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LDB/im
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Comments on the 2008 Update to the Model Tax Convention – Place of Effective Management

Dear Mr Owens,

We hereby provide you with our comments to the draft contents of the 2008 Update to the Model Tax Convention (hereafter the “**2008 Update**”).

The following comments are limited to the proposed Commentary in respect of the “place of effective management” within the meaning of Article 4(3) of the Model Tax Convention.

The 2008 Update proposes to insert an alternative to the place of effective management concept since a significant number of countries adopt bilaterally a case-by-case approach to solve cases of dual residence of legal persons (page 8, paragraph 4 of the 2008 Update).

Paragraph 24.1 of the proposed Commentary lists a number of factors that the competent authorities are expected to take into account when they apply the case-by-case approach, such as the place where the meetings of the board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, etc.

Countries not applying this approach determine the residence of a legal person on the basis of its place of effective management as is provided by Art. 4 (3) of the Model Tax Convention. The current text of paragraph 24 of the 2005 Commentary offers guidance to tax authorities and taxpayers to construe the term “place of effective management”. It explicitly provides that *“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". The 2008 Update suggests to delete this sentence in the future Commentary.

Consequently, the Commentary would not provide for a testable criterion. However, it further states that all relevant facts and circumstances must be examined to determine the place of effective management without enumerating possible facts and circumstances to take into account, as opposed to the case-by-case approach. In other words the new Commentary would not offer any guidance to tax authorities and taxpayers.

By deleting the sentence mentioned above, the OECD Commentary makes a distinction between two systems. It provides relevant factors to be taken into account when a State applies the case-by-case approach, but only gives a general principle in the case of a State applying the concept of the place of effective management as a tie-breaker rule. By doing this, the legal certainty of a taxpayer resident in a State applying the latter approach is affected.

We therefore suggest to amend paragraph 24 of the OECD Commentary as follows (proposed additions to the existing Commentary appear in ***bold italics***; deletions appear as ~~striketrough~~):

24. 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~~ ***All relevant facts and circumstances must be examined to determine the place of effective management. The place of effective management will ordinarily be the place where the most senior person or group of persons (e.g. a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined. Where a board of directors formally finalizes and/or routinely approves key management, commercial and strategic decisions necessary for the conduct of the entity's business in one State but these decisions are in substance made in another State, the place of effective management will be in the latter State. In determining the place where a decision is in substance made, one should consider the place where advice on recommendations or options relating to the decision were considered and where the decision was ultimately taken.*** 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 proposed addition is partly based on the discussion draft "*Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention*" of the Business Profits TAG which was released on May 27, 2003 and emphasizes the importance of the

location where the key management decisions are in substance made. It offers both taxpayers and tax authorities guidance for determining the residence of a legal person.

At the same time, it meets the objection put forward by the 2008 Update following which undue priority would be given 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. Indeed, the place where the board of directors meet is overruled as the place of effective management when it appears that the key management decisions are in substance made in another State.

We hope that these suggestions will be taken into consideration when the OECD finalizes its 2008 Commentary.

Yours sincerely,

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