

The POEM of a Trust for Income Tax purposes: a SA and comparative perspective

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Agenda

- Introduction
- Where does POEM fit in and is it (still) important?
- What meaning should be given to POEM?
- POEM in the case law
- Inferences and Guidelines from the cases



Introduction

- Trusts widely used
- Variety of purposes
- Globalisation
- Residence important



Where does POEM fit in and is it (still) important?

- One of the criteria to determine residence
 - South Africa (def of “resident” in s1 of the Income Tax Act)
 - A person other than an individual will be resident in SA if:
 - It is incorporated, established or formed in SA; or
 - Has its place of effective management in SA
 - BUT: if a person is deemed to be exclusively a resident of a foreign country i.t.o a DTA, it will be deemed not to be a SA resident



Where does POEM fit in and is it (still) important?

- Double Taxation Agreements (“DTAs”)
 - Prior to 2017: POEM was default tiebreaker (art 4(3) of the OECD Model Tax Convention on Income and on Capital)
 - After 2017: still a factor to be taken into account as part of MAP
- Still important? Yes



What meaning should be given to POEM?

- In South Africa: domestic law and DTAs
- Same meaning
- Central management and control (“CMC”) vs POEM
 - Case law
 - Academics
 - Guidelines
- Companies vs Trusts



Cases dealing with POEM United Kingdom

- ***De Beers Consolidated Mines Ltd v Howe*** [1906] AC 455 (HL)
 - “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. ... [A] **company resides for purposes of income tax where its real business is carried on** I regard that as the true rule, and the real business is carried on where the **central management and control actually abides.**” (own emphasis)
- *United Construction Co Ltd v Bullock (Inspector of Taxes)*[1960] AC 351 (HL)
- *Wensleydale’s Settlement Trustees v IRC* [1996] STD (SCD) 241
- ***Wood v Holden (Inspector of Taxes)*** [2006] 1 WLR 1393
- *Laerstate BV v HMRC* [2009] UKFTT 209 (TC)
- ***HMRC v Smallwood*** [2010] BTC 637
- *Richard Lee, Nigel Bunter v HMRC* [2017] UKFTT 0279 (TC)
- ***HMRC v Development Securities plc*** [2020] EWCA Civ 1705



Cases dealing with POEM South Africa

- *C: SARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA)
- *The Oceanic Trust Co Ltd NO v C: SARS* 74 SATC 127



Cases dealing with POEM Canada

- *Fundy Settlement v Canada* [2012] 1 S.C.R 520
- *Landbouwbedrijf Backx BV v Her Majesty The Queen* 2018 TCC 142
and 2019 FCA 310



Cases dealing with POEM Australia

- *Koitaki Para Rubber Estates Ltd v Federal Commissioner of Taxation* (1941) 64 CLR 241
- *Malayan Shipping Company Ltd v Commissioner of Taxation (Cth)* (1946) 71 CLR 156
- *Esquire Nominees Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 177
- ***Bywater Investments Ltd v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation*** 2016 HCA 45



Inferences from case law

1. Level of decision-making

- Highest level
- Policy decisions
- “Key”, “paramount”, “significant” decisions
- “where the shots are called”
- Administration and day-to-day management is not POEM/CMC



Inferences and guidelines from case law

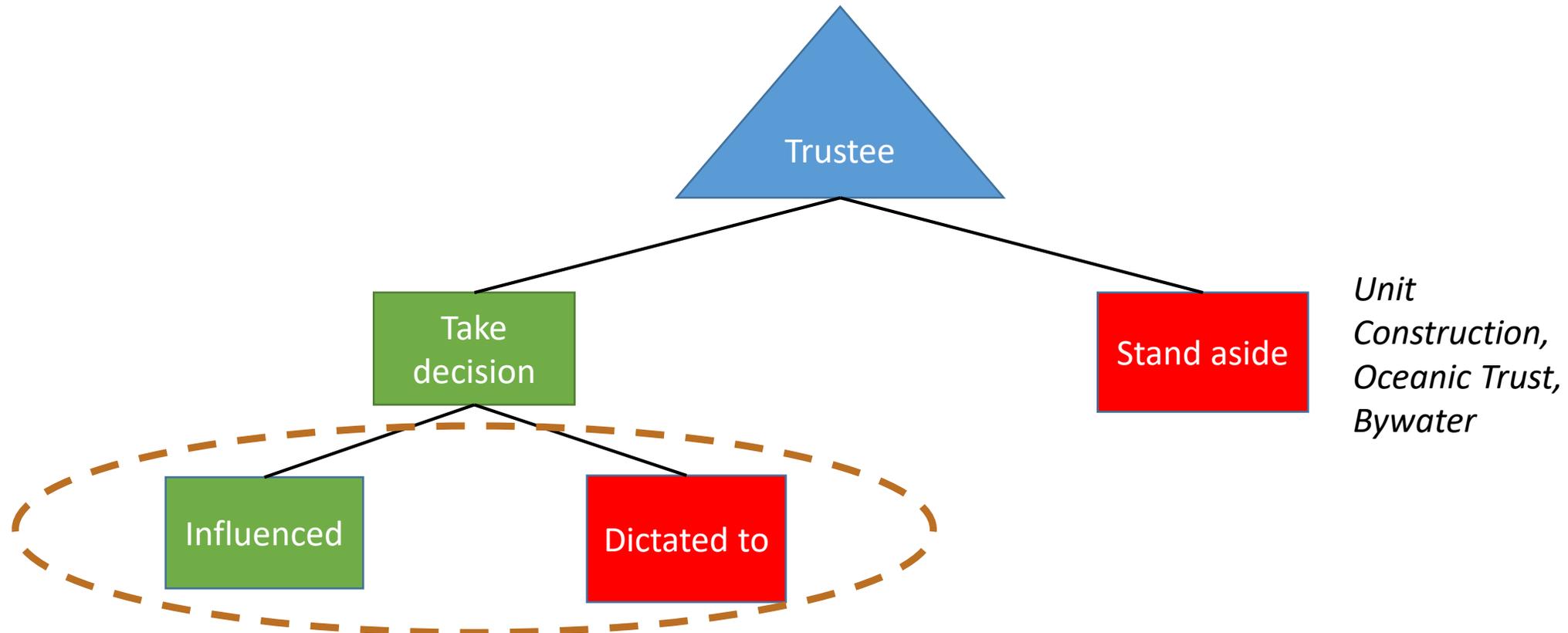
2. The facts are important, not the constitutional documents
 - POEM/CMC not determined by trust deed
 - E.g. *Unit Construction*, *Wensleydale*, *Smallwood*, *Oceanic Trust* and *Fundy*
3. Facts and circumstances related to business and trading
 - Very few decisions



Inferences and guidelines from case law

4. The role of the trustees and the role of outsiders

- USUALLY trustees effectively manage the trust, but no presumption;
- Starting point: examine the role of the trustees (Wood v Holden)





Inferences and guidelines from case law

- Influenced or dictated to?
- Discretion or judgment exercised? (e.g. *Esquire nominees*, *Wood v Holden*, *Bywater*, *Development securities*, *Wensleydale*, *Fundy*, *Landbouwbedrijf*, *Lee*)
- **Indicators** of whether discretion was exercised
 - Would the trustees do something improper or inadvisable?
 - If yes, no discretion (*Wensleydale*, *Lee*)
 - If not ????
 - Discretion exercised (*Esquire nominees*)
 - Not enough – must decide engage with merits of decision. i.e. should the transaction have been entered into? (*Development Securities*)



Inferences and guidelines from case law

- **Indicators** of whether discretion was exercised
 - Extensiveness of information available to trustees (the *Laerstate* scenarios)
 - I. Trustees sign mindlessly (*Landbouwbedrijf; Bywater*)
 - II. Trustees know what they are signing, but no consideration given to whether it should be done (*Lee*)
 - III. Trustees have minimum information available to them but consider whether to sign or not (*Wood v Holden*)
 - IV. Informed decision (*Esquire nominees*)
 - Expertise or skill of the trustee
 - Less than the required skill (*Landbouwbedrijf; Lee*)
 - Expert



Inferences and guidelines from case law

5. Part of a larger tax avoidance scheme?

- *Development Securities (also Wood v Holden, Esquire Nominees)*
- *Smallwood, Lee.*