

TAXREP 14/01

THE IMPACT OF THE COMMUNICATIONS REVOLUTION ON THE APPLICATION OF “PLACE OF EFFECTIVE MANAGEMENT” AS A TIE BREAKER RULE.

*Text of a memorandum submitted in June 2001 to the OECD in response to a
Discussion paper issued in February 2001*

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THE IMPACT OF THE COMMUNICATIONS REVOLUTION ON THE APPLICATION OF “PLACE OF EFFECTIVE MANAGEMENT” AS A TIE BREAKER RULE.

Comments on the Discussion Paper issued by OECD Technical Advisory Group (TAG) February 2001.

Introduction

- 1 Set out below are the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales on the paper issued by the Business Profits TAG of the OECD in February 2001.

General comment

- 2 The place of effective management test is a tried and tested method of determining the residence of a company. It also reflects the underlying substantive connection with the place from which profits are generated. We are therefore not in favour of replacing this test. We would prefer that the test be refined or that a hierarchy of tests is established.

Specific comments

Replacing the place of effective management test

- 3 As mentioned above, we are not in favour of replacing the test. However, in applying the test, we recognise the difficulties (as set out in paragraphs 37 to 44) caused by the use of modern technology. We agree that, for example, virtual board meetings by video conferencing make it extremely difficult on the facts to determine the place of effective management. However, even in an e-commerce environment, this set of circumstances is likely to be the exception rather than the rule.
- 4 If the place of effective management test were to be replaced, Option A (i), that is replacing the place of effective management test as the tie-break test with a test based upon the place of incorporation, would have the advantage of being easily understood and applied. However, it would not reflect the underlying commercial reality.
- 5 As the discussion paper suggests at paragraph 58, Option A(ii), using the place of residence of the directors/shareholders, is unlikely to give a clear cut result.
- 6 Of the three Options presented, the 'economic nexus' test in Option A (iii) would seem to provide an approach that would fit best with e-commerce (and indeed generally). As the paper suggests, this would align the residence approach with the source based approach to taxing profits based on permanent establishments. However, even this approach may not produce a clear-cut result. The enterprise may have premises and employees in several States, with equivalent presence in each and it may be difficult

in some cases to determine with which State the company has its strongest ties. There is also the issue of increased mobility in the case of internet based businesses.

Refining the place of effective management test

- 7 The refining of the place of effective management test (option B) by the use of some form of weighting system for the various factors would help to provide further clarity. It would be helpful if a formal clearance procedure was available under all treaties in accordance with the competent authority provisions, as a fallback in cases where the effective management test could not be clearly applied.

Hierarchy of tests

- 8 In the event that a hierarchy of tests (Option C) was decided appropriate, the economic nexus should be next in the list after the place of effective management as the deciding factor, ie. higher than the place of incorporation test. This order of tests will match more closely the commercial and economic reality.

Combining refined place of effective management test and hierarchy of tests

- 9 Option D would again provide a system that would provide greater certainty, but, as we mentioned above in respect of refining the effective place of management test, clarity would only be achieved by a formal clearance procedure.

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