded on the New York Stock Exchange through American Depository Receipts.

The company's head office is located in South Africa and its Managing Director, Financial Director and Chief Operating Officer are based in South Africa. The divisional managers who are responsible for the company's operations in the United Kingdom and the United States are based in those countries, as are several non-executive directors.

Bigco's board makes the key management and commercial decisions for the conduct of the company's business as a whole. It generally holds three meetings each year, one in each of the countries where Bigco operates. Bigco's Managing Director, Financial Director and Chief Operating Officer typically attend all of the company's board meetings and use the trips to meet with the company's operational managers in the United Kingdom and the United States as well as to meet with investors or investment analysts in those countries. In some instances, these senior board members attend the board meetings virtually in other countries besides South Africa, the United Kingdom and the United States.



All of the “board packs” are prepared by personnel at Bigco’s head office, which may include information sent to the head office by the divisional managers. Head office personnel, including the Managing Director, Financial Director and Chief Operating Officer, and their direct staff, are also responsible for developing and formulating proposed strategic plans for consideration and action by the board. The board actively reviews these plans before taking a decision and, from time to time, either rejects or requires modifications to those proposals.

*Result:*

Under the circumstances, Bigco’s place of effective management is South Africa. Amongst other things, one of the three board meetings at which decisions are made is held in South Africa with a majority of board meetings not being held at the other locations. In addition, its head office and highest level of senior management are both located in South Africa. The fact that Bigco is incorporated in the United Kingdom is irrelevant. Furthermore, the fact that senior board members sometimes attend board meetings in other countries where Bigco operates, does not alter the place of effective management being South Africa since its head office is in South Africa, which is the predominant location where key decisions are in substance made. Any circumstantial evidence related to the company’s economic nexus with any of the countries in question would also be of limited or no probative value in this instance.

Should there be a change of circumstances which necessitates a board member moving to a different country and attending board meetings from such country while also making key management decisions, some of the factors that must be taken into consideration include whether the move pertains to an exceptional and temporary period and where the usual and ordinary place of effective management of the company is.<sup>13</sup>

Other factors as provided in paragraph 24.1 in the Commentary on Article 4<sup>14</sup> must also be considered when determining if there has been a change in the place of effective management of Bigco.

#### 4.2.2 Delegation of authority

A company’s board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered the company’s place of effective management.

The delegation of authority may be either *de jure* (by means of a formal resolution or shareholder agreement) or *de facto* (based upon the actual conduct of the board and the executive committee). Again, the goal is to determine where the key management and commercial decisions for the company as a whole are in substance made and not where those decisions are merely formally approved. This determination applies irrespective of whether the delegation is formal or informal, enforceable or not. It is

<sup>13</sup> OECD “Updated Guidance on Tax Treaties and the Impact of the Covid-19 Pandemic” (21 January 2021) in paragraphs 28 and 29 available online at [www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/](http://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/) [Accessed 30 June 2023].

<sup>14</sup> As provided in the OECD Model Tax Convention dated 13 June 2017.

critically important to consider what the executive committee does in assessing whether its functions amount to making key management and commercial decisions.

### 4.2.3 Board

The location where a company's board regularly meets and makes decisions may often be the company's place of effective management provided the board retains and exercises its authority to govern the company. Furthermore, it must, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole. This situation often prevails when the board meetings are held in the same country as the country where the company's head office is located, and all the directors participating in the board meetings are physically present at the meetings. The impact on the place of effective management arising from the holding of board meetings in different locations is another aspect that requires consideration. The location of the board meetings, assuming for the moment it is the place where the key management and commercial decisions are made, may or may not be the same as the place where the relevant directors are tax resident. It can also be useful to examine how a company's board handled a crisis or various crises, expected or unexpected, that arose during the relevant period.

There is, however, no assumption that a company's place of effective management must be where its board meets. For example, if a board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior managers and does nothing more than routinely ratifying decisions that have been made, the company's place of effective management will ordinarily be the place where those senior managers made those decisions. This situation would potentially apply, for instance, when the formal board meetings are held in a location that bears no relationship to the company's activities or the primary location from where the senior managers perform their duties. Management structures, reporting lines and responsibilities vary from company-to-company and no hard and fast rules exist.

In considering whether a board is making the decisions or, alternatively, is limited to formally approving or rubber-stamping the decisions made by someone else, a variety of factors must be taken into consideration.

These factors include, for example, whether the directors –

- have sufficient knowledge and information at hand;
- are suitably qualified and experienced generally and in relation to the particular company; and
- had reasonable time to assess the information and make the decision.

The details regarding quorums and casting votes and the circumstances in which those aspects are applied may be relevant. Again, it is necessary to look at all the relevant facts and circumstances of a particular case.

Similarly, when considering the role of different directors, it must be established whether the particular director is involved in the decision-making or is perhaps merely ratifying a decision made by other directors or people. For example, it is possible for a director to be appointed with a governance-focussed role or as a shareholder representative and custodian as opposed to being actively involved in making decisions on behalf of the company. In some companies, executive directors have traditionally been involved in decision-making while non-executive directors have not

had a decision-making role. A title may give an indication of a particular director's involvement in decision-making, although this is not always the case. Accordingly, while a title may be useful in identifying the role that a particular director performs, it is the actual role a particular director performs and whether it involves participating in key management and commercial decisions that is determinative, not the director's title.

In *Laerstate v The Commissioner for Her Majesty's Revenue & Customs [Corporation Tax]*<sup>15</sup> the court was in the first instance required to consider where the company was managed and controlled for United Kingdom tax purposes. Secondly, it had to consider where the company's place of effective management was for tax treaty purposes. In so doing, the court was required to consider whether a director acted on another person's wishes or instructions without truly considering the merit of those wishes or instructions or whether the director considered the wishes or instructions but still made the decision while in possession of the minimum information required to make a decision. In the interests of brevity, the detailed facts of the particular case, which were critical to the court's judgment, are not summarised in this Note. Accordingly, readers who would like to obtain a deeper understanding of this case should refer to the judgment. See also *Wood & another v Holden (HMIT)*<sup>16</sup> and *Commissioner for Her Majesty's Revenue and Customs v Smallwood & another*.<sup>17</sup>

In some situations, taxpayers have a pre-meeting which, as the name suggests, precedes a board meeting. In these circumstances consideration must be given to what happens in the pre-meeting, who participates, where the meeting takes place and what, if any, decisions are made since this could impact on the place of effective management.

#### 4.2.4 Modernisation and global travel

Changes in telecommunications, information technology, global travel, and modern business practices can impact on the place of effective management. These factors have meant that physical meetings of the board are often no longer required or implemented. Further that even when physical board meetings are held in a particular location some, possibly a majority, of the directors or the key directors with overriding decision-making powers, are not in the same location as the physical meeting. Consequently, what initially appears to be the location where the decisions are made, that is, the physical location of the board meeting, may not be where the key management and commercial decisions are in substance being made.

Other guidelines as provided by the OECD include, but is not limited to the following:<sup>18</sup>

- If senior managers adopt conferencing through the Internet, for example, as a key medium for making management and commercial decisions and those managers are located throughout the world, it may be difficult to determine a place of effective management. In such cases, a place of management might be regarded as existing in each jurisdiction where a manager is located at the time of making decisions, but it may be difficult (if not impossible) to point to any particular location as being the one place of effective management.

<sup>15</sup> [2009] UKFTT 209 (TC).

<sup>16</sup> [2006] EWCA Civ 26.

<sup>17</sup> [2010] EWCA Civ 778.

<sup>18</sup> See "The Impact of the Communications Revolution on the Application of 'Place of Effective Management' as a Tie Breaker Rule" [www.oecd.org/ctp/treaties/1923328.pdf](http://www.oecd.org/ctp/treaties/1923328.pdf) [Accessed 30 June 2023].

- German case law suggests that, in cases where the place of management cannot be determined, the residence of a company may be determined by the residence of the top manager. It may be that this approach could be extended to companies managed by a board of directors or senior executives. However, it is likely that situations will increasingly arise where those people are not all residents of one country.
- A board of directors may arrange to meet in different places throughout the year. For example, the board of a multinational enterprise may agree to meet at the offices of the enterprise around the globe on a rotational basis. This can also lead to an enterprise having a mobile place of effective management.

Accordingly, it is important not to place an undue focus on the location where board meetings take place without considering the surrounding facts and circumstances of a particular case.

#### **4.2.5 Round robin voting**

The use of round robin voting or a round robin resolution<sup>19</sup> is also something that must be considered from the perspective of the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located.

#### **4.2.6 Shareholders**

Company law or a company's rules or by-laws often reserve the making of certain fundamental decisions for the shareholders of the company. For example, such decisions may include the sale of all or substantially all of the company's assets, the dissolution, liquidation or deregistration of the company, the modification of the rights – attaching to various classes of shares or the issue of a new class of shares. Fundamental decisions such as these typically affect the existence of the company itself or the rights of the shareholders as shareholders, rather than the conduct of the company's business from a management or commercial perspective. Accordingly, such decisions are generally not relevant to the determination of a company's place of effective management.

Shareholder involvement can cross the line into that of effective management. For example, a shareholder may effectively usurp the powers of the directors of the company. This situation typically (but not necessarily) arises when the company is wholly owned by a single person (whether a company, other juristic person or individual) or when there are multiple shareholders, but those shareholders are either connected persons in relation to each other or are acting in concert. This issue is of particular concern in connection with passive holding companies located in low-tax jurisdictions.

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<sup>19</sup> Section 60 of the Companies Act allows for resolutions to be validly adopted by a written resolution and not at a meeting of shareholders, known as a "round robin" meeting. If the written resolutions are supported by enough persons entitled to exercise sufficient voting rights, then the resolution is adopted and has the same effect as if it had been approved by voting at a validly called meeting. [www.swart.law/post.aspx?id=16](http://www.swart.law/post.aspx?id=16) [Accessed 30 June 2023].

There is a distinction between shareholder guidance or influence and usurpation. Influence does not constitute effective management, but undue influence may do so. For instance, if the board considers what the shareholder has recommended and independently makes its own decision, this would not constitute usurpation even if the decision made by the board is in line with the shareholder's recommendation. Importantly, it must be established whether the board independently makes its own decisions or is merely implementing what the shareholder has already decided for the company and in that way does not actually make decisions. Depending on the facts, the line between influence and merely approving or rubber-stamping may be unclear. Situations in which a shareholder or another party usurps effective management will probably be the exception rather than the norm.

In *Unit Construction v Bullock*,<sup>20</sup> the subsidiary companies' constitutions required that they be managed by their own boards. The court, however, found that in all matters of real importance affecting central management and control, the real management and control was exercised by the board of the parent company. The House of Lords agreed that although the parent company's actions were arguably unlawful, it did not override the factual reality of by whom and from where the subsidiary companies were managed and controlled.

Shareholders sometimes limit the authority of, or provide guidelines for, the board and senior managers of a company. For example, a parent company may set limitations of authority or guidelines for a subsidiary company. These limitations must, in conjunction with all the other facts and circumstances, be reviewed in detail to determine whether the effect is that the shareholder is actually making the key decisions or whether the company, although receiving guidance or some input, is still making them. It is quite common for a parent company of a multinational group to set guidelines and policies for the group as a whole in order to direct, coordinate and monitor activities of the entire group. This does not necessarily mean, and often does not mean, that the subsidiary company is not making its own decisions, but all the facts must be considered when making this assessment.

### **Example 3 – Limitation of authority**

*Facts:*

Company A concludes long-term contracts with clients, which extend over a number of years. A single contract can have a significant effect on the financial viability of Company A and as a result Company A's senior management team sign off on all contracts. The conclusion of sales contracts represents a predominant key commercial decision for Company A.

<sup>20</sup> [1960] AC 351, [1959] 3 All ER 831, [1959] 3 WLR 1022, 38 TC 712, 38 ATC 351, [1959] TR 345, 52 R&IT 828. See also *Laerstate v The Commissioner for Her Majesty's Revenue & Customs [Corporation Tax]* [2009] UKFTT 209 (TC), *Wood & another v Holden (HMIT)* [2006] EWCA Civ 26 and *Commissioner for Her Majesty's Revenue and Customs v Smallwood & Another* [2010] EWCA Civ 778.

Under a limitation of authority, the company's senior management team is restricted to concluding contracts not exceeding a contract value of R10 million. For contracts exceeding this value, the company must submit its recommendation to the parent company and the parent company makes the decision whether or not the contract may be accepted. The company must implement the parent company's decision.

90% of contracts have a value that exceeds R10 million.

*Result:*

Although more detail would be required and all the facts affecting all the key management and commercial decisions of the company as a whole would have to be taken into account, the facts suggest that the effective management of the company may have been usurped by the parent company. The limitation of authority in this case has effectively removed the company's real authority to make decisions and has gone beyond a mere monitoring mechanism or information-reporting requirement.

Limitations of authority and guidelines are common in multi-national groups of companies. The details are critical in assessing who is, in substance, making the company's key management and commercial decisions.

#### **4.2.7 Operational management versus broader top-level management**

Operational management decisions are generally of limited relevance in determining a company's place of effective management and must be distinguished from the key management and commercial decisions.

Operational management generally concerns the oversight of the day-to-day business operations and activities of a company. Key management and commercial decisions are concerned with broader strategic and policy decisions and tend to be made by members of the senior management team. A decision to open a major new manufacturing facility or to discontinue a significant product line would be examples of key commercial decisions affecting the company's business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls, and human resources policies, would be examples of operational management.

What constitutes a key management or commercial decision as opposed to an operational management decision is critical since it is the former that is relevant in the context of establishing the place of effective management. Again, determining what constitutes a key management or commercial decision is an aspect that can be determined only on a case-by-case basis. For example, in some businesses the conclusion of each and every contract will be a key commercial decision while in other businesses the setting of standardised pricing will be a key commercial decision, but the conclusion of individual contracts will not be.

Depending on the particular case, the person responsible for operational decisions may be the same as the person responsible for the key management and commercial decisions. In this situation it is still necessary to distinguish between the two types of decisions and to assess where the key management and commercial decisions are made. The location of this decision-making is critical.

#### **4.2.8 Legal factors**

Legal factors such as a company's place of incorporation, formation or establishment, the location of its registered office and the location of its public officer are generally not relevant in the determination of a company's place of effective management.

#### **4.2.9 Economic nexus**

The extent of a company's economic nexus with a country is generally irrelevant in the determination of its place of effective management. However, this factor may be considered circumstantial and given some weight in cases where other factors are inconclusive.

#### **4.2.10 Support functions**

It is not uncommon for a multinational company to centralise certain support functions such as data management, human resources, customer support or accounting, and to locate those services in countries that offer advantages such as superior infrastructure, lower costs or a highly skilled workforce. A group of companies may house these services in the group's ultimate holding company or in a separate subsidiary, which provides the services to all the members of the group.

In these situations, the locations where those services are primarily performed and where the senior managers responsible for them are based may be different to the location of the company's head office where the top senior management and the senior management's direct support staff are located. Although such support services may be essential to a company with support service related policies and procedures having a company-wide effect, the managers in charge of those services are often not involved, or only secondarily involved, in making key management and commercial decisions that affect the conduct of the company's business as a whole (outside of the area of the specific support functions that they are responsible for). Consequently, the location where such support services may be located is generally of limited relevance to the determination of a company's place of effective management.

The location where a company's accounting records are retained will generally not be indicative of the place where the key management and commercial decisions made in these circumstances would therefore be irrelevant in determining a company's place of effective management.

### **4.3 Effect of the COVID-19 pandemic on a company's "place of effective management"**

According to the OECD document "Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic", it is stated that the pandemic may raise concerns about a potential change in the "place of effective management" of a company owing to relocation, or inability to travel, of board members or other senior executives. The concern is that such a change may result in a change in a company's residence under relevant domestic laws and affect the jurisdiction where a company is regarded as a resident for tax treaty purposes.

The OECD suggests that it is unlikely that the COVID-19 pandemic will create any changes to a company's residence status under a tax treaty, because a temporary change in location of senior executives would most likely be seen as "an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency, especially once the tie breaker rule contained in tax treaties is applied".<sup>21</sup>

The above approach is one that is accepted by SARS. However, the merits of each case will be considered before a determination on a company's place of effective management is made.

## 5. Conclusion

A "place of effective management", in determining the tax residence of a company, is only one of the considerations under the tie-breaker rule in a tax treaty that adheres to Article 4 of the OECD Model Tax Convention and its accompanying Commentary.

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

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

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

The place of effective management test is one of *substance over form*. It therefore requires a determination of those persons in a company who actually "call the shots" and exercise "realistic positive management".

## Leveraged Legal Products

### SOUTH AFRICAN REVENUE SERVICE

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<sup>21</sup> OECD "Updated Guidance on Tax Treaties and the Impact of the Covid-19 Pandemic" (21 January 2021) in paragraphs 28 and 29 available online at [www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/](http://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/) [Accessed 30 June 2023].