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A Study on the Interpretation and Limitations of the Concept “Place of Effective Management” as laid down in Article 4(3) of the OECD Model Tax Convention

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A STUDY ON THE INTERPRETATION AND LIMITATIONS OF THE CONCEPT "PLACE OF EFFECTIVE MANAGEMENT" AS LAID DOWN IN ARTICLE 4(3) OF THE OECD MODEL TAX CONVENTION

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ABSTRACT

The notion of 'corporate residence' in terms of Article 4(1) of the OECD Model Tax Convention on Income and on Capital (hereinafter "OECD MC") is fundamental to the application of the provisions of the double tax treaties. Of particular importance is the interpretation of the concept "place of effective management" in terms of Article 4(3) OECD MC, with its purpose to solve any dual residence problems which may arise pursuant to reliance on domestic law by virtue of Article 4(1) OECD MC.

Curiously however, we have very little guidance as to the meaning of the "place of effective management" concept. The lack of a uniform and commonly accepted definition of this concept has led to much uncertainty in its interpretation leading to varying results by different Contracting States. This difference in interpretation may not be successful in pointing to a *single* "place of effective management", rendering the current tie-breaker inefficient in this respect.

Following this lack of consistency in the interpretation of the concept in treaty practice, this work explores the two main approaches to the interpretation of "place of effective management" by different Member States. Analysing the concepts "central management and control" and "place of management", as evidenced by decisions of the domestic courts and academic literature on the subject. Whilst also determining whether an autonomous meaning to the "place of effective management" does exist.

Furthermore, it is known that the quality of a legal provision must always be determined by its competence in solving exceptional cases. This work therefore goes on to analyse the limitations of this concept which became apparent pursuant to the change in organisational structures to bi- or polycentralised networks as opposed to strict hierarchical systems; and the opportunities being offered by the ever evolving information and communication technologies (ICT). The limitations analysed are those of multiple "places of effective management", mobility of the "place of effective management" and the problem of treaty dual non-residence encountered in triangular cases.

This work draws to a conclusion that the current tie-breaker, which is of such fundamental relevance to the interpretation and application of tax treaties in practice, is in dire need of review as it may be found to be unsuccessful in terms of its interpretation and exceptional cases expressed above.

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List of Abbreviations

BV	Besloten Vennootschap
CIR	Commissioners of Inland Revenue
HMRC	Her Majesty's Revenue and Customs
ICT	Information and Communication Technologies
IFA	International Fiscal Association
IRS	Internal Revenue Service
LON	League of Nations
MAP	Mutual Agreement Procedures
MNE	Multinational Enterprises
OECD	Organisation for Economic Cooperation and Development
OECD-TAG	OECD Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits
OECD MC	Organisation for Economic Cooperation and Development Model Tax Convention
OEEC	Organisation for European Economic Co-Operation
UK	United Kingdom
WP N°2	Working Party N°2
WP N°5	Working Party N°5

CHAPTER 1

CORPORATE RESIDENCE IN TERMS OF ARTICLE 4(1) OECD MC

1.1 "RESIDENT OF A CONTRACTING STATE"

"Corporate residence" plays a key role both for domestic tax law and for tax treaties.[1] The term "resident" as used in the OECD MC has numerous functions, thus plays a crucial role in the application of the Convention.

Primarily, the term is necessary to determine the scope of the Convention, as per Article 1 OECD MC, a person is only eligible to treaty benefits if resident in one or both of the Contracting States. Clarity of the concept "resident of a Contracting State" found in Article 4(1) is therefore of utmost importance in determining the scope of the Convention, determining the legal consequence of primary or secondary taxation, which in turn will pave the way for the application of the distributive rules and methods for the elimination of double taxation found in the Convention.[2]

Article 4(1) of the OECD MC provides:

> "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, *under the laws of that State*, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature…"[3]

[1] Luc Hinnekens, "Revised OECD-TAG Definition of Place of Effective Management in Treaty Tie-Breaker Rule" (2003) 31(10) Intertax 314

[2] Philip Baker, *Double Taxation Conventions: A Model on the OECD Model Tax Convention on Income and Capital* (Sweet & Maxwell, London 2001) and Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* (Kluwer Law International Ltd, 3rd Edition, United Kingdom 1997)

[3] *Model Double Taxation Convention on Income and on Capital*, Paris: OECD, 2010, Article 4(1) [emphasis added]

Article 4(1) OECD MC provides no clear definition of the term "resident". Pursuant to the words quoted above, the notion "resident of a Contracting State" is simply determined by the definition laid down in the Contracting States' domestic law, provided it administers for a comprehensive tax liability. Further, the use of the term "by reason of" imposes a casual link between the "liability to tax" and one of the prescribed connecting factors.[4] The words "liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature" therefore reflects taxation in connection to the person rather than the income.

It is evident that, as a consequence to this reference to domestic law when interpreting the notion "resident of a Contracting State", a person may be found to be a resident of both (or neither) of the Contracting States. This problem of dual corporate residence (or dual non-residence) may arise from the use of different criteria of residence being retained by the two Contracting States, different interpretations by the said States of the same criteria or due to the complex nature of the criterion used.[5]

It is therefore clear that this attachment to domestic law may be seen as a route to potential dual residence (or dual non-resident) issues, which may result in double taxation (or double non-taxation).

1.2 "Domicile, Residence, Place of Management or Any Other Criterion of a Similar Nature"

The meaning of the connecting factors present in Article 4(1) take the interpretation given to them by the domestic law of the respective States. It is therefore impossible to give the connecting factors an exact meaning, and it would be expected to have varying interpretations of such terms among different States.

The focus of this study is on *corporate residence*. For this reason, when analysing the various connecting factors and the role of domestic law in connection to such, the interpretation will have regard to legal persons alone.

[4] The Queen v Crown Forest Industries Limited et al. [1995] 95 DTC 5389
[5] Hinnekens[n1]314

1.2.1 "DOMICILE"

The term "domicile" is often associated with natural persons rather than legal persons. However, in the context of corporations, the term "domicile" is based on judicial interpretation.[6] Rivier commended that the term "domicile", when used to determine fiscal residence, should have regard to "where the company is established",[7] referring to the company's place of incorporation, registered office, statutory seat or place of management.[8]

It may be noteworthy to point out that none of the OECD Member States make use of the term "domicile", when determining corporate residence under domestic law.[9]

1.2.2 "RESIDENCE"

The term "residence" is again associated with natural rather than legal persons. The application of this connecting factor to a legal person may be said to be "artificial" or "metaphorical" in the words of Couzin.[10] However, a case law test has been developed by UK judges to apply the term "resident" to corporations. Lord Loreburn clarified this test in the landmark case *De Beers*[11] where he held:

> "In applying the conception of residence to a Company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see [where] it really keeps house and does business."[12]

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[6] Marcel Widrig, "The Expression "by Reason of His Domicile, Residence, Place of Management …" as Applied to Companies" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 275

[7] J.M Rivier, "The Fiscal Residence of Companies, General Report", 41st IFA Congress, Brusels, in *Cahiers De Droit Fiscal International* (Kluwer, Rotterdam, Vol. 72 A 1987) 57

[8] ibidi

[9] Appendix I

[10] Robert Couzin, *Corporate Residence and International Taxation* (IBFD Publications BV, The Netherlands, 2002) 137

[11] De Beers Consolidated Mines, Limited, Applants; Howe (Surveyor of Taxes), Respondent [1905] 2 K.B. 612

[12] ibidi at 212-213

Lord Loreburn goes on to confirm, having regard to the "real business" test in *Calcutta Jute Mills v Nicholson* and *Cesena Sulphur Company v Nicholson*[13] that "the real business is carried on where the central management and control abides."

1.2.3 "PLACE OF MANAGEMENT"

When interpreting the concept "place of management" as laid down in Article 4(1), it is important to point out that a person is "liable to tax therein by reason of his…place of management". In this context "place of management" seeks to identify a person liable to comprehensive tax as opposed to a limited liability to tax. It is therefore important that the interpretation of "place of management" under Article 4(1) is distinguished from this concept as used in Article 5(2)(a) as a connecting factor for permanent establishment. Since in terms of Article 5(2)(a), the concept "place of management" is a factor determining source taxation of business profits.[14]

"Place of management" as used in Article 5(2)(a) is of a broader nature than that used in Article 4(1). Yet the interpretation of "place of management" in Article 4(1) is still broader than that of "place of effective management" as used in Article 4(3), as these two concepts again are used in different context. It is crucial that a distinction is made between the different concepts and their intended use.

Article 4(1) requires "place of management" to be interpreted in terms of domestic law, which may differ depending on the domestic tax law addressed. This difference may not only arise due to the different facts and circumstances taken into account by the various domestic laws, but as a result of differences in corporate laws.[15] This difference in corporate law may highlight a cause of dual corporate residence pursuant to the different interpretations by the two Contracting States of the same criteria. Since common law and civil law countries attach importance to different levels of management when interpreting the concept "place of management".

[13] Cesena Sulphur Co, Ltd v Nicholson; Calcutta Jute Mills Co, Ltd v Nicholson [1874-80] All ER Rep 1102
[14] Widrig[n6]276-280
[15] Widrig[n6]276

Generally civil law countries take on the approach of having a two-tier board structure, in that, having a supervisory board consisting solely of non-executive directors and a management board consisting solely of executive directors. Whilst in common law countries, an approach of a single board structure is generally[16] taken, consisting of both executive and non-executive directors.[17] It may therefore be determined that the civil law test with its two-tier board structure attributes importance to day-to-day management, whilst the common law countries, to policy by combining management activities of both executive and non-executive directors, that is, the central policy core of the whole enterprise.[18]

1.2.4 "OTHER CRITERIA OF A SIMILAR NATURE"

When interpreting the words "other criteria of a similar nature" in Article 4(1), it would be necessary to determine what the connecting factors "domicile, residence, place of management" have in common. It is evident that the three connecting factors have a local connection creating taxation on a residence principle.[19] As advocated by Vogel, there must be a "locality-related attachment that attracts residence-type taxation."[20]

It is clear that the OECD, when using such a phrase is referring to criteria, other than domicile, residence or place of management, which, when used in domestic law of the Contracting States would subject a person to *comprehensive* taxation.

A connecting factor under domestic law which subjects a person to *limited* taxation cannot therefore be an appropriate factor thus not a "criteria of a similar nature" for purposes of Article 4(1). Couzin precisely opines:

> "If every nexus for taxation is a "criterion of a similar nature", i.e. if the requisite similarity is nothing more than the fact that the criterion serves as a basis for taxation, then the full expression "liability to tax by reason of

[16] Historically the single board structure consisted merely of non-executive directors.
[17] John Avery Jones, et al., "The Origins of Concepts and Expressions Used in the OECD Model and Their Adoption by States" (2006) 60(6) IBFD, 232
[18] ibidi
[19] Widrig[n6]280
[20] Vogel[n2]233

> domicile, residence, place of management or any criterion of a similar nature" collapses to "liable to tax"."[21]

The concept of "incorporation" raises some debate in this respect. There seems to be little, or no consensus as to whether this vastly used concept may be said to be classified as a "criteria of a similar nature". Couzin supports the view that incorporation is not mentioned explicitly in Article 4(1), however "might well be considered to be within the scope of other criteria". [22] Conversely however, Widrig follows the view that, incorporation cannot be said to be a "criteria of a similar nature", seeing that it lacks the effective personal attachment to a territory. [23] A number of States which allocate importance to this concept would therefore include the term in Article 4(1) as one of the connecting factors together with those prescribed in the OECD MC.

1.3 CONCLUSION

It may be concluded that the concept "resident of a Contracting State", defined and based solely on the interpretation given to the connecting factors in the relevant domestic laws, may undoubtedly create an issue of dual residence. It is noteworthy to point out that it is not the function of Article 4(1) to avoid dual residence. Article 4(1) alone does not ensure that a person is a resident *only* of one of the two Contracting States. Rather it has as its aim the identification of taxpayers resident of *at least* one of the two Contracting States by virtue of the connecting factors provided in the Convention, thus allocating unlimited taxation to a person in one or both of the Contracting States.

Nonetheless, such dual residence pursuant to the application of Article 4(1) is not accepted with equanimity, deeming it necessary to look to the subsequent paragraphs to remedy this problem. Article 4(3) acts as a tie-breaker rule to remedy the dual corporate residence issue. The function of Article 4(3) is to allocate residence to that State in which the person has its "place of effective management"; it however does not resolve the domestic consequence of dual residence.

[21] Couzin[n10]143
[22] Couzin[n10]142
[23] Widrig[n6]281

The outcome of Article 4(3) is crucial in the application of the distributive rules as well as the methods to avoid double taxation found in the OECD MC. Since they assume a potential conflict between residence and source taxation and refer to one of the countries as a resident State and the other as the source State. Article 7 (Business Profits), Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties) and Article 13 (Capital Gains) all impose a limit on the scope of source taxation where the beneficiary is a resident of the other Contracting State. For these Articles to be effective, a single treaty residence must first be established. For this reason, treaties contain tie-breaker rules in order to clearly determine which of the Contracting States will be considered the resident State for purposes of the treaty.

Article 4(3) has the capacity to act as a tie-breaker being that it requires the concept of "place of effective management" to be interpreted autonomously. This concept is however surrounded by uncertainty. The rest of this study focuses on the tie-breaker, "place of effective management" as used in Article 4(3). Highlighting its limitations and determining whether it is capable of breaking ties of dual residence as an efficient tie-breaker in all respects.

Chapter 2 will study the history of the concept "place of effective management", determining its origin whilst also highlighting its ambiguity over the years. Chapter 3 and 4 will discuss the problems encountered in interpreting the concept "place of effective management" due to the lack of a common international meaning, tempting Contracting States to base interpretation of this concept on their own domestic tax law. Chapter 5 will then move on to the inherent limitations of the current tie-breaker rule pursuant to the globalisation of the economy and possibilities offered by information and communication technologies (ICT) which is an exacerbation of the interpretation problem. Whilst Chapter 6 explores possible conclusions to curtail or eliminate such limitations highlighted in prior Chapters.

CHAPTER 2

ORIGIN OF THE CONCEPT "PLACE OF EFFECTIVE MANAGEMENT"

2.1 THE MEXICO AND LONDON MODELS[24]

Uncertainty surrounding the concept of corporate residence existed earlier than the 1940's. Doubt between the use of the term "place of incorporation" and "real seat" surfaced when the League of Nations (LON) Mexico Model of 1943 and the LON London Model of 1946 were drafted. The Mexico Model defines 'fiscal domicile' in the case of "partnerships, companies and other legal entities of *de facto* bodies" as the "the State under the laws of which they were constituted",[25] whilst the London Model differed, giving importance to "the State in which its real centre of management is situated.[26]

The Mexico and London Models contained rules which determined the domicile of a person autonomously. In that, corporate residence in terms of the said Models was not conditional on domestic law, or on a liability to tax.

Problems may however arise when determining a person's domicile for treaty purposes without having any regard to its domestic law. A person may be deemed a resident of a State for treaty purposes, therefore eligible to treaty benefits when neither Contracting State subjects the said taxpayer to comprehensive taxation. Conversely, a taxpayer may be found in a position where it is not deemed resident in a Contracting State for treaty

[24] The discussion of "fiscal residence" dates back earlier than the Mexico and London Models, however, for the purpose of this thesis, starting the history of "fiscal domicile" at this stage would suffice.
[25]London and Mexico Model Tax Conventions Commentary and Text <http://setis.library.usyd.edu.au/pubotbin/toccer-new?id=brulegi.sgml&images=acdp/gifs&data=/usr/ot&tag=law&part=15&division=div1> accessed 4 August 2011
[26] ibidi

purposes, although that State subjects the taxpayer to comprehensive taxation subsequent to domestic law.[27]

2.2 OEEC Evolution on the Concept of "Fiscal Domicile"

The Fiscal Committee of the OEEC in May 1956 set up Working Party N°2 on Fiscal Domicile consisting of delegates from Denmark and Luxembourg (hereinafter "WP N°2"). This Working Party issued a number of reports[28] on the concept of fiscal domicile, which ultimately led to the tie-breaker rule "place of effective management" which is present in the current OECD MC.

The proposals put forward by WP N°2 differ from that of the Mexico and London Models, in that; it does not make use of a treaty autonomous concept. However, relies on the domestic law of the Contracting States in determining whether a person is a resident of a Contracting State for tax purposes.

Following on from the problem of dual corporate residence, pursuant to the nature of Article 4(1) as discussed in Chapter 1, it is evident that a tie-breaker, or "preference criterion" as referred to by WP N°2, must be in existence in order to deal with cases of dual residence.

2.2.1 Management and Control

The first report issued by WP N°2, dated 27 May 1957, introduced a tie-breaker to resolve the problem of a person being fully liable to tax in more than one State. This gives priority "to the country in which its [the company's] business is *managed and controlled*."[29] Recognising possible uncertainty in determining corporate residence bases on the location of the company's "management and control", the draft Article goes on to propose that, following any doubt of the State in which the business of a company is

[27] Jacques Sasseville, "The Meaning of Place of Effective Management" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 288
[28] FC/WP2(57)1 dated 27 May 1957, FC/WP2(57)2 dated 19 September 1957, FC/WP2(57)3 dated 5 November 1957 and FC/WP2(58)1 10 January 1958. These reports may be consulted at http://www.taxtreatieshistory.org/
[29] FC/WP2(57)1 dated 27 May 1957, A.II (emphasis added)

"managed and controlled", "the competent authorities shall determine the question by agreement between themselves."[30]

The rationale behind the proposed concept "managed and controlled" as the preference criteria, was given by WP N°2:

> "A study of the agreements in force has shown that the great majority of these accord the right to tax to the country where the corporation is managed and controlled. Only as a rare exception is importance attached to the place where the corporation has been registered. … The Working Party considered that it was natural not to attach importance to a purely formal criterion like registration, but to attach importance to the State in which the corporation is actually managed, and it is proposed to choose the term "managed and controlled"…"[31]

The concept "managed and controlled" was therefore proposed as a tie-breaker based on a combination of majority practice and formality of place of incorporation.[32] This concept originated from the terminology found in the UK's treaties, WP N°2 was attracted by the consistency found in those treaties. Thus proposed the use of the term "managed and controlled", despite the uncertainty which lingers around this concept. WP N°2 recognises such uncertainty when it held:

> "…the term "managed and controlled" is not in itself clear. Normally no doubt would supposedly exist, but in the case of a company which satisfies the conditions for full liability to tax in several countries the question may arise whether it is "managed and controlled" by the managers, the board of directors or the shareholders (the general meeting). If, say, the controlling interest (the majority of the shares) is to be found in one country, the board of directors has its seat in another, and the company is managed from a third, there appears to be a problem which must be solved."[33]

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[30] ibidi
[31] ibidi, A.II B
[32] Richard Vann, "Liable to Tax and Company Residence under Tax Treaties" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 235
[33] [n29]A.II B

The uncertainty outlined above, however, was not a major issue for WP N°2 as they explained, "the question will *hardly be of practical importance*, it has been found reasonable and natural to reserve such cases for agreement between the interested parties."[34]

The "management and control" concept borrowed from the UK cannot be said to be a good tie-breaker. Although it was thought that "central management and control" could be found in only one place as indicated in Article 4 of the Irish Agreement, the court in *Union Corporation Ltd v IRC*[35] rejected this view.[36] Lord Radcliffe confirmed this in his statement in *Unit Constructions Co. Ltd:*[37]

> "individual cases have not always so arranged themselves as to make it possible to identify any one country as the seat of central management and control at all. Though such instances must be rare, the management and control may be divided or even, at any rate in theory, peripatetic."[38]

Making clear that the concept "central management and control" cannot be introduced with a view to break ties of dual residence.

Although, Avery Jones confirmed that, the inclusion of the concept "managed and controlled" in the UK's tax treaty with the Irish Free State was not intended to be used as a tie-breaker between different types of management.[39] It did however serve as a tie-breaker between the concepts "incorporation" and "management" following the decision in the *Swedish Central Railways* case.[40]

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[34] ibidi
[35] Union Corporation Ltd v Inland Revenue Commissioners [1952] 1 All ER 646 [1953] 1 AC 482; (1953) 34 TC 207
[36] John Avery Jones, "2008 OECD Model: Place of Effective Management - What One Can Learn From the History" (2009) 63(5/6) IBFD, 185
[37] Unit Construction Co Ltd v Bullock (Inspector of Taxes) [1959] 3 All ER 831
[38] ibidi at 831
[39] Avery Jones[n36]185
[40] Swedish Central Railway Company v Thompson [1924] 2 K.B. 255

2.2.2 "PLACE OF EFFECTIVE MANAGEMENT"

The concept "place of effective management" originated from comments submitted by the Swiss Delegation to WP N°2. The draft Article put forward by the Swiss Delegate read as follows:

> "If it results from the application of paragraph 1 that a legal person is domiciled in each of the two States, then the *place in which its effective management is situated* shall be determinative of its domicile."[41]

The proposal introduced by the Swiss Delegate was not adopted immediately. WP N°2 remained loyal to the concept "managed and controlled" until the issue of its fourth report dated 5 November 1957, were it replaced the concept of "management and control" with that of "place of effective management". The reason for this change was not however to follow the Swiss Delegate's submission, but to be in line with the work of WP N°5, in the "Report of the Taxation of Income and Capital of Shipping and Air Transport Enterprises and of Their Crews", dated 6 May 1957.[42]

The draft Article in the 5 November 1957 report reads:

> "A company or other body corporate (excluding estates of deceased persons) shall be regarded as resident in the State in whose territory its *place of effective management* is situated."[43]

WP N°2 made clear the logic behind the change to "place of effective management":

> "In its former reports Working Party No. 2 proposed to adopt [as] a preference criterion the term used in the Conventions concluded by the United Kingdom: "where its business is managed and controlled". As it has been stated that this term means the effective management of the enterprise,

[41] FC/WP2(57)2 dated 19 September 1957

[42] The 6 May 1957 Report of WP N°5 (FC/WP5(57)2) held:

> "An enterprise which has its fiscal domicile in one of the two contracting States is to be taxed, in respect of income from the international operation of ships or aircraft, and in respect of the capital (other than real property) appertaining [thereto], only in the State in whose territory its *place of effective management* is situated."

[43] FC/WP2(57)3 dated 5 November 1957 (emphasis added)

> and as it must appear natural to use the same criterion in the two Articles, the Working Party now proposed the same formula in paragraph (2) as proposed in the Article on shipping and air transport enterprises."[44]

It should be noted also, as at that date, recourse to the mutual agreement procedure (MAP) which has been included in previous drafts, was removed. The justification for its removal was that "it will hardly ever be required".[45]

2.3 OECD Evolution of the Concept "Place of Effective Management"

2.3.1 1963 OECD Draft and 1977 OECD MC

The final report on the concept of fiscal domicile dated 10 January 1958 became the Commentary to the First Report of the Fiscal Committee of the OEEC (1958). Which in turn formed the basis of Article 4(3) of the 1963 OECD Draft and the 1977 OECD MC and the Commentaries thereof.

Article 4(3) of the 1977 OECD MC reads:

> "Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which its *place of effective management* is situated."

It may be noted at the outset that paragraph 22 of the Commentary to Article 4(3) attaches importance to the State in which a company is "actually managed" whilst opposing "a purely formal criterion like registration".[46] The OECD goes on to express the similarity between the concept "management and control" and "effective management" in paragraph 23 of its Commentary:

> "Concerning conventions concluded by the United Kingdom which provide that a company shall be regarded as resident in the State in which "its

[44] ibidi
[45] ibidi
[46] *Model Double Taxation Convention on Income and on Capital*, Paris: OECD, 1977, paragraph 22 of the Commentary on Article 4

> business is managed and controlled", it has been made clear, on the United Kingdom side, that this expression means the "effective management" of the enterprise."

Clearly in line with WP N°2's reasoning. The Commentary to Article 4(3) in the 1977 OECD MC however provides no further guidance on the interpretation of the concept "place of effective management".

New Zealand put forward an observation in respect of paragraph 23 of the Commentary to the 1977 OECD MC:

> "New Zealand's interpretation of the term "effective management" is practical day to day management, irrespective of where the overriding control is exercised."[47]

This observation is in conflict with the UK's view which attaches importance to the control exercised by the board of directors. New Zealand deems the "day to day management" to be a better interpretation of "effective management".

2.3.2 THE 1992 UPDATE

The first major amendment to the OECD MC was the *1992 Update*, were, reference to the UK's treaty practice in paragraph 23 of the Commentary to Article 4(3) was deleted. This change proposes dissimilarity between the concepts "managed and controlled" and "place of effective management".

Due to the lack of a concrete definition of the concept "place of effective management", countries were likely to interpret this concept in accordance with their domestic tax law rather than as an autonomous concept. This approach was not supported by the OECD, intending the interpretation of the tie-breaker to be of an autonomous nature. This reference to domestic law may be the reason for the subsequent 2000 update to the Commentary on Article 4(3), as an attempt to reduce uncertainty surrounding this concept.

[47] ibidi paragraph 25

2.3.3 THE 2000 UPDATE

The *2000 Update* to the OECD MC bolstered paragraph 24 of the Commentary to Article 4(3) with an added 'definition' with a view to clarifying the concept "place of effective management". The addition to paragraph 24 is accentuated in bold below:

> "As a result of these considerations, the "place of effective management" has been adopted as the preference criterion for persons other than individuals. [1]**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.** [2]**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**."

The first sentence added in the 2000 update may be read to support the management of both the board of directors as well as top-level executives.[48] Whilst the second sentence clarifies the first, attaching importance to management by the board of directors which may demonstrate an analogy to the concept of "central management and control",[49] opposing the implications of the 1992 deletion.

Importantly however, "board of directors" may mean different things in different countries.[50] This difference may be pursuant to the corporate law in force in the different States as discussed in Section 1.2.3 above. Avery Jones et al. opine, the second sentence added in the 2000 Update, although seems to favour the common law test, may be read to mean the same as the internal law test of both common law and civil law countries.[51]

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[48] Sasseville[n27]293
[49] Sasseville [n27]294
[50] ibidi
[51] Avery Jones et al.[n17]233

Following the 2000 change, New Zealand withdrew its observation. However Italy added an observation expressing its views on "the place of effective management".

> "Italy does not adhere to the interpretation given in paragraph 24 above concerning "the most senior person or group of persons (for example, a board of directors)" as the sole criterion to identify the place of effective management of an entity. In its opinion the place where the main and substantial activity of the entity is carried on is also to be taken into account when determining the place of effective management of a person other than an individual."[52]

2.3.4 OECD Proposals For Changes to the OECD MC and its Commentary

In 2001 the OECD-TAG released its first discussion paper in this respect, entitled "The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie-Breaker Rule".[53] This paper identifying the limitations of the concept "place of effective management" brought about by the advancement of the technological environment of enterprises whilst also putting forward possible solutions. This was then followed by the 2003 discussion draft entitled "Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention".[54] This draft proposed two alternative amendments with a view to improving the OECD MC and its Commentary as follows:

- The first proposal **"Refinement of the place of effective management concept"**: this seeks to refine the concept of "place of effective management" by expanding the OECD Commentary explanations to give guidance on how the concept should be interpreted.

- The second proposal **"Hierarchy of tests"**: puts forward an alternative version of Article4(3) OECD MC in that replacing the excising tie-breaker rule.

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[52] *Model Double Taxation Convention on Income and on Capital*, Paris: OECD, 2000, paragraph 25 of the Commentary on Article 4
[53] May be found at www.oecd.org/dataoecd/46/27/1923328.pdf
[54] May be found at www.oecd.org/dataoecd/24/17/2956428.pdf

Although it emerged that the proposed expansion to the OECD MC and its Commentary was not in line with the majority of the OECD Member States' interpretation of this concept. It was held that the proposed interpretation "gave undue priority to the place where the board of directors of a company would meet over the place where the senior executives of that company would make key management decisions."[55] Also finding the hierarchal test unnecessary.

It also emanated from the discussions that the number of Member States adopting a case-by-case approach, where tax authorities determine a "place of effective management" on the facts and circumstances of each case, are increasing.

2.3.5 THE 2008 UPDATE

Subsequent to the discussions, the Commentary to Article 4(3) was amended once again. Here, the second sentence added to paragraph 24 of the Commentary to Article 4(3) in the *2000 Update* was removed. This amendment may be a possible attempt to reverse the analogy previously given to the concept "central management and control" with great importance being given to the management performed by the board of directors.

The said change has been reproduced hereunder:

> "As a result of these considerations, the "place of effective management" has been adopted as the preference criterion for persons other than individuals. 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 as a whole 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 a~~All relevant facts and circumstances must be examined to determine the place of effective

[55] Kees van Raad, *Materials on International and EU Tax Law"* (IBFD, the Netherlands, Vol.1 10th ed 2010) 121

> 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."[56]

Once the importance given to the board of directors has been removed, paragraph 24 provides a general statement which seems to be open to support different levels of management. It also confirms (once again) that the concepts "central management and control" and "place of effective management" differ.

Further to the increased use of a case-by-case approach when resolving dual resident cases by Member States, the 2008 Update brought about a further amendment to the OECD MC. It has been held that an alternative to the current provision provided in Article 4(3) can be used. The OECD allows States to solve cases of dual corporate residence on a case-by-case basis, if such an "approach is the best way to deal with the difficulties in determining the place of effective management of a legal person that may arise from the use of new communication technologies."[57] Thus the current Article 4(3) may be replaced by the following provision:

> "3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States *shall endeavour* to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. *In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.*"[58]

The Commentary goes on to provide guidance on the salient factors to be taken account of by the competent authorities in determining corporate residence:

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[56] *Model Double Taxation Convention on Income and on Capital*, Paris: OECD, 2008, paragraph 24 of the Commentary on Article 4. Underlined words represent added words in 2008 and strikethrough a deletion.
[57] ibidi paragraph 24.1
[58] ibidi

> "where the meetings of its board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc."

This alternative approach has been validated and recommended by a number of States, therefore accepting this alternative Article.[59] However, it has also been criticized as being unnecessary; since the competent authorities always have recourse to MAP, now reinforced by the arbitration clause. It has also been criticized as having "far reaching negative consequences", being that the competent authorities may not come to an agreement if Contracting States follow different approaches or take into account different factors in their interpretation.[60]

De Broe also criticizes the 2008 update, as he argues that the Commentary now provides factors to be taken into account when applying the alternative to Article 4(3), however no such guidance is given for the current tie-breaker rules. He argues that the change may jeopardise the legal certainty of taxpayers affected by the tie-breaker. The current rule is merely given a general principle, which is seen to be unsatisfactory.[61]

This alternative Article, unlike Article 4(2)(d) which provides that the authorities "shall" settle by mutual agreement, provides that the authorities "shall *endeavour*" to settle by mutual agreement, therefore, with no obligation for the competent authorities to reach a solution. In addition, the dual resident company cannot claim treaty benefits as a resident of either Contracting State until the competent authorities have reached a solution.

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[59] Luis A. Martinez Giner, "Spain" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 790

[60] Criticism made by BIAC on the OECD Discussion Draft on the Draft 2008 Model (31 May 2008) available on http://www.oecd.org/document/22/0,3343,en_2649_33747_40764502_1_1_1_1,00.html.

[61] Criticism made by Luc Le Broe on the OECD Discussion Draft on the Draft 2008 Model (28 May 2008) available on http://www.oecd.org/document/22/0,3343,en_2649_33747_40764502_1_1_1_1,00.html.

Further, should the competent authorities come to no conclusion, the dual resident company losses its entitlement to treaty benefits although still being considered a resident of both Contracting States for other treaty purposes such as exchange of information.[62]

2.4 CONCLUSION

Following this study of the evolution of the tie-breaker "place of effective management", it is clear that this is a well-established concept, however, its interpretation is in no way certain. It is also noticeable that the OECD has gone around in a circle with its various updates ending up with its 2008 update very close to where it started in 1977. The 1977 and the updated 2008 Commentaries both put forward a concept that could be interpreted in different ways.[63]

In order to avoid conflicting views as to what this concept means, it is clear that a common international understanding is necessary. The proceeding chapters will demonstrate the limitations of the current tie-breaker rule following different interpretation of this rule.

[62] Raffaele Russo, "The 2008 Model: An Overview" (2008) 48(9) Euro Tax 459
[63] Avery Jones[n36]186

CHAPTER 3

INTERPRETATION OF THE CONCEPT "PLACE OF EFFECTIVE MANAGEMENT"

3.1 INTRODUCTION

Despite the intended autonomous nature of the tie-breaker "place of effective management" as laid down in Article 4(3), many States tend to affiliate this tie-breaker with similar concepts of residence in terms of their respective domestic laws. This close affiliation to domestic law is a consequence of the lacking definition of this concept or constructive guidance in the Commentary to Article 4(3). This may lead to different outcomes which is clearly not an appropriate approach for a tie-breaker as it will inevitably create qualification conflicts.

In this respect, there are two main approaches; the Anglo-American "central management and control" concept and the Continental European "place of management" concept.[64] A broad interpretation of these concepts has been setout below. Focusing on the UK for the former concept and Germany for the latter whilst also having regard to other OECD Member States. This Chapter seeks to demonstrate that a tie-breaker influenced by different "fiscal cultures" will undeniably bring about difficulties in determining the *appropriate* level of management when interpreting the concept "place of effective management", which may render the current tie-breaker unsuccessful.

3.2 CENTRAL MANAGEMENT AND CONTROL

A substantial number of countries adopt the common law test, "central management and control".[65] As discussed in Chapter 1, this test was first established in the landmark case,

[64]Eva Burgstaller and Katharina Haslinger, "Place of Effective Management as a Tie-Breaker-Rule – Concept, Developments and Prospects" (2004) 32(8/9) Intertax 377
[65] As illustrated in Appendix I

De Beers. Lord Loreburn, having regard to the principal introduced in the *Calcutta Jute Mills* and *Cesena Sulphur* case, that a company resides "where its real business is carried on" opined:

> "I regard that as the true rule; and the real business is carried on where the central management and control abides."

3.2.1 "CENTRAL MANAGEMENT AND CONTROL": A QUESTION OF FACT

The test of corporate residence is a question of law, however, its application is a question of fact.[66] In the words of Lord Loreburn:

> "This is a pure question of fact, to be determined, not according to the construction of this or that regulation or byelaw, but upon a scrutiny of the course of business and trading."[67]

It is therefore important to point out that "central management and control" is determined by analysing how the affairs of the company were in fact conducted, rather than as it was prescribed under internal regulations.[68] The factual position of "central management and control" may only be determined by scrutinising what the company actually does, as this will ascertain how a corporation's actions are directed.[69]

This was clearly demonstrated in *Unit Construction Co Ltd* where the Articles of Association expressly stated that management and control rested with the directors of the Kenyan subsidiaries. It was however revealed that the parent company directors in fact exercised the management powers whilst the local directors stood aside in all matters of real importance. Viscount Simonds commended "the business is not the less managed in London because it *ought* to be managed in Kenya".[70] This was further strengthened by Lord Radcliff who opines, "the articles prescribed what ought to be done, but they

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[66] Couzin[n10]44
[67] De Beers[n11] at 213
[68] Christina HJI Panayi, "United Kingdom" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 828
[69] Couzin[n10]45
[70] *Unit Construction*[n37]at 363

cannot create an actual state of control and management in Africa which does not exist in fact."[71]

The decision in *Unit Construction Co Ltd* was later considered in a number of cases including *Esquire Nominees Ltd*[72] where Gibbs J concluded; it is the *actual* place of management of a company that would determine corporate residence, rather than the place where the company *ought* to be managed.

3.2.2 Attributes of The "Central Management and Control" Test

In terms of the *International Tax Handbook,* the UK Revenue interprets the "central management and control" test as "the central policy core of the whole enterprise", directed at the highest level of control. [73]

The words used by Lord Loreburn, "where central management and control abides" makes clear that "management and control" must be located collectively following its unitary nature.[74] Individually, the term "management" may be interpreted as the conduct of the day-to-day business performed by executives, [75] whilst "control" may be interpreted as the power exercised by shareholders through general meeting.[76] It is the directors who can manage and control the business of a company, whilst shareholders can merely control the directors.[77] The highest level of control cannot however be associated with the ultimate authority of the shareholders, rather it is the policy-making decisions of the directors which equates to the "*central* management and control" test.[78]

3.2.3 Location of Board of Director's Meetings

It has been determined that "central management and control" is directed at the highest level of management. It is however important to ascertain where such management is

[71] ibidi at 370
[72] Esquire Nominees Ltd v. FTC (1972) 129 CLR 177
[73] INTM120200 - Company Residence
http://www.hmrc.gov.uk/manuals/intmanual/INTM120200.htm 30 August 2011
[74] Couzin[n10]43
[75] Ibidi
[76] Michael Dirkis, "Australia's Residency Rules for Companies and Partnerships" (2003) 57(8/9) IBFD 405, 407
[77] The Gramophone and Typewriter Ltd v Stanley (1908) 2 KB 89
[78] Burgstaller and Haslinger[n64]377 Dirkis[n76]407

being exercised. The location of board meetings, although generally important, is not 'the test' of corporate residence. The mere fact that board meetings are held, or their frequency or composition is not of crucial importance, but it is the nature of the decisions taken in each location which is essential when determining the location of "central management and control".[79] According to the UK Revenue, "the place of directors' meetings is significant only insofar as those meetings constitute the medium through which central management and control is exercised."[80]

It was in fact established in *Waterloo Pastoral Co Ltd*[81] that "central management and control" was found where the most important decisions of the company were made, which happened to be outside the board meetings. Williams J explained that, it was necessary for the directors to take decisions on the spot rather than in board meetings for control to be exercised effectively.

Furthermore, in interpreting this test, the Courts have made a clear distinction between the inevitable influence by a parent company on its subsidiary's activities and an usurpation of such activities.[82] The former cannot be said to lead to "central management and control" at the parent company's level this line of thinking was expressed by Gibbs J in *Esquire Nominees Ltd*.[83] Whilst the latter, similar to *Unit Construction v Bullock* with the subsidiary's directors standing aside for all decisions of major importance or merely 'rubber stamping' the parent company's decisions may in fact lead to "central management and control" at the parent company level.

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[79] De Beers[n11] and News Datacom Ltd and another v Atkinson (Inspector of Taxes) [2006] STC (SCD) 732

[80] Panayi[n13]

[81] Waterloo Pastoral Co Ltd v FCT (1946) 72 CLR 262

[82] Influence and policy interest of the parent company must not be confused with its powers. There is a difference in *Esquire Nominees Ltd v. FTC* (1972) 129 CLR 177, *Re Little Olympian Each Ways Ltd* [1994] 4 All ER 561, *Untelrab Ltd v McGregor* (Inspector of Taxes) [1996] STC (SCD) 1 on the one hand and *Unit Constructions Co Ltd* on the other. A good analysis may be found in J. David B. Oliver, "Company Residence – Four Cases" (1996) 5 BTR 505

[83] "The firm has power to exert influence, and perhaps strong influence on the appellant, but that is all…it was in my opinion managed and controlled there [Norfolk Island], none the less because the control was exercised in a manner which accorded with the wishes of the interests in Australia."

This distinction was decisive in *Wood v Holden:*[84]

> "There is a difference between, on the one hand, exercising management and control and, on the other hand, being able to influence those who exercise management and control. There is another difference, highlighted by *Unit Construction v Bullock*, between, on the one hand, usurping the power of a local board to take decisions concerning the company and, on the other hand, ensuring that the local board knows what the parent company desires the decisions to be."[85]

3.2.4 THE UK'S PERSPECTIVE

The UK's opinion that "central management and control" equates to "place of effective management expressed in the Commentary of the 1963 Draft and 1977 OECD MC was later revised. The UK Revenue now opines:

> "…that effective management may, in some cases, be found at a place different from the place of central management and control. This could happen, for example, where a company is run by executives based abroad but the final directing power rests with non-executive directors who meet in the UK. In such circumstances the company's place of effective management might well be abroad but, depending on the powers of the non-executive directors, it might be centrally managed and controlled (and therefore resident) in the UK."[86]

The UK no longer supports the view that the two concepts are identical, however still considers them to be similar, finding difficulty in distinguishing the two.

3.3 PLACE OF MANAGEMENT

A number of Continental European countries determine corporate residence by using the criteria "place of management" or "place of effective management".[87] "Place of

[84] Wood v Holden [2005] EWHC 547 at 25
[85] ibidi at 25
[86] [n73]
[87] As illustrated in Appendix I

management" is interpreted as the centre of top-level management, the place where the person authorised to represent the company carries on his business management activities. Similar to the "central management and control", the "place of management" is not a matter of law but one of fact.[88] Importantly, management activities concerning daily business must be placed in the foreground.[89]

When interpreting the concept "place of management", a number of countries give importance to a logical sequence of examination, where a three-step approach is taken to determine a company's centre of top-level management. It is primarily necessary to identify the crucial decisions of the company, in that determining the relevant management activities characterising the specific company's activities. It would then be necessary to determine who actually makes these decisions, and lastly to ascertain the location of the person making these decisions.[90]

3.3.1 IDENTIFICATION OF THE CRUCIAL DECISIONS OF THE COMPANY

It is essential to determine, on a case-by-case basis,[91] the crucial decisions taken by the executive management of a company. In that, looking at the factual, contractual and organisational activities which have a certain degree of importance for the management of the company as a whole.[92] These activities must pertain to the company's day-to-day management, that is managing the ordinary operations of the business as opposed to activities concerning strategic direction, corporate policy or certain extraordinary activities.[93]

The German Federal Tax Court has confirmed, when interpreting "place of management", that it only matters where the management decisions have been taken whilst disregarding the place of their execution.[94] This has also been Vogel's view:

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88 Burgstaller and Haslinger[n64]378
89 Gerd Scholten, "EC Tax Scene: Germany: Place of Management of a Corporation" (1998) 24(4) 149
90 Karin Simader, "Austria" and Joachim Englisch, "Germany" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 351, 489 respectively
91 A case-by-case approach is implied being that specific day-to-day management functions may be significant in determining the centre of top-level management of one company but not necessarily for another. The importance of decisions depend on the company in question.
92 Englisch[n90]487
93 Burgstaller and Haslinger[n64]378
94 Englisch[n90]489

> "what is decisive is not the place where the management directives take effect, but rather the place where they are given."[95]

3.3.2 DETERMINATION OF PERSONS MAKING DECISIONS

Executive managers are said to exercises the chief business management of a company. As already mentioned, many civil law countries adopt a two-tier structure for their board of directors,[96] under such a structure, the management board rather than the supervisory board is given importance when determining the actual managers.[97]

It is also conclusive that, shareholders merely providing advice or business-related information and owners of the company constantly monitoring and controlling executive management do not imply day-to-day management of the company and therefore do not establish "place of management".[98]

Shareholders and owners will only be assumed to effectively undergo the centre of top-level management if they constantly interfere with regular day-to-day management of the company, and effectively make all the management decisions of importance themselves.[99] A controlling shareholder can act as factual manager, however, the simple exertion of shareholder power does not qualify the shareholder as a factual manger for the determination of the centre of top-level management.[100] Furthermore, in the event that a subsidiary is actually managed and controlled by a parent company, where the subsidiary is a mere business unit of its parent, the chief management of the latter will also constitute the "place of management" of the subsidiary.[101]

The factual manager need not therefore be a managing director per se, this may be a shareholder, owner of the company or otherwise, so long as the factual manager is identified as the person exercising the centre of top-level management.

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95 Vogel[n2]262
96 Avery Jones et al.[n17]233
97 Englisch[n90]490
98 ibidi
99 Scholten[n89]
100 Simader[n90]353
101 Englisch[n90]490

3.3.3. ASCERTAINING THE LOCATION OF PERSONS MAKING DECISIONS

It is important to note that any extraordinary, unique, occasional or temporary decision-making at a location generally would not render that as the "place of management".[102] Decision-making must be of a permanent nature.[103] Furthermore, it is not sufficient when establishing the "place of management" to determine where some of the company's key decisions are taken, it is necessary to identify the place where the key management is conducted without interruption.[104]

A company's centre of top-level management will generally be located where the managing directors[105] perform their duties; that is where the actual, organisational and legal activities in the normal course of business are performed.[106] As already mentioned, the setting of mere business policies and exceptional decisions are not considered.

If a collective body performs the business direction during board meetings, the decision-making process will generally determine the location of such meetings as the "place of management". This however cannot be taken for granted as, if the meetings merely serve to formally approve decisions already taken elsewhere, then this location cannot be decisive.[107] Therefore, only to the extent that no other persons are effectively allotted the power to represent the company and to replace the board of directors with respect to the management functions, could this be deemed the "place of management".[108]

3.4 "PLACE OF EFFECTIVE MANAGEMENT"

The purpose of the tie-breaker rule in Article 4(3) OECD MC is to give an explicit result as to where a company is resident,[109] to point to a *single* State and break ties in the case of dual corporate residence. It may be concluded that the concept "place of effective

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102 Simader[n90]354
103 Englisch[n90]493
104 Gianluigi Bizioli, "The Evolution of the Concept of the Place of Management in Italian Case Law and Legislation: Interaction with Tax Treaties and EC Law" (2008) 48(10) Euro Tax 527
105 The word "generally" is used as the factual manager may in fact be someone other than the managing director as indicated in Section 3.3.2
106 Simader[n90]354
107 ibidi
108 Mario Tenore, "Italy" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 534
109 Burgstaller and Haslinger[n64]376

management" was introduced with a view to having an autonomous meaning rather than being interpreted according to the domestic law.[110]

It is understandable that an autonomous meaning to the concept is necessary for the tie-breaker to be an effective one.[111] Its success is somewhat dependent on it being given a common meaning by both Contracting States. Should "place of effective management" be interpreted in terms of the relevant domestic law, due to the uncertainty of the appropriate level of management demonstrated above between the executive directors or the higher level board of directors, there is a possibility that the tie-breaker will fail, seeing that two States may interpret this concept by looking at different levels of management which may be located in different State.

3.4.1 INTERPRETING "PLACE OF EFFECTIVE MANAGEMENT"

It may be beneficial to first analyse the interpretation of "place of effective management" by a few selected States.[112] Briefly pointing to the interpretation of the connecting criteria used under domestic law together with the interpretation of the "place of effective management" as a tie-breaker.

3.4.1.1 AUSTRIA

Austrian domestic law makes use of the "place of effective management" as a connecting criteria, looking at where the factual managing director make decisions relevant for the business. Importance is given to the place where day-to-day management is performed as opposed to where decisions are approved or implemented.[113]

From an Austrian perspective, the concept "place of effective management" in terms of Article 4(3) should be interpreted autonomously. However, seeing that Austrian tax law makes reference to the "place of effective management" when determining corporate residence, it is said that the concepts "place of management" in Article 4(1) and "place of

110 J. David B. Oliver, "Effective management" (2001) 5 BTR 289, 290
111 ibidi
112 The States and interpretation focuses on material found in *Residence of Companies under Tax Treaties and EC Law*.
113 Simader[n90]350-357

effective management" in Article 4(3) should be given the same meaning as is given under Austrian law. [114]

3.4.1.2 BELGIUM

Under Belgian tax law, using the "place of effective management" as a connecting factor gives importance to the place where the decisions controlling the company are taken and where the company's general interests are looked after.[115]

Bammens opines that the interpretation of the "place of effective management" both in the domestic context and in the treaty context is the same. Belgian tax law defines the concept as the place where the factual circumstances are decisive, in that, the location where the actual key decisions are taken, disregarding the location where the board of directors formally approve decisions taken elsewhere.[116]

3.4.1.3 FRANCE

The notion of "residence" of a company is not used under French domestic law, however tax is imposed on a territorial basis.

France included an observation in the Commentary as reproduced below:

> "France considers that the definition of the place of effective management in paragraph 24, according to which "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 as a whole are in substance made", will generally correspond to the place where the person or group of persons who exercises the most senior functions (for example a board of directors or management board) makes its decisions. It is the place where the organs of direction, management and control of the entity are, in fact, mainly located."[117]

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[114] ibidi 358-371
[115] Niels Bammens, "Belgium" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 382-390
[116] ibidi 390-406
[117] [n3]paragraph 26.3

From a French perspective therefore, a distinction is made between the supervisory and management board. The last part of the French observation may suggest that the "place of effective management" is closer to the headquarters of the company.[118]

3.4.1.4 GERMANY

German tax law makes use of the "place of management", associating it with the commercial top management. Importance is given to the daily operations of an entity.[119]

There is unanimity amongst German scholars that "place of effective management" should have an autonomous treaty meaning, which will guarantee univocal results with respect to both Contracting States involved. It is however thought that this 'autonomous' meaning would lead to identical or very similar results to the criterion used under its domestic law.[120]

3.4.1.5 ITALY

It is debatable whether "place of management" as used in Italian domestic law is to be interpreted as the day-to-day management activities or whether it relates to the main management guidelines. It is understood that the activities of the various persons involved in the decision-making must be weighed against each other.[121]

The "place of management" is normally understood as having the same scope as the "place of effective management" referred to in A.4(3). In that Italy takes the view that the "place of effective management" is based on its own concept of corporate residence for tax purposes, also taking into account the main and substantial activities of the business.[122] Italy has put forward an observation to this effect.

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[118] Nicolas de Boynes, "France" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 452-457
[119] Englisch[n90]479-494
[120] ibidi 495-514
[121] Tenore[n108]530-540
[122] [n56]paragraph 25

3.4.1.6 THE NETHERLANDS

The Netherlands use a facts-and-circumstances approach in determining the "place of management". Domestic law gives preference to the place of ultimate managerial responsibilities over the place where day-to-day management is effected.[123]

It may be observed that the Netherlands makes reference to Article 3(2) OECD MC making clear that the meaning given to the "place of effective management" in terms of Article 4(3) will be given the same meaning that it has at the relevant point in time under Dutch tax law. The tie-breaker will therefore be based on facts and circumstances. It would generally correspond to the place in which the executive board makes its decisions.[124]

3.4.1.7 SPAIN

Importance is given to the place where key management decisions are taken as opposed to the day-to-day management of the company under in terms of domestic law.[125]

Spanish law defines the "place of effective management" as the place where management and control of all the company's activities are carried on. Recognising the different meanings given to the "place of effective management" by various States, there is consensus that the tie-breaker should be given an autonomous meaning. The risk of resorting to domestic law has however been observed.[126]

3.4.1.8 SWITZERLAND

Generally Swiss law looks at the place where the day-to-day business of the company is undergone.[127]

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123 Reinout de Boer, "Netherlands" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 560-577
124 ibidi 578-595
125 Martinez Giner[n59]764-777
126 ibidi 778-789
127 Jean-Frédéric Maraia, "Switzerland" in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 801-807

From a Swiss perspective, the concept "place of effective management" shall be interpreted without having reference to domestic law. Legal authors associate the "place of effective management" in terms of Article 4(3) as the place of the top management of day-to-day business.[128]

3.4.1.9 UNITED KINGDOM

As already mentioned, the UK looks to the top management decisions and overall function of the business, the place of management is the place where "central management and control abides".

In the absence of the force of law of the Model and its Commentary, the concept of "place of effective management" is open to the UK Revenue authorities and courts to decide what this concept means. It is still debatable whether "place of effective management" is the same as "central management and control".[129] Some authors believe the terms to be similar[130] whilst others identical.[131] The UK Revenue states that:

> "it is not easy to divorce effective management from central management and control and in the vast majority of cases they will be located in the same place."[132]

3.5 CONCLUSION

It is clear from the above analysis and from the outcome of the 2004 joint IFA/OECD seminar that,[133] although it is known that the tie-breaker should have an autonomous meaning, due to the lack of a clear definition or constructive conclusions in the Commentary and its similarity to connecting factors used in domestic law, States tend to rely on their own laws when interpreting the "place of effective management".

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[128] ibidi 808-815
[129] Panayi[n68]839-848
[130] Oliver[n110]
[131] Philip Owen, "Can effective management be distinguished from central management and control?" (2003) 4 BTR 296
[132] INTM120180 - Company residence: how to review residence http://www.hmrc.gov.uk/manuals/intmanual/intm120180.htm 30 August 2011
[133] John Avery Jones, "Place of effective management as a residence tie-breaker" (2005) 59(1) IBFD 20

This is an inherent limitation of the current tie-breaker as it may result that a *single* location of the "place of effective management" may not be determined if the relevant States give importance to different levels of management. It is evident therefore that dual residence may not only feature due to States using different connecting factors under domestic law. But the uncertainty of the concept "place of effective management" and its different interpretation may also be a problem which may render the current tie-breaker inefficient in fulfilling its purpose.

CHAPTER 4

AUTONOMOUS INTERPRETATION

OF

"PLACE OF EFFECTIVE MANAGEMENT"

4.1 INTRODUCTION

It can be gathered from the analysis in Chapter 3 that some States conclude that the "place of effective management" should be given the same meaning as that of its domestic law, some deem it necessary to give this concept an autonomous meaning, whilst others maintain a "domestically-influenced" autonomous meaning.

It is evident that a tie-breaker cannot be efficient if it is interpreted on based domestic law. It can only be successful if it is given a common interpretation to ensure a *single* "place of effective management" is located, thereby fulfilling its intended purpose. Despite, due to the limited guidance provided in the OECD MC and its Commentary this is not always possible.

4.2 INTERPRETATION OF THE "PLACE OF EFFECTIVE MANAGEMENT"…

The "place of effective management" is a question of fact, this may be determined through the use of the adjective "effective", as well as through the illustration put forward in paragraph 22 of the Commentary to Article 4(3) highlighting the inadequacy of the use of a "purely formal criterion like registration" when interpreting the "place of effective management". Rather giving importance to the place where the company is "actually managed". This reliance on actual management does not seem to comprise the determination of long-term corporate policy.[134]

The Commentary also emphasis that the place where the "key management and commercial decisions" are made is of utmost importance when interpreting the "place of effective management". With a further requirement of the examination of "all relevant facts and circumstances" however, no real guidance is given.

[134] Burgstaller and Haslinger[n64]380

4.2.1 …IN THE 2001 AND 2003 OECD-TAG DISCUSSION PAPERS

In this respect, the 2001 OECD-TAG paper identifies a number of factors that have been taken into account by courts when interpreting the concept "place of effective management":

- where the centre of top-level management is located,
- where the business operations are actually conducted,
- legal factors such as the place of incorporation, the location of the registered office, public officer, etc.
- where controlling shareholders make key management and commercial decisions in relation to the company; and
- where the directors reside.[135]

It may be noticeable that some of the factors listed above are not in line with the concept "place of effective management". The location where the business operation are conducted and the use of legal factors cannot be said to shed light on interpretation of this concept. Therefore, not adding much to the interpretation of this tie-breaker rule.

It has been questionable as to what level of management the OECD refers to when using the words "key management and commercial decisions that are necessary for the conduct of the entity's business…" Although not clearly pointing to a specific level of management, it seems to tie in closer to the discussion above on the European Continental approach "place of management". However, prior to the 2008 update, the Commentary made reference to the most senior persons, specifically the board of directors.

Subsequent to the 2003 discussion draft, which started off by giving importance to the place where the board of directors meets, and the OECD Member States' views on the 2001 and 2003 discussion papers, it emerged that the strong reliance on the place where the board of directors meet was the interpretation of the UK and countries following its concept of corporate residence; which does not correspond with the majority of the

[135] OECD-TAG[n53]

OECD Member State's interpretation. These discussions are a reflection of the current guidance in the 2008 Commentary on this concept.

4.2.2 …FOLLOWING THE 2008 UPDATE

Following the OECD's work and discussions, the Commentary has been amended to delete the reference to the place where the most senior group of persons meet. This deletion avoids a possible misleading of the Commentary that the "place of effective management" should always be considered to be the place where the board of directors meet, particularly in circumstances where such a board simply ratifies or rubber stamps decisions taken elsewhere.[136]

As a consequence, the Commentary currently provides no testable criteria,[137] whilst merely providing a general guidance on the concept. This may be said a surprising result following the ongoing debate in relation to this concept between 1999 and 2008.

4.3 LIMITATIONS OF UNCERTAINTY

4.3.1 APPROPRIATE LEVEL OF MANAGEMENT

The most significant practical issue is to determine what level of management is in fact being referred to in this phrase.[138] The history of "place of effective management" confirms that there has never been any real agreement on this issue.

With this general definition, it is hardly helpful in determining a common interpretation of the term. It is therefore inevitable for States to have recourse to their own domestic law, however this is unsatisfactory due to the different interpretations outlined in Chapter 3 which are likely to lead to different locations of "place of effective management". The guidance provided in the 2008 Commentary on the current tie-breaker rule may still refer to both the board of directors and top-level executive managers alike.[139]

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136 Russo[n62]549
137 De Broe[n61]
138 ibidi
139 Sasseville[n27]295, Avery Jones et al.[n17]233, Burgstaller and Haslinger[n64]308

4.3.2 MULTIPLE LOCATIONS UNDER DOMESTIC LAW

Another problem is that criteria used in domestic law may not lead to a *single* location of corporate residence. It is not the intention of domestic law to act as a tie-breaker, but simply to determine whether a company is a resident of *that* State.

The UK has accepted that "central management and control" as interpreted in domestic law may be divided so that a company may be managed and controlled, therefore resident in more than one State.[140] It may therefore be concluded inappropriate to assume that "central management and control" could be equated with the concept "place of effective management" as the term has a much wider meaning.[141]

It is debatable amongst the German Federal Tax Court and academics whether the "place of management" may also be found in more than one place. The court sometimes takes the view that every company must have *at least* one place of management,[142] whilst academics believe "there can exist *at most* one "centre" of chief business management".[143]

4.4 DISTINCTION BETWEEN "CENTRAL MANAGEMENT AND CONTROL" AND "PLACE OF EFFECTIVE MANAGEMENT"

Much debate has surrounded the question of whether the concept "central management and control" can be distinguished from the "place of effective management" as used as a tie-breaker rule in Article 4(3). As noted in Section 3.2.4, the UK has recognised that the "place of effective management" and "central management and control" may be distinguishable under certain circumstances. Pointing out that *when* the two can be distinguished the "place of effective management" will be found at a lower level than that of "central management and control".

In the *International Tax Handbook*, the UK recognises that the "place of effective management is generally understood to be the place where the Head Office is", defining the Head Office as the place where "the executives and senior staff who actually make the

140 *Union Corporations*[n35] and *Unit Construction*[n37]
141 Vogel[n2]268
142 Englisch[n90]494
143 Englisch[n90]495

business tick" are located, as opposed to the "centre policy core" of the enterprise. Therefore acknowledging that the "place of effective management" may be closer to European Continental approach "place of management."

4.4.1 JUDGEMENTS ON THE INTERPRETATION OF "PLACE OF EFFECTIVE MANAGEMENT"

The question of "place of effective management" has not been considered in many cases, albeit, some insight to this concept and answers to the uncertainty explained above may be gathered from the following relevant cases.

- **TRUSTEES OF WENSLEYDALE' SETTLEMENT V CIR**

The meaning of the concept "place of effective management" as encountered in the 1976 UK-Ireland tax treaty was considered in the UK case *Trustees of Wensleydale' Settlement v CIR.*[144] In this case, Special Commissioner Shirley, having regard to German case law establishes that the "place of management" is the centre of top-level management, which is where the important business policies are actually made.[145]

The Special Commissioner goes on to consider what the term "effective management" really means, emphasising on the adjective 'effective', stating, "it is not sufficient that some sort of management was carried on". The term "effective" implies "realistic, positive management…it is where the shots are called, to adopt a vivid transatlantic colloquialism."[146]

The Commissioner equates the "place of effective management" with "the centre of top level management" and the place where the "shots are called". In this respect, Owen argues that both these descriptions imply the highest level of management going on to state that

144 Trustees of Wensleydale' Settlement v CIR [1996] STC (SCD) 241
145 Trustees of Wensleydale' Settlement[n132]at 250
146 ibidi

> "the place where the shots are called is if anything a higher level of management than the place where "the company organs take the decisions that are essential for the company's operations"[147]

Whilst Vogel equates the "place of effective management" with top-level management commending:

> "The DTCs define the term 'place of management' as being 'the place where the centre of top level management is situated'. In the language of the OECD model convention, this is the 'place of effective management'."[148]

- **Wood v Holden**

The "place of effective management" was briefly considered in *Wood v Holden*. Doubt about the assimilation of the two concepts emerged from this case. Chadwick LJ advocated in respect of their distinction:

> "It is not clear…whether the article 4(3) test differs in substance from the *De Beers* test; and, if the two tests are not, in substance, the same, I find it very difficult to see how, in the circumstances of this case, the two tests could lead to different answers"[149]

Although no clear conclusions may be drawn from this case seeing that no judgment had to be given on the interpretation of the "place of effective management", the comments put forward were followed by the Special Commissioners in *Trevor Smallwood Trust v Revenue & Customs.*[150]

- **TREVOR SMALLWOOD TRUST & LAERSTATE BV**

More recent judgments have explored the concept "place of effective management" in this respect. The *Smallwood* case draws a clear distinction between the concepts "place of effective management" and "central management and control", which was later endorsed

147 Owen[n131]299
148 Vogel[n2]262
149 Wood v Holden[n84] at 6
150 Trevor Smallwood Trust v Revenue & Customs [2008] UKSPC SPC 00669

in *Laerstate BV v Revenue & Customs*.[151] It was conclusive that the two concepts serve entirely different purposes:[152]

> "[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. [Central management and control] is essentially a one-country test; the purpose is not to decide where residence is situated, but whether or not it is situated in the United Kingdom, even though courts do sometimes express their decisions in terms of a company being resident in a particular foreign jurisdiction, as was the case in Wood v Holden. There is nothing impossible in finding [central management and control] in two countries, in spite of the word "central."[153]

It was further held that the "place of effective management" must be concerned with what happens in *both* states in order to fulfil its purpose. Therefore to determine the "place of effective management":

> "One must 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 (to quote article 31 of the Vienna Convention on the Law of Treaties) decide in which state the place of effective management is found."[154]

The judgement expands on the term "effective" which should be understood in the sense given to it by the French meaning (*siège de direction effective*) which may be denoted as "real". Besides distinguishing "central management and control" and "place of effective management", this judgement concludes that, when interpreting the "place of effective management" emphasis was on "the real top level management, or the realistic, positive management…or the place where key management and commercial decisions that were

[151] Laerstate BV v. Commissioners for Her Majesty's Revenue and Customs, 11 August 2009 (Decision) [2009] UKFTT 209 (TC)
[152] *Smallwood* [n150] at 111
[153] ibidi
[154] ibidi at 112

necessary for the conduct of the…business were in substance made, and the place where the actions to be taken by the entity as a whole" took place.[155]

4.5 CONCLUSION

It may therefore be concluded from the above analysis that the "place of effective management" tie-breaker rule tends to place more weight on the day-to-day ruling of the company's affairs, this however cannot be conclusive from the general guidance provided in the Commentary. It was further determined that, a domestic interpretation can be similar to the "place of effective management" but in no way identical as this concept has as its intention the role of breaking ties which is not the intention of domestic law.[156]

[155] ibidi at 145
[156] Oliver[n110]293

CHAPTER 5

LIMITATIONS OF THE TIE-BREAKER RULE "PLACE OF EFFECTIVE MANAGEMENT" IN TERMS OF ARTICLE 4(3)

5.1 INTRODUCTION

The quality of a legal provision must always be determined by its capability to solve exceptional cases.[157] As has been illustrated in the 2001 OECD-TAG discussion paper, as well as academic literature, it is clear that the tie-breaker suffers in some areas to solve the problem of dual residence. The limits of the concept "place of effective management" became apparent particularly due to the change in organisational structures and the possibilities offered by ICT.

This has introduced scenarios where the tie-breaker is not efficient in solving the problem of dual residence. The main issues outlined in the 2001 OECD-TAG, will be developed in some detail in the coming sections:

- Multiple "places of effective management"
- Mobility of the "place of effective management"
- Problems encountered in triangular cases

Such concerns exacerbate the pressures placed on the "place of effective management" concept.

5.2 MULTIPLE PLACES OF EFFECTIVE MANAGEMENT

The existing tie-breaker rule is based on the assumption of traditional organisational structures with strict hierarchy systems, therefore capable of solving dual residence in a mono-centralised hierarchical company. However, the change in management structures

[157] Burgstaller and Haslinger[n64]381

from mono-centralised hierarchical to bi- or possibly polycentralised networking operation,[158] as well as the vast use of ICT has threatened the tie-breaker's success.

The availability of advanced ICT with the use of e-mail, electronic discussion group applications and videoconferencing renders it unnecessary for a group of persons in a bi- or polycentralised structure to physically meet in one place in order to hold discussions and make decisions.[159] The use of such modern communication systems therefore increases the possibility of having company directors of a single MNE taking decisions all over the world.

Two simple examples may illustrate this limitation. A company may have physical headquarters in multiple jurisdictions, with key managers working and residing in such various jurisdictions. A further example is that of virtual enterprises, digital markets functioning with little or no physical infrastructure,[160] again with persons responsible for management activities working and residing in multiple jurisdictions.[161]

In the two examples reproduced above, managers working and residing in multiple jurisdictions can communicate through the use of ICT rather than physically meeting in one location to take decisions, whether the company has physical headquarters or not. Therefore, if ICT is used as the key medium for making management and commercial decisions, each jurisdiction in which a manager is located at the time of decision-making can be regarded as a "place of management". Therefore, unless one person clearly dominates the process of decision-making, it can become burdensome if not impossible to pinpoint to a single location as the "place of effective management".

This change in organisational management structure with the possibility of communicating via ICT without physically meeting in a single location,[162] undoubtedly threatens the effectiveness of the current tie-breaker. To the extent that the use of the "place of effective management" as a tie-breaker cannot point to a *single* jurisdiction in

158 Hinnekens[n1]315
159 OECD-TAG [n53] and Burgstaller and Haslinger[n64]381
160 Hinnekens[n1]315 and Otto H Jacobs, Christoph Spengel and Anne Schafer, "ICT and International Corporate Taxation: Tax Attributes and Scope of Taxation" (2003) 31(6/7) Intertax 214, 225
161 Jacobs et al.[n160]224 and Hinnekens[n1]315
162 Jacobs et al.[n160]225

which the business of a company is in fact "effectively managed", will be rendered unsuccessful. As the problem of dual residence has not been solved.

5.3 MOBILE "PLACE OF EFFECTIVE MANAGEMENT"

The ever-increasing MNEs operating across the globe may have a further impact on the "place of effective management" tie-breaker rule. It is not uncommon to come across a managing director who is always on the move, taking decisions in various locations. The OECD-TAG also introduced a scenario where the managing director responsible for the management of that company, takes decisions while flying over the ocean or while visiting various sites in different jurisdictions where his business is conducted.[163]

In the event that the board of directors do actually physically meet to take decisions. Due to the globalisation of MNEs, it may be found that the board of directors meet in different jurisdictions throughout the year. This may result when meetings are held in jurisdictions chosen arbitrarily, or out of convenience sake. An MNE with headquarters all over the globe may also organise to meet in different jurisdictions of operation on an internal rotational basis.

With a peripatetic managing director or board of directors, the tie-breaker as laid down in Article 4(3) may be unsuccessful in pinpointing to a single jurisdiction to be the "place of effective management". Since decisions are taken in multiple jurisdictions, as distinct from a permanent headquarter, the company may be concluded to have a "mobile place of effective management".[164] Once again rendering the current tie-breaker unsuccessful in this respect.

5.4 TRIANGULAR CASES

The current tie-breaker rule operates effectively where the "place of effective management" is located in one of the two Contracting States. It may however prove to be unsuccessful when a third State is involved. By way of example, where a company is a resident of both Contracting States (State A and State B) by virtue of their domestic laws,

[163] OECD-TAG[n53]
[164] ibidi

with its "place of effective management" in a third State (State C). The tie-breaker rule is only capable of resolving dual residence issues under the StateA-StateC treaty and the StateB-StateC treaty. However it will not serve its purpose to resolve the dual residence issue between the two Contracting States under the StateA-StateB treaty being that the "place of effective management" is in neither of the States.

Since Article 4(3) provides, if an entity is a resident of both Contracting States "it shall be deemed to be a resident *only* of the State in which its place of effective management is situated." These words may therefore imply that the company cannot be said to be a resident of either State A or State B for treaty purposes pursuant to the simple example above. This cannot be a satisfactory outcome deeming the tie-breaker inefficient in this respect.

5.4.1 Qualification of the Term "Resident of a Contracting State"

Prior to the 2008 update in relation to paragraph 8.2 of the Commentary to Article 4(1), debate as to whether the second sentence of Article 4(1) OECD MC stating "this term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein," qualifies the term "resident of a Contracting State".

The relevant sentence of paragraph 8.2 reads as follows:

> "It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States."

The effect of this addition to the Commentary is that a dual resident is denied access to other treaties concluded by the 'loser' State if the second sentence to Article 4(1) is present in the relevant treaty.

Therefore, Article 4(1) should be interpreted in such a way that, when Article 4(3) assigns residence to one of the Contracting States, then the other State's taxing rights will be limited to income derived from sources within that State. By way of example, provided the "place of effective management" is located in State C, State A would be the 'loser' State pursuant to the StateA-StateC treaty. Following this qualification, the said company cannot be a resident in StateA under that State's treaties.

However, Article 4(1) states "for the purposes of *this* Convention" which may be interpreted as opposing the view that the outcome of one treaty will have an influencing effect of the company's status under other treaties. Furthermore, it may be important to point out that the second sentence in Article 4(1) OECD MC, through the Commentary is being given a new interpretation that is not conveyed by the wording of the Article.[165] Courts in many countries will not accept this change to the Commentary being that it goes beyond what is provided for in the OECD MC.[166]It has been gathered from country analysis that States do not interpret the tie-breaker as having an effect on other treaties.

5.5 CONCLUSION

The OECD is well aware of the mentioned limitations to the current tie-breaker. The 2001 OECD-TAG discussion paper mentions these limitations with a view to implementing possible solutions. The amendments to the 2008 Commentary however do not seem to remedy the prevailing limitations. Both proposals in the 2003 OECD discussion draft were dismissed since it emerged from the WP's discussions as well as from the 2004 IFA Congress that the proposals were not in line with the majority of the OECD Member State's views on the concept "place of effective management". As already alluded to, the following is the background to the dismissal of such proposals:

> "Many countries, in particular, considered that the TAG's proposed interpretation gave undue priority to the place where the board of directors of a company would meet over the place where the senior executives of that company would make key management decisions. A majority of countries also considered that the cases of dual residence of legal persons that they

165 BIAC[n60]

166 Augusto Fantozzi, Jean Pierre Le Gall, Kees van Raad, Yariv Brauner and Angelo Nikolakakis, "Round Table: The Issues, Conclusions and Summing-up" in in *Residence of Companies under Tax Treaties and EC Law* (IBFD, The Netherlands 2009) 900

> encountered in practice did not justify replacing the current concept of "place of effective management" by the approach based on hierarchy of tests that was put forward by the Business Profits TAG"[167]

It can hardly be said that the 2008 update to the Commentary may solve any of the problems emerging from the current tie-breaker as discussed above. It is clear that the OECD's work on this concept is in no way complete. Possible alternatives to the current tie-breaker will be developed in the following chapter.

[167] van Raad[n55]121

CHAPTER 6
CONCLUSIONS

6.1 INTRODUCTION

As expressed in Chapter 5, the quality of any legal provision must always be determined by its capacity to solve exceptional cases. Therefore, the question whether the existing tie-breaker rule is capable of resolving all dual residence disputes will be answered in the negative pursuant to the analysis in the preceding Chapters.

As analysed in Chapter 3 and 4, the lack of a common international meaning of the concept "place of effective management" highlights a fundamental limitation of the current tie-breaker rule. With no constructive conclusion in the current Article and its Commentary, but a mere confirmation that "the place of effective management is the place where key management and commercial decisions…as a whole are in substance made."

No indication is made as to *what level of management* is the appropriate level for determining the "place of effective management". It may be interpreted as the country in which the board of directors meet or that in which the executive officers operate. It is due to this lack of clarity that States will have recourse to their own domestic law.

Further limitations highlighted in Chapter 5 exacerbate this problem, since, further to an interpretation issue, the tie-breaker is not successful particularly where the place in which the board of directors meet is retained as the main residence criterion.[168] Owing to the change in organisational structures and opportunities offered by ICT, the location of a single "place of effective management" may not be determinable. Since directors may meet on a rotational or arbitrary basis or do not physically meet at all, with a result of a mobile place of effective management in the former scenario and multiple places of effective management in the latter.

[168] ibidi, 893

It may be proven difficult to determine a predominant "place of effective management" in one country over the others. This was never an easy task however with the new ways of business this has become a daunting one. Awareness of such limitations have been recognised in academic literature and a number of possible alternatives have emerged as will be discussed below.

6.2 POSSIBLE ALTERNATIVES

6.2.1 USE OF AN UNFAMILIAR CONCEPT

Avery Jones, following the 2004 joint IFA/OECD seminar has pointed out the limitation discussed in Chapter 3 and 4; that States are heavily influence by their own "fiscal culture".[169] Which would inevitably lead to conflicting views on the "place of effective management".

By way of remedy of such an inherent problem it was suggested in the IFA seminar, that the concept be replaced with one which is unfamiliar to the Contracting States. Using a concept not used under any domestic law. This is contrary to the work of WP N°2, where in their 27th May, 1957 report, it was held:

> "…term proposed in the London model tax Convention: "Real centre of management is situated" is but rarely used…"

For this reason WP N°2, at the time, deemed the concept "managed and controlled" to be the most appropriate preference criterion, a term borrowed from the UK's treaties being the most consistent in its agreements. Shying away from "real centre of management" due to the lack of use of this term. Avery Jones takes an opposing view providing; the fact that a term is rarely used is an advantage since States will not be tempted to use their own domestic understanding of the tie-breaker.[170]

[169] Avery Jones[n133]31
[170] Avery Jones et al.[n17]186

6.2.1.1 "REAL CENTRE OF MANAGEMENT"

It was therefore suggested by Avery Jones that the "place of effective management" be replaced by the unfamiliar concept "real centre of management". Opining that by using this alternative concept, all States will be on the same level of ignorance.[171] This would therefore lead to States looking at the two centres of management and determining which is the "*real* centre of management" by analysing the degree of management in both States rather than simply having regard to their individual domestic laws.

This alternative may avoid the automatic reliance on domestic law by the Contracting States seeing that the concept is not one of familiarity, also making them weigh-up what happens in each of those States. Therefore remedying the interpretation problem, this approach may encounter the same limitations as the current tie-breaker in respect of the exceptional cases expressed above.

6.2.1.2 "PLACE OF EXECUTIVE MANAGEMENT"

It may be important to note that the UK Revenue has identified three levels of management, the board of directors, the senior executives and the shop floor management. Management of senior executives is deemed to be the most relevant for treaty purposes when interpreting the corporate residence tie-breaker rule by panelists in the IFA seminar.[172]

During the seminar, it was suggested that the concept "place of *effective* management" be replaced by "place of *executive* management". The use of the latter term may be an appropriate alternative, since this concept is not identical[173]to any criteria used under domestic law of OECD Member States.[174] Thus forcing the Contracting States to identify a common international meaning as opposed to turning to their own domestic laws. The "place of executive management" may solve the problem of interpretation, i.e. introduce a common interpretation of the tie-breaker.

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171 ibidi
172 Avery Jones[n133]21
173 Avery Jones[n133]23
174 Appendix I

The interpretation of this concept may be obvious to civil law countries with their two-tier boards however not so obvious for common law countries with a single board consisting of both executive and non-executive directors. Still this concept is more direct in its application as it points to an appropriate level of management – *the executive management*. The current tie-breaker does not and is therefore more burdensome to apply.

Although "place of executive management" may be more explicit in its application, and may therefore solve the issue of implementation. It would however have the same success as the current tie-breaker with regards the other limitations outlined in Chapter 5.

6.2.1 FORMAL CRITERION

By virtue of the problems being encountered when using the current tie-breaker rule, van Weeghel is of the strong opinion that a formal criterion, such as registration or incorporation should be given some serious attention.[175] It is true that a formal criterion may effectively solve the problem of corporate dual residence with certainty when a company is in fact registered or incorporated in *one* of the two Contracting States.

Following a formal criterion may solve the majority of the limitations of the current tie-breaker:

- *Interpretation:* this will not be problematic following this appraoch as States will look to the State of incorporation.
- *Multiple places of effective management:* this problem will *generally* be eliminated. The word 'generally' is used as some States allow companies to be incorporated in more than one States. In such an instance therefore, this formal tie-breaker cannot be deemed successful.
- *Mobility:* this is also solved being that the location of directors is not considered under this alternative.
- *Triangular cases:* this tie-breaker will have the same success as the current tie-breaker in such cases, also being rendered unsuccessful.

[175] Stef van Weeghel, "The Tie-Breaker Revised: Towards a Formal Criterion?" in *A Vision of Taxes Within and Outside European Borders* (Kluwer Law International, Deventer 2008) 966

The concept of incorporation may be equated to that of nationality in relation to individuals, which is not a locality-related criteria. It may be determined from Article 4(2) OECD MC that nationality is given little importance in determining an individual's residence. The concept of nationality is used as a last resort before having recourse to MAP.

It must be pointed out when using such a tie-breaker that a company may be incorporated in State A but having all its business operations located in State B where it makes use of the country's infrastructure and generates all its business profits. Under this formal tie-breaker, State A will be located as the resident State for treaty purposes, therefore capable of taxing the company on its income as a resident State whilst State B, the State of operation is given the status of a source State. This suggested tie-breaker may therefore lead to *inequality*.

Furthermore, the use of a formal approach may create an incentive for a company to look for a jurisdiction that is party to a treaty with the country with which the company has a strong economic nexus and which has other attributes that would render it an attractive holding location.[176] Although a formal criterion may be the cause of manipulation, van Weeghel proposes an anti-abuse proviso:

> "a requirement that the company would need to have a substantial business presence in the country of its incorporation, in order for the tie-breaker to be employed."[177]

Adding to the outright rejection of a formal criterion in paragraph 22 of the Commentary. Although a formal criterion used as a tie-breaker rule may bring about *certainty*, it will surely not bring about *equality* which does not seem to be a reasonable conclusion for dealing with the limitations of the concept "place of effective management".

6.2.3 Introduction of an Additional Article

The term "effective management" is used elsewhere within the Model; in addition to Article 4(3), this term is used in Article 8 in relation to the taxation of profits from shipping

[176] ibidi, 968
[177] ibidi, 969

and air transport. The analogy of the two Articles has been alluded to in Chapter 2. Therefore, when reading Article 8(3) OECD MC which deals with the mobility of the "place of effective management" aboard a ship stating:

> "If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident."

It may be plausible to devise a similar Article to remedy the mobility of the "place of effective management" with respect to legal persons in a similar way to that detailed above. An Article to this effect in relation to legal persons may solve the limitations of mobility; it however will not be successful in solving the other limitations outlined above.

6.2.4 HIERARCHICAL APPROACH

It was made clear that the OECD Member State's rendered the hierarchical approach unnecessary, this outcome is somewhat curious seeing that this approach might have the greatest success in solving all the limitations outlined above. Therefore, an approach similar to that available for individuals in Article 4(2) may be a good method to remedy such limitations in the case of legal persons.

The OECD-TAG proposed the "place of effective management" to be kept as the first test to the hierarchical approach, whilst introducing three options which may be implemented as the second rule; the State with which the entity's economic relations are closer, the State in which the entity's business activities are primarily carried on or the State which the entity's senior executive decisions are primarily taken.

Subsequent to the uncertainty of the interpretation of "place of effective management", it has been questionable whether this concept should be used as the first test of the hierarchical tie-breaker.

- The first test will determine an entity resident only of that State in which the "place of effective management" (or an alternative concept as discussed above) is situated;
- If the State in which the "place of effective management" cannot be determined (leading to mobile/multiple "place of effective management") or it is found in neither (pursuant to triangular cases) it shall be deemed a resident in the State in which the entity's economic relations are closer;
- If this cannot be determined then the authorities may have recourse to the State from the laws of which it derives its legal status;
- Finally, as a last resort, if the competent authorities cannot come to any agreement in determining a single State of residence, they may have recourse to MAP.

The language used in this final test must also be analysed. The words "shall settle" as used in Article 4(2) rather than "shall endeavour" as used in the case-by-case alternative have different implications on the authorities. It is important that the words "shall settle the question by mutual agreement" requiring the competent authorities to come to a conclusion be used.

Furthermore, the alternative case-by-case approach introduced in paragraph 24.1 of the Commentary using the words "shall endeavour" imposes no obligation on the authorities to settle the problem by mutual agreement. In addition, the dual resident company cannot claim treaty benefits as a resident of either Contracting State until the competent authorities have reached a solution. Further, should the competent authorities come to no conclusion, the dual resident company losses its entitlement to treaty benefits although still being considered a resident of both Contracting States for other treaty purposes such as exchange of information. Which is detrimental to the dual resident company.

6.5 CONCLUSION

This study on the "place of effective management" as a tie-breaker rule for dual corporate residence has made clear the inherent limitations of this concept in fulfilling its purposes of identifying a *single* State to be the residence State. Observing also that the amendments to the 2008 Update, which stirred much debate amongst academics, commentators as well as the OECD between 1999 and 2008 does not seem to give much guidance on this concept or solutions to its limitations.

It may therefore be concluded that the current tie-breaker cannot be said to be an efficient one in all cases of dual residence as it does not have the capacity to solve exceptional cases determining the inadequacy of this provision.

As a consequent of the globalisation of the economy as well as the recent trend of opting to omit the current tie-breaker for a case-by-case approach being resolved by MAP, the success of this concept as a prosperous tie-breaker is in dire need of review.

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Appendix I

Residence Under Domestic Law[178]

OECD Member States	Residence under domestic law
 Australia	A company is resident if it is incorporated in Australia or, if not incorporated in Australia, it carries on business in Australia and either has its central management and control in Australia or its voting power is controlled by shareholders who are residents of Australia.
 Austria	A company is treated as resident for corporate income tax purposes if it has its legal seat or the place of effective management in Austria
 Belgium	Taxpayers for corporate income tax purposes are treated as a resident if they have their legal seat, main establishment or place of effective management in Belgium.
 Canada	A company is deemed to be resident in Canada if it has been incorporated in Canada. A company that has been incorporated outside Canada is considered resident in Canada if its central management and control is located in Canada. The central management and control of a company is located in the country in which its essential business decisions are made. Usually, central management and control of a company is exercised by the directors. If so, the company is resident where the directors meet.
 Chile	Companies incorporated in Chile are treated as resident. Permanent establishments in Chile of non-resident persons are considered non-residents.
 Czech Republic	A company is treated as resident if it has its legal seat or place of management in the Czech Republic.
 Denmark	A corporate entity is resident if it is incorporated in Denmark or if its place of management is located in Denmark.
 Finland	A company is resident if it is registered in Finland and incorporated under Finnish law.

[178] Material extracted from Luis Nouel (ed), *OECD Model Taxation on Income and on Capital and Key Tax Features of Member Countries 2010* (IBFD, the Netherlands 2010)

 France	There is no definition of residence in French tax law as far as companies are concerned. In general, a company is resident in France if it has its place of effective management in France.
 Germany	An entity is resident if either its legal seat or its place of management is in Germany.
 Greece	Companies incorporated in Greece are treated as residents for tax purposes. Entities incorporated outside Greece but effectively managed from Greece are in principle deemed to be tax residents of Greece, although Greek tax authorities have not applied the effective management criterion so far.
 Hungary	Taxpayers for corporate income tax purposes are treated as residents if they are created under Hungarian law or have their place of management in Hungary.
 Iceland	Legal entities, such as companies, associates, funds and foundations, are considered to be resident in Iceland if they are registered in Iceland, if their home, according to their articles of association, is in Iceland or if their place of effective management is in Iceland.
 Ireland	Any company incorporated in Ireland is generally deemed to be a resident for tax purposes. The rule does not apply to companies carrying on, or related to companies carrying on, a trade in Ireland, provided that they are either under direct or indirect control of persons resident in an EU Member State or in a tax treaty country, or the company or related company are quoted companies. In this instance, the central management and control test will determine where the company is resident. In addition, the incorporation rule does not apply where a company is treated as not resident under a tax treaty.
 Italy	Resident companies are those which for the greater part of the tax year have had their legal seat, place of effective management or main business purpose in Italy. The place of incorporation is not relevant in determining residency status.
 Japan	Japan technically applies the concept of residence, but does not call it so. Instead, the status of a corporation as domestic or foreign is used. A domestic corporation is a corporation that has its head or

	main office in Japan. This includes all Japanese incorporated corporations, because under the Japanese civil law a corporation incorporated in Japan must have its head or main office in Japan.
 Korea	The concept of residence is not relevant for Korean corporate income tax purposes. Taxation of companies is based on whether a company is domestic or foreign, rather than whether it is resident or non-resident. A domestic company is a company having its head or main office in Korea.
 Luxembourg	Companies are resident for tax purposes if they have their legal seat or place of effective management in Luxembourg.
 Mexico	A company is resident in Mexico if its place of effective management is established in Mexico.
 Netherlands	There is no clear definition of "residence" in corporate tax law. Companies that are incorporated under Netherlands law are generally deemed to be resident in the Netherlands. In the case of companies incorporated under foreign law, the place of residence of a company is determined according to the circumstances, the most important being the place in which the company is effectively managed.
 New Zealand	A company is resident in New Zealand if (a) it is incorporated in New Zealand, (b) it has its head office (i.e. actual, physical establishment which is the company's place of administration and management at the highest level) in New Zealand, (c) it has its centre of management (i.e. day-to-day management) in New Zealand, or (d) control of the company by the directors (i.e. the decision making of a strategic and policy kind), acting in their capacity as directors, is exercised in New Zealand, whether or not their decision making is confined to New Zealand.
 Norway	There is no definition of "residence" in the Norwegian tax legislation for legal entities. In principle, the place of residence depends on the location of the central management and control of the company (normally by the non-executive board of directors). In practice, however, a company is normally deemed to be a resident if it is incorporated under Norwegian law.

 Poland	A company is resident in Poland for tax purposes if its legal seat or place of management is located in Poland.
 Portugal	A company is resident in Portugal for IRC purposes if it has its legal seat or place of effective management in Portugal.
 Slovak Republic	A company is treated as resident if it has its legal seat or place of effective management in the Slovak Republic.
 Slovenia	
 Spain	A company is resident in Spain if it meets one of the following condition: • it is incorporated under Spanish law; • its legal seat is located in the territory of Spain; or • its place of management is in Spain. The Spanish tax authorities may deem a company located in a tax haven or a low-tax territory to be resident in Spain if the majority of its assets consists of immovable property located in Spain, or rights on such immovable property, unless the location in such a territory is based on valid economic reasons other than the pure management of securities.
 Sweden	A company is resident in Sweden if it is registered with the Swedish Companies Registration Office.
 Switzerland	Companies which have their legal seat (registered office or place of effective management in Switzerland are considered residents.
 Turkey	A company is resident in Turkey if it has either its legal seat or its place of effective management (or both) in Turkey. The concept of legal seat refers to the place indicated in the company's formation document. The place of effective management refers to the place where the top management of the company is situated.
 United Kingdom	Companies incorporated in the United Kingdom are always resident there. Other companies are resident if the central management and control takes place in the United Kingdom. If a company is resident in the United Kingdom under domestic law but is treated as resident in another country for the purposes of a tax treaty, it is treated as not resident in the United Kingdom.

 United States	The concept of residence is not generally used by the United States with regards to the taxation of corporations. Instead, the status of a corporation as domestic or foreign based on its place of incorporation, determines the method of taxation that applies. Corporations are considered to be domestic corporations if they are organised under the laws of one of the US states or the District of Columbia. Corporations are considered to be foreign corporations if they are organised under the laws of a foreign corporation.