The Place of Effective Management in the OECD Model: overview and implementation

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I PoEM in the OECD Model Convention
Function of the PoEM criterion

Tie-breaker rule in case of dual residency

Article 4 (3) of the OECD Model Convention
“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 only of the State in which its place of effective management is situated”

See also ARTICLE 8 : SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT
Substance over form approach

“It would **not be an adequate solution to attach importance to a purely formal criterion like registration.** Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed”

(commentary of article 4 of the OECD Model Convention, §22)
- Application of art. 3 (2): **autonomous concept required by context?**

- In practice, **reference is made to national law** but **with** guidance provided by the **commentary of article 4 paragraph 3** (2008 update): “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. **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.” (OECD Commentary on Article 4, §24)
“Competent authorities (...) would be expected to take account of various factors, such as

- 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” (OECD Commentary on Article 4, § 24, but not directly relevant?)
The 2008 wording allows references to **both continental and Anglo-Saxon approach-based national definitions**

- Continental: focus on the location of day-to-day management
- Anglo-Saxon: focus on the location of strategic management

⇒ Both require assessing actual circumstances to determine the location of the abovementioned management level qualified as PoEM
Specific cases

**PoeM of a subsidiary (OECD Commentary on Article 1)**

10.1 Also, in some cases, claims to treaty benefits by subsidiary companies, **in particular companies established in tax havens or benefiting from harmful preferential regimes**, may be refused where careful consideration of the facts and circumstances of a case shows that the place of effective management of a subsidiary does not lie in its alleged state of residence but, rather, **lies in the state of residence of the parent company** so as to make it a resident of that latter state for domestic law and treaty purposes (this will be relevant where the domestic law of a state uses the place of management of a legal person, or a similar criterion, to determine its residence).

See also 10.2.
II Overview of national implementations
Trends? Examples

Continental approach-based definition in Austria; Germany; Denmark; Finland; etc.

Anglo-saxon approach-based definition in Belgium; Czech Republic; the Netherlands; Norway; France; Spain; Switzerland; etc. *yet in certain cases some nuances should be made (see infra)*
Continental Approach

GERMANY

- equivalence of territorial connecting factors of seat and place of management
- reference is made to the concept of “Mittelpunkt der geschäftlichen Oberleitung” (chief business activities)
- Between mere administrative management and strategic decisions (typically reserved for the shareholders)
- Day-to-day management (involving the authority to represent the company)
Continental Approach

- DANEMARK: location of ordinary and ongoing operations, regardless which body carries them out (executive board or board of directors, but not general assembly), like contacts with suppliers, clients and banks, public authorities and other parties, human resource management, and marketing and sales activities.

- AUSTRIA: location wherefrom emanate the **necessary and important management** measures and instructions, to be understood with a focus on **day-to-day** management (similar to Germany).
Anglo-Saxon Approach

- UK: “place of incorporation”, and if not in UK, “central management and control” (“location where the final decisions binding the company are made”).

- Various factors should be taken into account such as residency of top management (i.e. directors) and the location of board meetings, and whether the board effectively takes strategic decisions.

- Approach largely applied by other countries under various forms
Examples

- **BELGIUM** where the company is administrated and controlled understood as being the place of *strategic* (fundamental policies) and *actual management* (implementation of the said policies), the said place being presumed to be the principal establishment (yet rebuttable)

- **CZECH REPUBLIC** Reference to the “place of leadership” notion under national tax law, being where the business policy is formulated (*strategic management*)

- **THE NETHERLANDS** “place where the top management exercises its activities, such as taking key decisions concerning investment and financing, formulating the top instructions for the staff and taking final responsibility”

- **SWITZERLAND** reference is made to the concept of “*actual administration*”, i.e. current direction of the company, “*concept which opposes a simple administrative activity execution and a work of supreme corporate bodies of the company is limited to taking fundamental decisions of principle character strategic or control the actual current direction*”
Anglo-Saxon but to be nuanced?

**Norway**

- Assessment depending on whether registered in Norway or not
- **If yes, overall evaluation**: board members’ location and meetings’ location, day-to-day management, split of activities between Norway and the other country, general meetings’ location etc. *(similar approach in Hungary)*
- **If not, focus on location wherefrom emanate important decisions**, to be understood as board decisions (formal approach) => in line with the OECD MC commentary?
- Evolution towards an “overall evaluation” of the management’s connection with Norway in both cases, even if in the practice, for foreign companies the focus remains on board activities
Anglo-Saxon but to be nuanced? (2)

Poland

- According to courts and scholars, location wherefrom emanate decisions on the highest level concerning key issues, i.e. crucial from a managerial, economical and functional standpoint.
- According to tax authorities: **both the location of the strategic decisions and of the day-to-day ones** should be taken into account.
Anglo-Saxon but to be nuanced? (3)

Spain

- Vague definition being the location of the management and control activities as a whole = absence of national definition?

⇒ Tendency to be understood as referring rather to “strategic” management so that courts tend to look at the location of board meetings (formal approach)
⇒ Tendency to make reference to the Commentary of the OECD Model Convention

Consequence? Less formal approach by authorities since the 2008 amendment and suppression of the “Anglo-Saxon”-inspired sentence: “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”
III. PoEM as sole tie-breaker?
Majority but not totality

Alternative solutions (other than mutual agreement)?
- statutory seat as tie-breaker (for instance in some DTC entered into by Austria, the Netherlands, Italy and Russia)
- Absence of a tie-breaker (for instance the DTC entered into by Austria with China)
A few mutual agreement clauses

- Mutual agreement clauses are rather minority (exception: for instance Finland having 33 out of 76 DTCs based on mutual agreement)
- Consequence of the absence of agreement
  - double taxation
  - exclusion from the benefit of DTCs
IV. BEPS Action 6
Amendment proposal

- To remove the PoEM criterion as tie-breaker rule
- To rely on mutual agreements

⇒ administrative discretion?
Amendment proposal

- “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”
**LOB clauses**

“**Primary place of management and control**”

- “must be distinguished from the concept of “place of effective management”
- “interpreted by some States as being ordinarily the place where the most senior person or group of persons (for example a board of directors) made the key management and commercial decisions necessary for the conduct of the company’s business.
- The concept of the primary place of management and control, by contrast, refers to the place where the day-to-day responsibility for the management of the company (and its subsidiaries) is exercised.
- “the executive officers and senior management employees exercise day-today responsibility for more of the strategic, financial and operational policy decision making for the company (including direct and indirect subsidiaries) in that State than in the other State or any third State, and the staff that support the management in making those decisions are also based in that State”.
Conclusion

- Function of the PoEM concept is changing

- Impact of BEPS initiatives on the use of residence criterion for profit allocation (Transfer pricing, IP Boxes, CBC reporting, ...)

- What future for residence-based corporate taxation?

- And for alternatives?