A comparative analysis of residence issues in income tax and a case study of Nigerian and South African legal system

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Declaration by the Supervisor

As the candidate's supervisor, I agree to the submission of this thesis.

Professor RC Williams Date:

DECLARATION

I, Nuhu Musa Idris, hereby declare that:

i) The research reported in this thesis is based on my original work, except where acknowledgements indicate otherwise.

ii) Neither the whole nor part of this thesis has been, is being or is about to be submitted to this or any other University for the award of any other degree.

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Nuhu Musa Idris **Date**

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ABSTRACT

In exercising income tax jurisdiction, the state can choose to have a link with the personality of the income earner who resides within its territory whether or not the income was derived from a source within its territory (residence-based taxation). No universal rules for determining the tax residence of a person (either natural or juristic) for tax purposes apply in all circumstances. Thus, the states have different definitional rules of residence as contained in their respective income tax legislation and as interpreted by their courts. The global economic integration makes taxpayers move freely and exploit ambiguity created by the divergence of definition of tax jurisdiction between the States. The research explores the possibility of achieving cooperation amongst the States in delimiting the scope of their substantive and enforcement tax jurisdiction without losing their sovereignty. The cooperation envisioned by this research is a departure from the traditional approach, where the focal point of achieving cooperation is either bilateral or multilateral tax treaties. that focus on protecting the tax base of the party-state, ignoring the taxpayers who face conflicting claims due to inconsistencies in the definitional rules. The research argues that the cooperation could be achieved through comparative analysis of the definitional rules in order to ascertain the level of convergence and divergence and how they could extend mutual respect for each other's tax sovereignty and balance their interests against that of the taxpayers in defining the tax residence. For the purpose of in-depth analysis, the research is restricted to Nigeria and South Africa. Nigeria has adopted the residence-based system at the inception of its income tax system, while South Africa initially adopted sourced-based system but later switched to the residence-based system. Thus, the two states operate residence-based tax system. They are also parities to Bilateral Treaties in order to resolve the double taxation inherent in the system. However, the conflict remained unresolved.

The thesis found that the definitional rule of tax residence is not universal. Traditionally, the States adopted the bilateral tax treaty regime to resolve the potential jurisdictional caused by the diversity. However, the reality of the economic integration foists a challenge on that regime. Hence, the current move towards a multilateral tax treaty, which also runs against the tenet of the states' tax sovereignty. Therefore, there is a conflicting interface between the need for the States' cooperation in designing their tax residence rules and the states' tax sovereignty. The research revealed that a comparative analysis of the diverse definitional rules balances the two conflicting interests. The comparison of the Nigerian and South African regimes bring home the significance of the comparative analysis. It is found that the two regimes operate different and irreconcilable rules on the definition of tax residence. While, the South African regime is closer to the global trend, the Nigerian rules are complex and inconsistent, which could have impacted the existing double taxation agreement (DTA) between Nigeria and South Africa.

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CHAPTER ONE
GENERAL INTRODUCTION

1.1 Background

The power to impose tax is a dimension – and a crucial dimension – of state sovereignty.[1] The state must have a jurisdictional basis for exercising this power. Thus, the necessary precondition for the exercise of fiscal jurisdiction by a state is the existence of the requisite link between that person (or the potentially taxable amount, where the source of income is in issue) and the state. It is relatively rate for taxpayers to question the State's jurisdictional power to tax them, but they may fear that the divergence of the definitional rules in this regard may expose them to being regarded as tax residents of more than one state. Taxpayers may legitimately expect that states should cooperate with each other in defining who are 'residents' for tax purposes. On the other hand, States balance two conflicting interests when designing their domestic fiscal laws. That is to say they want to design their definitional rules in this regard in such a way as to protect their tax base and prevent manipulation by the taxpayers. But, at the same time, they need to accept the reality of

[1] Martha, RSJ 'The Jurisdiction to Tax in International Law' (1989) Kluwer, Deventer at 12–18; Avi-Yonah, RS 'International Tax as International Law' (2004) 57 Tax Law Rev 483 at 484–91Qureshi, AH 'The Public International Law of Taxation: Texts, Cases and Materials' (1994) Graham & Trotman, London at 1–9 Knechtle, AA 'Basic Problems in International Fiscal Law' (1979) Kluwer, The Netherlands 37, 41; Qureshi, AH 'The Freedom of a State to Legislate in Fiscal Matters under General International Law' (1987) 41 BIFD 14; Rosenbloom, HD 'International Tax Arbitrage and the "International Tax System"' (2000) 53 Tax Law Rev 137.

globalisation, by taking into account the jurisdictional rules applied by other states.

Thus, the state may take account of the link to the income and impose tax on the basis that the source of that income is located within the state, whether or not the income was derived by a resident.[2] Alternatively, the state can take account of its linkage to the persona of an income earner who resides[3] within its territory. It can then tax that person on a residence basis, whether or not the income was derived from a source within its territory. The distinction between residence and source-based systems is irrelevant to a person who earns and invests his earnings in the state where he resides. The distinction between residence and sourced-based systems becomes relevant where the person derives his income in a state other than where he resides. There are no universal rules for determining the tax residence of either natural or juristic persons.[4] Thus, each jurisdiction has its definitional rules in respect of 'residence' as contained in their respective domestic income tax legislation and as interpreted by its own courts.

The absence of a globally accepted criterion for fiscal 'residence' test has led to diversity and inconsistencies in defining both individual and corporate residence. Thus, there are situations where an overlapping taxing power occurs between two or more states that have both adopted a residence-based system. In resolving such conflicts, States usually adopt both unilateral and bilateral mechanisms in the form of double taxation relief provisions in their

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[2] Williams RC 'Income Tax in South Africa: Law and Practice (2006) 4[th]ed LexisNexis, Durban

[3] Or in the case of United States of America, if the person is a citizen even if he is not a resident. See Blum, C and Singer, PN 'A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals' (2008) 41 Vand. J. Transnat'l L. 708

[4] The determination of the residence status of the taxpayers is crucial because as it affects all other aspects of the tax system. It determines the scope of the taxable income, the rate of the tax, the level of allowable deductions, the availability of exemptions and the obligation to withhold tax. See Williams, RC (2006) at 32

domestic laws and an international bilateral Double Taxation Agreement (DTA) to resolve the conflicting jurisdictional claims and to enhance fiscal cooperation.[5] A DTA is a bilateral treaty entered into by the two states involved. Thus, it binds only the two contracting parties. However, as a result of current global economic integration, a network of bilateral tax treaties may not achieve the desired result in this regard. This is why many commentators[6] have called for a shift from a bilateral treaty regime to a multilateral one in order to address the divergence of tax laws in this regard. However, a proposed Multilateral Tax Treaty regime may be vulnerable to constitutional challenge on the basis of its dilution of a State's sovereignty in tax matters.[7]

The interface between state fiscal sovereignty and global economic integration raises questions as to the effectiveness of bilateral treaties in resolving jurisdictional conflicts, inter alia in regard to the definition of fiscal residence. That is to say, globalisation brings States economically closer to each other but a bilateral treaty regime cannot resolve potential jurisdictional conflicts. Thus, fiscal sovereignty hinders the impetus toward a multilateral tax treaty regime. Nonetheless, States need to cooperate with each other. This thesis argues that the requisite cooperation can be achieved outside the tax treaty

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[5] For the purpose of this thesis, references to a bilateral or multilateral tax treaty regime are limited to the definitional rule of 'resident' for the purposes of the treaty, not the detailed content of the treaty.

[6] Cockfield, AJ 'International Tax Competition: The Last Battleground of Globalization' (2011) 63 (12) Tax Notes International 867; from the empirical research conducted there are more than 2600 DTA around the globe. See Braun, J and Zagler, M 'An economic perspective on double tax treaties with(in) developing countries' (2014) 6 (1) World Tax Journal 1.

[7] XU, M 'Road forward to a multilateral tax treaty regime? '(2014) Global Tax News available at hhtp://www.dlapiper.com/en/global/insights/publication/2014/10 assessed on 10/5/2015 (He observes that the proposed multilateral tax treaty would require significant changes to the domestic tax laws. Therefore. the states that are highly protective of their sovereignty such as US, China Russia and the UK are not likely to endorse the proposal which may consequently remain at regional level.) see also Yonah, RS 'Hanging Together: A Multilateral Approach to Taxing Multinationals' (2016) 5 Mich. Bus. & Entrepreneurial L. Rev. 137; Cockfield, A J 'The rise of the OECD as informal 'world tax organization' through national responses to e-commerce tax challenges' (2006) 8 (1) Yale Journal of Law and Technology; Brauner, Y 'An International Tax Regime in Crystallization' (2003) 56 Tax L. Rev. 259

regime and suggests that a comparative analysis of the rules adopted by states in defining the concept of 'residence' reveals that that States can preserve their fiscal sovereignty whilst achieving mutual cooperation through a better understanding of their respective definitional rules, after making any necessary reforms in this regard.

1.2 **Scope of the Thesis**

Research for this study was conducted within the framework of a residence-based tax system, including the issue of double taxation[8] and tax avoidance,[9] and including an analysis of the concept of residence either as a tiebreaker rule or as an anti-avoidance mechanism. However, this research will be limited to the definitional aspects of residence as expressed in domestic legislation.[10] A residence-based system connotes that States should impose a tax on both the domestic and foreign income of their residents. The residence status of a person is thus crucial in determining his tax liability as the ascertainment of tax liability is the condition precedent that person's becoming subject to tax. A liability to tax is distinct from being subject to tax. Under a residence-based

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[8] Gutuza, T 'An analysis of the methods used in the South African domestic legislation and in double taxation treaties entered into by South Africa for the elimination of international double taxation' Unpublished PhD Thesis submitted to the Faculty of Law University of Cape Town, South Africa, 2013.

[9] Oguttu, AW 'Curbing offshore tax avoidance: the case of South African companies and trusts' Unpublished PhD Thesis submitted to the Faculty of Law, University of South Africa 2007.

[10] The establishment of a jurisdictional link is a condition precedent for asserting tax jurisdiction. It is the primary connecting factor. The tiebreaker rule, as well as the rules for determining the eligibility for tax reliefs or exemptions, are secondary connecting factors. Because, the nexus between the taxing state and the potential taxpayer must first be established before the issue of enjoying certain relief or exemptions or even benefiting from any DTA come up. A point worth noting is that before a tiebreaker rule applies to any situation, the resident status of the taxpayer in one of the parties must have been established. Thus, its application is grounded on the establishment of the jurisdictional link. Therefore, while dealing with the jurisdictional nexus under the domestic laws, the role of residence in the DTA should be a secondary consideration. Conversely, in analysing the role of residence under the DTA, the question of jurisdictional nexus under the domestic law is of equal importance. In the same vein, the issue of eligibility for reliefs or exemption is also grounded an established jurisdictional link.

regime, a person becomes both ‘liable to tax’ and ‘subject to tax'[11] once he falls within the definition of "resident" provided by the tax system. He remains liable to tax even if, the regime exempts him from paying the tax, or if it granted him certain tax relief thereby making that person not subject to tax. Thus, all persons subject to tax are liable to tax, but not all persons liable to tax are subject to tax.[12] ‘Residence’ can be used to determine whether or not a person is liable or is subject to tax. The crux of this thesis is the notion of residence as a determinant of establishing ‘liability to tax’ not of being ‘subject to tax.'

Nigeria has adopted a residence-based system from the inception of its income tax system and it has been in operation ever since. The Republic of South Africa initially adopted a source-based system, but in 2001, it switched to residence-based regime. Thus, the two countries currently impose income tax on both corporate and individuals on the same basis. Furthermore, the two nations are trading partners with an existing Double Taxation Agreement.

The comparison undertaken in this thesis centres on the concept of residence as a means of establishing fiscal jurisdiction, but not for determining eligibility to tax exemption or relief. Thus, this thesis does not merely deal with the relationship between Nigeria's and South Africa's respective residence-based regimes. It also undertakes an in-depth analysis of the definitional rule of both corporate and individuals' residence in these two countries to ascertain the intricacies involved in the respective laws of the two states.[13] Reference will

[11] Wheeler, J ‘Persons qualifying for treaty benefits’ in Trepelkov, A et al (ed) ‘United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries’ (2013) UN Publication, New York 60 at 63.
[12] A person is said to be liable to tax once he falls within the category of taxable persons provided by the taxing statute. However, the statute may exempt the taxable person from paying the tax or the class of income earned by the taxable person,
[13] United Kingdom, United States of America, Canada, Australia, New Zealand and some civil law jurisdictions notably, France, Germany, Netherland, Belgium, Switzerland, Austria and Spain.

be made to other jurisdictions for purposes of an extended comparison. The comparative analysis explores the diversity of the rules adopted by the two states in determining the residence status of both corporate and individual. It also shows the weakness of the current DTA regime. Given the importance of the comparison, this thesis argues that it is possible to achieve cooperation between the states outside the realm of the tax treaty, whether bilateral or multilateral.

1.3 Methodology

For the purposes of this study, both the doctrinal and comparative methods of research will be adopted. By the doctrinal method, data will be collated from primary sources and from secondary sources. The primary sources include domestic statutes and the law reports of the jurisdictions covered. The secondary sources comprise journal articles, textbooks, legal encyclopaedias, and periodicals as well as previous relevant research. The statutes and case law will be used to derive relevant statute law and judicial pronouncements. Secondary sources will be used to access reflections of some other writers and to gain further insights into relevant issues at stake. In combination, these sources will reveal the juridical nature of the States' fiscal sovereignty, the diversity of the definitional rules of tax residence and the need for co-operation between states in defining fiscal residence in the context of increasing global economic integration.

The comparative method will be used as a means of revealing the detailed domestic rules of the various states in determining fiscal residence, and the potential for co-operation between states. The detailed rules for determining fiscal residence in both Nigeria and South Africa will be compared and analysed to highlight the areas of strength and weakness in these two regimes as well as the weaknesses of the DTA regime currently in force between these two states, and the lessons that each of these states may learn from the other.

1.3 Outline of the Thesis

Chapter one, as a general introduction, will serve as the background to the thesis as a whole. It will outline the nature and scope of the research, its objectives, justification, and the methodology applied in conducting the research.

Chapter two gives a general overview of the legal framework for taxation in both Nigeria and South Africa, tracing the historical development of the tax regime in the two States. It will show that the States are both former British Colonies, and that the British Parliament introduced the income tax system in both colonies.[14] Thus, these two States share a common antecedent in the development of their respective tax systems. However, despite the British policy of imposing source-based income tax in its colonies, the British government introduced a residence-based tax regime in Nigeria and a source-based system in South Africa. Nigeria has continued to operate a residence-based system to the present day, whereas, in 2001, South Africa switched from a source-based to a residence-based regime. This Chapter also gives highlights of the current legal and regulatory framework for the operation of the residence-based system in Nigeria and its earlier operation in South Africa.

Chapter three analyses the residence-basis as an aspect of tax jurisdiction through the lens of state sovereignty. It discusses the limitations that global economic integration foists on states' tax sovereignty, and the significance of

[14] See the Native Revenue Proclamation No. 2 of 1906 and the Cape of Good Hope Additional Taxation Act No. 36 of 1904 and the Income Tax Act No. 28 of 1914

co-operation between states. The chapter also analyses the underlying principles and tax policy considerations in designing residence-based system.

Chapter four discusses the nature of the current mechanisms for tax cooperation (namely, the treaty regimes) and role being played by the OECD. It also shows the impact of globalisation on the regime as well as the nature and scope of the OECD-BEPS initiatives. The chapter also highlights the weakness of the traditional method of achieving co-operation in this regard such as Double Tax Agreements. It also explores the possibility of achieving the desired cooperation between the states in defining the scope of their tax jurisdiction outside the traditional methods. The chapter makes a case for a comparative analysis of the different definitional rule for determining tax residence.

Chapter five sets the stage for a comparative analysis by comparing and analysing the various rules for the determination of 'residence' as a connecting factor for imposing income tax on both individuals and corporations. It highlights the diverse nature of the rules defining the tax residence. The chapter analyses diversity in this regard through the lens of the tests applicable in common law jurisdictions such as the United Kingdom, the United States of America, Canada, Australia, New Zealand and some civil law jurisdictions notably, France, Germany, the Netherlands, Belgium, Switzerland, Austria and Spain.[15] These jurisdictions were chosen because aspects of their legal regimes are relevant to that of Nigeria and the Republic of South Africa.

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[15], Thuronyi proposes Germany, France, the United States, and the United Kingdom as natural choices for tax comparison. These countries can be regarded as leaders in influencing the tax laws of other countries. See Thuronyi, V 'Comparative tax law' (2003) Kluwer Law International, London *See also* Thuronyi, V 'Tax law design and drafting' (1996) 1 International Monetary Fund, xxiii-xxxv (Thuronyi, V. ed.).

Chapter Six provides detailed comparative analyses of the tests being used by Nigeria and South Africa for the determination of tax residence as a jurisdictional link for the imposition of income tax on individuals,[16] that is to say, natural persons.[17] It critically examines the existing DTA between Nigeria and South Africa through the lens of the respective rules for determining tax residence. Finally, it narrows down the lessons that both states can learn from each other in this regard and how such lessons could foster co-operation in defining tax residence.

Chapter Seven as with Chapter six, this chapter compares and analyses the fiscal residence of corporations. Both chapters six and seven attempt an analysis of fiscal residence as a jurisdictional link, as distinct from being a mechanism for determining the eligibility of the person concerned to certain reliefs or exemption from tax or, alternatively, as a tiebreaker rule in a Double Taxation Agreement.

Chapter Eight contains the conclusions derived from the research and makes certain recommendations in respect of problems revealed by the research.

[16]In Nigeria, individual income tax applies to all recognised entities other than incorporated companies; such as partnership, Trustees, Estates, family and communities.

[17] In the case of South Africa, the term 'natural persons' refers to individuals as distinct from legal entities.

CHAPTER TWO

OVERVIEW OF THE LEGAL FRAMEWORK FOR TAXATION IN NIGERIAN AND SOUTH AFRICAN

2.0 Introduction

A tax system embraces tax policy, tax law (in the sense of the charging provisions of the relevant legislation) and tax administration. Fiscal policy is a governmental initiative that provides a set of guidelines, rules, and methods that regulate the tax system as a whole. It usually serves as the platform for both tax law and tax administration. Tax law thus deals with the imposition of tax while tax administration deals inter alia with the enforcement of tax law, and with the collection of tax. The determination of tax jurisdiction is crucial in the tax system. World-wide, residence and source are the two most commonly adopted connecting factors in determination of the tax jurisdiction. The theme of this thesis is the comparative analysis of the Nigerian and South African legal regime on residence-based taxation. The two regimes operate under the legal framework set out by their respective tax systems and the differences between the structural aspects of their legal systems must be recognised. This chapter concisely highlights the legal framework on which the residence-based tax system of Nigeria and South Africa operate. A detailed analysis of the provisions of their respective Constitutions relevant to issues of tax is however outside the scope of this chapter.

2.1 Overview of the Nigerian Fiscal system

Nigeria became a political entity in the year 1914 when the Southern and Northern Protectorates and the British colony of Lagos were amalgamated to form 'Nigeria'. The amalgamation coincided with the beginning of the modern Nigerian tax system.[1] Before the merger, many forms of taxation were practised by the various indigenous communities.[2] In Northern Nigeria, the two major Muslim states; the Sokoto Caliphate and the Kanem-Bornu Empire, imposed different types of taxes.[3] In Southern Nigeria, various forms of taxes were imposed by the Yoruba Empire[4] and The Benin Kingdom[5]. Under the Native Revenue Proclamation No. 2 of 1906,[6] the British Colonialist first harmonised the tax system that hitherto operated in Northern Nigeria and introduced in the

[1] Akanle, O 'The power to tax and federalism in Nigeria: Legal and Constitutional perspectives on the sources of Government revenue' (1988) Intec Printers Limited, Ibadan at 11.

[2] Okauru, IO 'A comprehensive tax history of Nigeria' (2012) FIRS Publication, Abuja at 69.

[3] In northern Nigeria the two major Muslim states; the Sokoto Caliphate and the Kanem-Bornu Empire, imposed different types of taxes. In the Sokoto Caliphate there was Zakkat which is one of pillars of Islam. It is a compulsory tax on all Muslims determinable by the nature of property owned by the taxpayer. Apart from zakat there were other form of taxes which included: 1) the agricultural tax (gandu) which was imposed at the rate of 1/8 of the total crops cultivated by a famer; 2) Plantation tax (Shuka-shuka); 3) land tax (Kurdin Kasa); 4) Cattle tax (Jangali); 5) Death tax (Kudin Ushira) a tax payable to the Emir when a person dies without legal heirs or as fee for the distribution of the estate to the eligible heirs; the accession tax (kurdin Sarauta) a tax payable to any person appointed to a traditional office. In the Kanem-Bornu Empire, there was Zakkat and other forms of taxes which included: 1) Compulsory income tax on all Muslims possessing tangible property (Sada'a); 2) Tax collected from all inhabitant of the Empire, whether or not Muslims (hakki bininram); 3) Grazing tax collected from nomadic-pastoral people (Kasasairam); Land tax (Kaleram); and 4) Death tax (Waratha). See Okauru, IO 'A comprehensive tax history of Nigeria' (2012) FIRS Publication, Abuja at 69; Omolewa, M. 'Certificate History of Nigeria' (1989) Longman Press Lagos, at 48; Benisheikh, A. K., 'A Preliminary Investigation into the Revenue System of the Borno Government in the Nineteenth Century' in Akinjogbin, IA and Osoba, S, (eds.) 'Topics on Nigerian Economic and Social History' (1980), University of Ife Press Ltd, Ile-Ife at 66.

[4] In Yoruba Empire taxes such as; land tax (Ishakole), tax for the support of the Kings (Owo ode) and personal service tax (Owo Asinghu).

[5] Benin Kingdom imposed taxes such Ugamwen and Akorbore see Igbafe, AA. 'The Pre-Colonial Economic Foundations of Benin kingdom' in Akinjogbin, I. A. and Osoba, S (eds.) 'Topics on Nigerian Economic and Social History' (1980), University of Ife Press Ltd, Ile-Ife at 19.

[6] The first Income tax legislation in Nigeria.

Northern Protectorate of Nigeria. Section 3 (a) and (b) of the Proclamation, empowered the Resident of the Northern Protectorate to impose a tax on natives[7] *residing* within the territory of his Province. This marked the beginning of the residence-based tax system in Nigeria.

After the amalgamation, the above proclamation was repealed by the Native Revenue Ordinance No. 1 of 1917. The ordinance retained the provisions of section 3 (a) and (b) of the Proclamation which imposed income tax on a residence basis. The only difference between the two was the extension of the income tax regime to the Western Provinces.[8] The income tax system was extended to the Eastern Provinces in 1927.[9] Up to 1931, the income tax system was applicable only to the indigenous people residing in Nigeria. In 1931, the income tax system was extended to cover non-natives residing outside the Colony of Lagos.[10] By 1940, all the ordinances mentioned above had been harmonised to form a single piece of legislation applicable throughout Nigeria except Lagos Colony.[11] The Ordinance applied to all groups of individuals *residing*, carrying on business or being within any town, village or settlement or in any locality therein and included a band of nomad herdsmen'.[12]

The corporate tax system was first introduced to Nigeria in 1939,[13] but a year later Nigeria adopted a single tax regime for both individuals and corporations.[14] For the taxation of individuals, the new Ordinance abolished the native and non-

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[7] Who were subject to the other forms of tax before the advent of British imperialism.
[8] Section 1 of the Native Revenue Ordinance No. 1 1917 and Section 2 Native Revenue (Amendment) Ordinance No. 29 1918.
[9] Sections 1 and 2 of the Native Revenue (Amendment) Ordinance No. 17 1927
[10] Section 4 (3) of the Non-Natives Income Tax (Protectorate) Ordinance No. 21 1931. By section 7 of the Ordinance, a non-native who was temporarily residing in Nigeria for less than six months in the year preceding the current year of assessment was exempted from the application of the ordinance. But the provision of the Ordinance was applicable only to male non-natives, as females were exempted.
[11] That was the Direct Taxation Ordinance No. 4 of1940.
[12] Ibid section 2 and 4.
[13] Companies Income Tax Ordinance No. 14 1939
[14] Income Tax Ordinance No. 3 1940

native dichotomy. Thus, the question was simply whether or not an individual was a Nigerian resident. While installing the Nigerian corporate tax regime, the new Ordinance defined a 'company' as:

> "Any company incorporated or registered under any law in force in Nigeria and any company which, though incorporated or registered outside Nigeria, carries on business, or has an office or place of business therein."[15]

Nigeria maintained its single tax regime from 1940 up to 1954 when Nigeria switched from a Unitary to a Federal state. The introduction of the federal system marked the beginning of the devolution of the taxing power as between the federal and regional governments.[16] However, the single tax regime continued up to 1961 when the individual and corporate tax systems were separated. Hence, the promulgation of two laws to regulate the income tax applicable to individuals and corporations, namely, the Income Tax Management Act No. 21 of 1961[17] and the Companies Income Tax Act 1961.[18]

2.2 Highlights of the Current Legal Framework

The above summarises the historical development of the Nigerian tax system and the chronicle of legislative developments. This heading focuses on the current legal regime. It highlights the Nigerian constitutional and legal

[15] Section 2 of the Income Tax Ordinance No. 3 1940. By section 15 of the same Ordinance, a company was deemed to be resident in the country where its CMC is located.

[16] The switch to a federal system of government has serious implications for the Nigerian individual residence-based tax regime because the question became whether or not an individual is a resident of one region or another or is even a resident of Nigeria as a whole.

[17] Several amendments were made between 1961 and 2011: Income Tax (Amendment) Decree No. 58 1968, Income Tax Management (Amendment) Decree No. 35 1968, Income Tax Management (Amendment) Decree No. 24 1971, Income Tax Management (Amendment) Decree No. 41 1973, Income Tax Management (Uniform Taxation Provisions, etc.) Decree No. 7 1975, Income Tax (Armed Forces and Other Persons) (Special Provisions) Decree No. 51 1972; The Personal Income Tax Decree No. 104 1993, The Personal Income Tax Act Cap P8 Laws of the Federation of Nigeria 2004 and The Personal Income Tax (amendment) Act 2011.

[18] Amended between 1961 and 2007. The Companies Income Tax Act 1979 has been amended by various Finance (Miscellaneous Taxation Provisions) Decrees, the Companies Income Tax Act Cap C21 P8 Laws of the Federation of Nigeria 2004 and the Companies Income Tax (Amendment) Act No. 11 2007.

framework for its residence-based system. It traces the constitutional developments up to the 1999 constitution. For tax laws, only the current legislation is considered. The Constitution is relevant to the tax system of every state in defining the scope of the states' taxing powers. Nigeria got its first constitution in 1914 which empowered the Governor-General to make laws for the administration of justice and revenue generation.[19] The Lyttleton Constitution of 1954 set in place the current Nigerian constitutional framework for taxation. The relevant section provided that:

> "Where under any law enacted by the Federal Legislature any tax is levied on incomes or profit, … of persons, other than bodies corporate, resident in that Region during that year."[20]

The above provision has echoes of the principles of the residence-based system in Nigeria. In applying the income tax laws, the Governor-General was empowered to make laws for the determination of the residence of all persons.[21] The 1960 and the 1963 Constitutions followed the same trend of the previous constitutions by maintaining the principles of the residence-based tax system.[22] The 1979 constitution maintained the tenor of the residence-based system, but it introduced changes in the devolution of the taxing power between the states and the Federal Governments. Under this Constitution, the Federal Government was clothed with both substantive and enforcement taxing powers in respect of

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[19] Section VIII of the Nigeria Protectorate Order in Council 1913. The other three Constitutions that immediately followed the 1914 Constitution contained similar provisions. For instance, the Nigeria Protectorate Order-in-Council 1922 (the Clifford Constitution) extended application of the income tax to Eastern Nigeria; under the Richard Constitution of 1946 the Legislative Council was empowered to impose income tax without seeking the consent of the Governor-General. The MacPherson Constitution of 1951 established Regional Houses of Assembly with the power to impose tax, but subject to the approval of Her Majesty, the Queen of England.

[20] Section 162 (1) of the 1954 Nigerian Constitution. See also item 36 of part I of the first schedule to the 1954 Constitution.

[21] Ibid at section 162 (3)

[22] See section 10 (1) and 70 of the Nigeria (Constitution) Order-in-Council 1960. Both the federal and the Regional governments shared both the substantive and enforcement income tax jurisdiction for individuals, but the federal government retained the substantive power of enforcement over corporations. By sections 63 and 76 the powers of the Regional legislature over income tax were made subject to the recommendation of the president.

both corporations and individuals. The states were left with only enforcement tax jurisdiction in respect of individuals, which they share with the Federal government.[23]

The current Constitution is the Constitution of the Federal Republic of Nigeria 1999. It sets out the framework for taxation in Nigeria and makes the payment of tax a duty that is imposed on all taxable persons in the following terms:

> "it shall be the duty of every citizen to declare his income honestly to appropriate and lawful agencies and pay his tax promptly".[24]

The section imposes the obligation to pay tax on a 'citizen' which extends to all taxable persons in Nigeria. The Constitution makes the compulsory acquisition of moveable and immovable properties of any person a breach of his fundamental rights.[25] However, the imposition and enforcement of tax is not considered a violation of fundamental rights.[26] Therefore, the imposition and the collection of the tax in Nigeria is made under a specific statutory provision. Moreover, once a statute imposes a tax, the constitutional right to property is suspended to the extent of the provisions of that statute.

The Constitution goes further and defines the scope of the taxing powers of the tiers of government, that is to say, the federal and state governments. It provides that:

> "The National Assembly shall have the power to make laws for the peace, order and good government of the Federation or any part thereof with respect to any matter included in the Exclusive Legislative List set out in Part I of the Second Schedule to this Constitution."[27]

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[23] See section 4 and part I and II of the second schedule to the 1979 Constitution of the Federal Republic of Nigeria.
[24] Section 24 (f) of the Constitution of the Federal Republic of Nigeria 1999
[25] Ibid Section 44 (1)
[26] Ibid section 44 (2) (a)
[27] Section 4 (2) of the 1999 Constitution

Item 59 of part of the second schedule provides for the –

> "Taxation of incomes, profits and capital gains, except as otherwise prescribed by this Constitution."

This means that exclusive substantive tax jurisdiction for the imposition of income tax on both individuals and corporations lies with the National Assembly (the second arm of the federal government). In addition to this exclusive jurisdiction, the National Assembly is also empowered to share the enforcement jurisdiction in respect of individual income tax with the states.

Thus, section 4 (4) of the 1999 Constitution provides:

> "In addition and without prejudice to the powers conferred by subsection (2) of this section, the National Assembly shall have the power to make laws with respect to the following matters, that is to say: - (a) any matter in the Concurrent Legislative List set out in the first column of Part II of the Second Schedule to this Constitution to the extent prescribed in the second column opposite thereto;"

Item 7 of part two of the second Schedule to the Constitution provides;

> "In the exercise of its powers to impose any tax or duty on - (a) capital gains, incomes or profits or persons other than companies … the National Assembly may, subject to such conditions as it may prescribe, provide that the collection of any such tax or duty or the administration of the law imposing it shall be carried out by the Government of a State or other authority of a State."

The above provisions governed the devolution of the taxing power between the Federal and State governments. All Nigerian tax legislation derives its validity from these constitutional provisions. However, the exercise of the power conferred on the federal and state legislature leads to some jurisdictional conflicts. In an attempt to resolve such disputes, the Taxes and Levies (Approved List for Collection) Act Cap T2 LFN 2004 was enacted to provide a list of the taxes that each of the three tiers of Government impose or administer.[28] In terms of the provisions of the 1999 Constitution, the Federal Government is clothed with both substantive and enforcement tax jurisdiction on all taxes imposed by the following Acts:

(i) Customs and Excise Duties,[29]
(ii) Personal Income Tax,[30]
(iii) Companies Income Tax,[31]
(iv) Petroleum Profits Tax,[32]
(v) Education Tax,[33]
(vi) Technology Tax,[34]
(vii) Capital Gains Tax,[35]
(viii) Stamp Duties.[36]
(ix) Value Added Tax Act

The State Governments are clothed with the enforcement tax jurisdiction in respect of the taxes imposed by the following Acts:

i) Personal Income Tax,[37]

ii) Capital Gains Tax,[38]

iii) Stamp Duties.[39]

The Taxes and Levies (Approved List for Collection) Act amplifies the above constitutional provisions. It delimits the enforcement jurisdiction of both the Federal Inland Revenue Service and the State Inland Revenue Service – all of

[28] See Emiko, G.I. 'An Analysis of Federal/State Taxing Powers' in Ajemo, M.A. (ed) Tax Law and Tax Administration in Nigeria (1991) NIALS Publication, Lagos, 12 at 40 Okorodudu, MT 'Nigeria: analysis of Federal and State taxing powers' (1985) 11 Int'l Tax J. 305 at 307
[29] Customs and Excise Management Act, Cap C4 LFN, 2004.
[30] Personal Income Tax Act, Cap P8, LFN 2004
[31] Companies Income Tax Act, Cap C21, LFN 2004.
[32] Petroleum Profits Tax, Cap P 13, LFN 2004.
[33] Education Tax, Cap E4, LFN 2004.
[34] National Information Technology Development Tax Act, No – 1997.
[35] Capital Gains Tax Act, Cap C1 LFN 2004.
[36] Stamp Duties Act, Cap S8 LFN 2004.
[37] Personal Income Tax Act, Cap P8, LFN 2004
[38] Capital Gains Tax Act, Cap C1 LFN 2004.
[39] Stamp Duties Act, Cap S8 LFN 2004.

which are tiers of government. The Act provides that the Federal Inland Revenue Service[40] shall administer the following:[41]

1) Companies Income Tax
2) Personal Income Tax in respect of:
    i) Residents of the Federal Capital Territory, Abuja
    ii) Non-resident individuals
    iii) Military personnel
    iv) Members of the Nigeria Police Force
    v) Residents of the Federal Capital Territory, Abuja
    vi) Individuals under the Employment of the Ministry of Foreign Affairs and non-resident individuals
3) Petroleum Profits Tax
4) Value Added Tax
5) Education Tax
6) Capital Gains Tax on residents of Federal Capital Territory, Abuja, bodies corporate and non-resident individuals
7) Stamp duties on the corporate bodies and the persons residing in the Federal Capital Territory, Abuja

The Act also provides that the State Inland Revenue Service shall administer the following:

1) Personal Income Tax in respect of individuals residing within the States
2) Capital Gains Tax (individuals only)
3) Stamp Duties on instruments executed by individual
4) Pool's betting and lotteries, gaming and casino tax
5) Road Taxes
6) Business premises registration fee

There is controversy on the validity of the Taxes and Levies (Approved List for Collection) Act vis-à-vis the provisions of section 4 of the Nigerian Constitution. Abiola[42] argues that the division of taxing power must broadly

[40] Established by the Federal Inland Revenue Service Act of 2007
[41] Part I of Schedule I of the Taxes and Levies (Approved List for Collection) Act Cap T2 LFN 2004
[42] Sanni, A, 'Division of taxing powers' in Abdulrazaq, MT (ed) CITN Nigerian Tax Guide and Statutes' (2002) CITN, Lagos. At 653

follow the division of legislative power as enshrined in the Constitution. Therefore, each level of government can impose a tax in respect of any of the items in respect of which it has the power to legislate. However, the general purport of the Act is to streamline the taxing powers of all level of government by division into a list of 39 specific items to avoid conflicts arising from encroachment.

2.3 Overview of the South Africa Fiscal system

The South African legal system traces its origins from the Roman-Dutch Law introduced in 1652 when the Dutch East India Company established a base at the Cape of Good Hope[43] and the law so introduced remained the applicable law up to 1806 when the British conquered the Cape.[44] Initially, Britain allowed Roman-Dutch law to continue in operation.[45] However, there was a gradual introduction of English Law into the Cape Colony. Dissatisfied inter alia with the introduction of English law, some Dutch Settlers trekked away from the Cape and established the Republics of Transvaal and the Orange Free State.[46]

These two Republics and Natal adopted Roman-Dutch Law as the basis of their law but retained some aspects of English law.[47] After the conflicts of 1899 – 1902, the Colonies of Cape Colony, Natal, Transvaal and Orange Free State were amalgamated to establish the Union of South Africa in 1910.[48] This laid the foundation for the later Republic of South Africa. Sections 135 and 136 of the 1909 Act allowed for the gradual integration of the laws applicable to all

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[43]Van der Merwe, C 'The origin and characteristics of the mixed legal systems of South Africa and Scotland and their importance in globalization' (2012) 18 Fundamina 91 at 92

[44] Farham, I 'Some reflections on the study of South African legal system' (2003) 9 Fundamina 1 at 7

[45] This was pursuant to Art 8 of the Articles of Capitulation, 1806 which provided that "the Burghers and Inhabitants shall preserve all their Rights and Privileges which they have enjoyed hitherto". The decision in the English case of Campbell v Hall (1774) 98 ER 848 held that the laws of the Cape Colony remained applicable until altered by the Sovereign.

[46] Van der Merwe (2012) at 96 – 97

[47] Ibid at 97

[48] Section 4 – 7 of The Union of South Africa Act, 1909.

four colonies thus maintaining the mixed legal system that was hitherto applied in those Colonies.[49] This legal arrangement made South Africa one of the countries which applied a mixture of Roman-Dutch and English Law.[50] The Union of South of Africa gained independence from the UK in 1931 in terms of sections 1 – 4 of the Statute of Westminster, 1931[51] and the Union of South Africa became a Republic in 1961.[52]

At its inception, South Africa adopted a sourced-based income tax regime. This had its origins in the Cape of Good Hope Additional Taxation Act No. 36 of 1904, which was the first legislation to introduce income tax in South Africa. Section 50 provided that:

> "From the 1st July 1904 … there shall be levied, collected and paid … an income tax … on all income … (1) arising or accruing to any person wheresoever residing…"

Section 42 of the Act defined income as:

> "Any gain or profits derived or received by any company or person … from any source within this colony…"

A source-based tax system was adopted when the income tax system was introduced to the whole of the Union of South Africa by the provisions of the Income Tax Act, 1914. This Act provided that:

> "Taxable income" means an income exceeding one thousand pounds, which has been received by, or accrued to or in favour of, any person wheresoever residing, from any source whatsoever in the Union…"[53]

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[49] Schreiner, OD 'The contribution of English law to South African law; and the rule of law in South Africa' (1967) Stevens & Sons, London at 6; Lenel, B 'The History of South African Law and its Roman-Dutch Roots' (2002) Toeberstrasse Thal, Switzerland at 5

[50] Palmer, VV 'Introduction to the mixed jurisdictions' in Palmer, VV (ed.) 'Mixed Jurisdictions Worldwide: The Third Legal Family' (2012) 2nd ed: Cambridge University Press, Cambridge 3 at 5. See also Zweigert, K and Kotz, H 'An introduction to Comparative law' (1998) 3rd ed. Oxford University Press, New York at 232.

[51] Which is described as the turning point in the British imperial history. See Mohr, T 'The statute of Westminster, 1931: An Irish Perspective' (2013) 31 (4) Law and History Review.

[52] Section 1 of the republic of South Africa Act No. 31 of 1961.

[53] Section 4 (2) of the Income Tax Act No. 28 of 1914. For instance, section 5(1) and 6 of the Income Tax (Consolidation) Act No. 41 of 1971; section 5(1) and 7(1) of the Income Tax Act No. 40 of 1925; section 5 (1) and 7 of the Income Tax Act No. 25 of 1940

This provision has been substantially replicated in the all subsequent Income Tax legislation[54] culminating in the 1962 Income Tax Act.[55] The 1962 Act (as amended) is the current income tax legislation in South Africa. In the South African Income Tax Act, the source-based system derived from its definition of 'gross income'. Reflecting most source-based systems, the 1962 Act defined 'gross income' as follows:

> "gross income" … means, in the case of any person, the total amount in cash or otherwise, received by or accrued to or in favour of such person … from a source within or deemed to be within the Republic…"[56]

2.4 Highlights of the Current South African Legal Framework

South Africa's source-based income tax system remained in operation to 2001 when the Republic switched to a residence-based system through an amendment to the above-quoted definition of 'gross income. 'Prior to this amendment, the residence status of a taxpayer was not relevant to the determination of income tax liability. Thus, a 'person', whether or not a resident of South Africa, had to include in gross income only such amounts as had their source in the Republic After the amendment, the definition of 'gross income" was as follows:

> "'gross income', in relation to any year or period of assessment, means-
> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
> (ii) in the case of any person other than a resident the total amount . . . received by or accrued to or if avour of such person from a source within or deemed to b within the Republic …"[57]

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[54] For instance, section 5(1) and 6 of the Income Tax (Consolidation) Act No. 41 of 1971; section 5(1) and 7(1) of the Income Tax Act No. 40 of 1925; section 5 (1) and 7 of the Income Tax Act No. 25 of 1940 and the Income Tax Act No. 31 of 1941

[55] Act No. 58 of 1962. It is should be noted that, for the purposes of ascertaining the amount that constitute 'gross income', source of income is still relevant in South Africa, despite the shift to residence-based regime. See Williams, RC (2006) at 43

[56] Section 1 of the Income Tax Act No. 58 of 1962

[57] section 2 of the Revenue Laws Amendment Act 59 of 2000

The amendments included a definition of the term ‘resident’ that draws a distinction between the residence of ‘natural persons’, that is to say, individuals, and the residence of juristic persons.

The South African income tax system is a centralised system in the sense that the charging legislation emanates from only one legislative organ (the South African parliament) and the income tax system is administered by only one organ (the South African Revenue Service). The Constitution of the Republic clothes Parliament with the power to legislate on any matter including the list set out in Schedule 4 to the Constitution (which is headed ‘Functional Areas of Concurrent National and Provincial Legislative Competence’). However, Parliament does not have legislative power over the matters contained in the list included in Schedule 5 to the Constitution[58] (which is headed ‘Functional Areas of Exclusive Provincial Legislative Competence’). The Constitution thus explicitly does not permit the provincial legislatures to legislate on income tax, value-added tax, and general sales tax.[59] It would however be wrong to conclude that Provincial Legislatures have no say in the imposition and administration of income tax, since the Constitution defines ‘parliament’ as comprising both the National Assembly and the National Council of Provinces.[60] Consequently, both the charging provisions (contained in the Income Tax Act) and the administrative provisions in respect of income tax (contained for the most part in the Tax Administration Act 28 of 2011) will have been debated by delegates from the provinces.[61] The latter Act is administered by the South African

[58] Section 44 (1) of the Constitution of the Republic of South Africa 108 of 1996
[59] Ibid at section 228
[60] Ibid at Section 42 (1)
[61] South African Reserve Bank and Another v Shuttleworth and Another (2015) ZACC 17. In his dissenting judgment at [95] Froneman J said, “The decision to raise revenue of whatever kind, tax or not, may only be done in original legislation passed by Parliament. Judging from past practice, the principle appears to have been regarded as obvious.” See also Ynuico Limited v Minister of Trade and Industry and Others (1996) ZACC 12

Revenue Service established by the South African Revenue Service Act No. 34 of 1997.

2.5 Conclusion

In 1914, the British Colony of Lagos, and the Northern and Southern Protectorates were merged to form a political entity called 'Nigeria' under Section I of the Nigeria Protectorate Order in Council 1913. The Union of South Africa was brought into existence in 1910 in terms of the Union of South Africa Act of 1909 which was an Act of the British Parliament. Thus, Nigeria and South Africa were established at almost the same time through instruments emanating from the British Parliament. Furthermore, their respective income tax systems were introduced in Nigeria and South Africa at almost the same time. However, Nigeria adopted a residence-based system in 1906 when its income tax system was first introduced, and it has been in operation ever since. South Africa operated a source-based system until it switched to a residence-based system in 2001. Thus, both Nigeria and South Africa now operate a residence-based income tax system. This commonality is the basis of the comparative analysis in this thesis of the definitional rule adopted by the two countries in determining residence for income tax purposes.

CHAPTER THREE

RESIDENCE-BASED FISCAL JURISDICTION

3.0 INTRODUCTION

The necessary condition for a state to exercise tax jurisdiction over an individual or taxable entity is the existence of the requisite juridical link between that individual or entity and the state. The state can legislate for such a nexus to be the factor of residence[1] within its territory, regardless of whether the income in question was derived from a source within the territory. Or the state can make the source of income the requisite nexus and legislate for jurisdiction in respect of income that has its source within its territory, whether or not it was derived

[1] Or in the case of United States of America, if the person is a citizen even if he is not a resident. See Zelinsky, EA 'Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile' (2011) 96 IOWA L. Rev. 1289Worster, WT 'The Constitutionality of the Taxation Consequences for Renouncing U.S. Citizenship' (2010) 9 Fla. Tax Rev. 921 at 1006; Kirsch, MS 'Taxing Citizens in a Global Economy'(2007) 82 N.Y.U. L. Rev. 443;

by a resident. Thus, each tax jurisdiction lays down its own definitional rules in this regard in their respective tax legislation, and these rules are of course subject to interpretation by their courts.

This chapter will focus on one of the connecting links, mentioned above, namely, residence-based income tax. This chapter sets the stage for a comparative analysis of the principle of residence for income tax purposes, to ascertain the intricacies involved in the definitional rules of residence in Nigeria and the Republic of South Africa, respectively. Reference may occasionally be made to other jurisdictions for the purpose of an extended comparison.

3.1 Residence as the Basis of Tax Jurisdiction

Tax jurisdiction is exclusively a creation of statute.[2] The taxing power cannot be conferred otherwise than by statute. However, the unsettled nature of the criteria used in determining such jurisdiction invites academic analysis of the fundamental operational concepts or connecting factors in the exercise of tax jurisdiction. As Avi-Yonah[3] puts it, "Taxes are the last topic on which one would expect sovereign nations to reach consensus". The analysis that follows will commence with the broad concept of state jurisdiction and then narrow the focus to tax jurisdiction.

The tax jurisdiction of a state connotes the sovereign power of that state to legislate in respect of all persons within that jurisdiction, in regard to the application and enforcement of such legislation.[4] The power of the state in this

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[2] Williams RC 'Income Tax in South Africa: Law and Practice (2006) 4thed LexisNexis, Durban 7 (Neither international law nor common law can in any way impose tax obligation on any person)

[3] Avi-Yonah RS 'The structure of international taxation: A proposal for simplification' (1996) 74 Tax L. Rev. 1301 1303

[4] Colangero A J 'Jurisdiction, immunity, legality and jus cogens' (2014) 14 Chi. J. Int'l L. 53 at 58 see also Ludsin H 'Returning sovereignty to the people' (2013) 46 Vand. J. Transnational L. 97 Beale,

regard is an attribute of sovereignty.[5] The sovereignty of the state can be extended to everything that exists within the state,[6] subject to any limitations imposed by international law,[7] and may be exercised in varying ways according to the policies of the state in question.[8] The sovereign power of the state can only be called into question or limited in terms of its own constitution or when it involves an international element where the action of the state affects a person who is not a subject of that state.[9] The twin principles laid down in the case of *France vs. Turkey*[10] (*the Lotus case*), namely. the principles of equality and non-interference in the domestic affairs of other states[11] established the limitations of the state sovereignty.The latter principle was first applied in the case of *United Kingdom of Great Britain vs. Northern Ireland-Albania (the Corfu Channel Case*).[12]

'The jurisdiction of a sovereign state (1923) 36 Harv. L. Rev. 241 see also Lowell A.L. "The limit of sovereignty' (1988) 2 (2) Harv. L. Rev 70 at 72.

[5] Wurzel H 'Foreign Investment and extraterritorial taxation' (1938) 38 Colum. L. Rev 809, Mann The Doctrine of jurisdiction in international law (1968) III RdC 1 30 (jurisdiction is an aspect of sovereignty, it is coexistent with it, and indeed, incidental to but is also limited by, the state's sovereignty, hence jurisdiction cannot exist without sovereignty.), Brownlie I 'Principles of Public international law' (1979) 3rded 289

[6] However, due to a particular relationship, a state may extend its jurisdiction to certain persons outside its territory. Also a state may lack power to exercise any form of jurisdiction over another group of persons living within its territory who enjoy certain legal immunity.

[7] Martha RSJ 'The jurisdiction to tax in international law: Theory and practice of legislative fiscal jurisdiction (1989) Kluwer Netherland, l, Martha RSJ 'Extraterritorial taxation in international law *in* Meessen KM (ed) 'Extraterritorial jurisdiction in theory and practice (1996) Kluwer Law International, London see also Yee S 'Universal Jurisdiction: concept, logic and reality (2011) 10 (3) Chinese Journal of Int'l Law 503 at 530

[8] Albrech AR "The taxation of alien under international law (1952) 29 British Yearbook of International Law (Brit. Y. B. Int'l Law) 145

[9] Danziger E International income tax (1991) Butterworth, Durban, 13, Martha RSJ 'The jurisdiction to tax in international law: Theory and practice of legislative fiscal jurisdiction (1989) Kluwer Netherland

[10] (1927) PCIJ

[11] Under the former principle no state is entitled to exercise any form of sovereign power beyond its boundaries, unless acting pursuant to a treaty or any principle of customary international law. The latter principle stipulates that in the absence of any prohibition by international law to the contrary; a state is at liberty to exercise any form of sovereign power within its boundaries without any form of outside intervention. see Shaw MN 'International law' (2008) Cambridge University Press, Cambridge at 621; Ryngaert C 'Jurisdiction in international law (2008) 1st ed oxford University Press, New York

[12] (1949) 4 ICJ and subsequently applied in the cases of Nicaragua vs. United States (1986) ICJ (the principle of non-interference is an important aspect of sovereignty); Democratic Republic of Congo

Tax jurisdiction is an aspect of the state's sovereign power to levy a tax on taxable persons within its sovereignty including those who derive their income from it. [13] The nexus between tax jurisdiction and sovereignty, suggests that every type of jurisdiction is limited and subject to any limitations inherent in sovereignty in general.[14] In income tax, the state exercises this power by determining the taxable income, the taxable person, and the tax rate.[15] The vital questions are whether international law imposes limitations on a state's taxing powers; if it does, the nature of the limitations imposed by international law on the state's taxing power and the extent to which such limitations affect the state's taxing powers on domestic tax issues.

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vs. Uganda (2005) ICJ see also Jamnejad M and Wood M 'The principle of non-intervention' (2009) 2 Leiden J. Int'l L. 345 at 346

[13] Pires M 'International judicial double taxation of income (1989) Kluwer

[14] Christians A 'Sovereignty, taxation and social contract (2009) 18 Minn. J. Int'l L. 99 see also Jackson RH 'Human Rights Protection in a World of Sovereign States' in Ronald Tinnevelt and Gert Verschraegen (eds.) Between Cosmopolitan Ideals and State Sovereignty (2006) Palgrave Macmillan, New York 134-146; Jackson RH 'Sovereignty as a Doctrine of Moderation,' (2004) in C. Nolan (ed.), Power and Responsibility in World Affairs: Praeger, New York. 57-76; Epstein, RA 'Consent, not power, as the basis of jurisdiction frontiers of jurisdiction,' (2001) University of Chicago Legal Forum 1 (He analysed the word 'power' being used in discussing sovereignty. He stated that the power mentioned refers to power of the subject who give consent to the state to exercise the power on their behalf.) see also Guzman AT and Hsiang J 'Some ways that theories on customary international law fail: A reply to Loszlo Blutman' (2014) 25 (2) Eur. J. Int'l law 559
However, due to economic integration, transactions are being carried out across borders resulting to a situation where more than one country is able to tax the same item (should the country in which the recipient of income resides or the country in which the income derived) makes the intervention of international law very relevant.

[15] Cappelen AW 'The Moral Rationale for International Fiscal Law' (2006) 15 (1) Ethic and International Affairs noted some features of tax jurisdiction;

1) The character of the country (rich or poor) and that of the tax subject (whether he has the ability to pay are immaterial to justification of taxation.
2) Historical relationships do not create the right to tax, for example, former residence or former citizenship—do not create tax liabilities.
3) The nature of the nexus between a state and its tax subjects determines the tax liability of the tax subjects. That is a personal nexus creates unlimited tax liability, while an economic nexus creates limited tax liability.
4) It regulates the distribution of the taxing right among nations and it does not recognize the tax right of any other groups or entities.

The traditional approach to the first question views tax jurisdiction as an aspect of the state's sovereign autonomy to tax those whom it is constitutionally proper to tax, without any outside interference.[16] This approach traces its origin to the judicial line of reasoning expressed by Lord Mansfield: *"*No country ever takes notice of the revenue laws of another.*"*[17] Wurzel succinctly argues in favour of the notion of states' absolute taxing power, thus:

> "National taxing power is an essential attribute of sovereignty and sovereignty is omnipotence...This connection with the notion of sovereignty makes a nation's taxing power primarily a problem of international, rather than of municipal, law…What we are merely interested in knowing: is there anything in the written or unwritten law of nations to indicate a universally recognised rule is authoritatively assigning among nations, and thereby impliedly limiting, the jurisdiction to tax? The answer is very definitely in the negative..." [18]

The central argument of the proponents of this approach is that the state's tax jurisdiction over persons within its sovereignty and any self-imposed limitation thereon is purely a creation of domestic laws. It could be argued that this approach was grounded on the principle of 'non-interference' in the domestic

[16] Finke J 'Sovereign immunity: rule, comity or something else' (2010) 21 (4) Eur. J. Int'l Law 881 (states are free to make as long as they observe the boundaries set by international law): Florani M 'The irony of int'l law: How int'l law limits state sovereignty (2010) available at www.aglr.wordpress.com/2010/04/05; Christians (2009) supra; Rosenbloom, HD "Sovereignty and the Regulation of International Business in the Tax Area" (1994) 20 Canada-United States Law Journal 267at 267. (No area of the law is closer to the subject of sovereignty than taxation); Park, WW 'Fiscal jurisdiction and accrual basis taxation: lifting the corporation veil to tax foreign company's profit (1978) 78 Colum. L. Rev. 1609

[17] *Hollman V. Johnson* (1775) 1120 at 1121.However, this line reasoning has been judicially negated in the cases of Government of India v. Taylor (1955) AC 491-8 and Krok v. CSARS (2015) ZASCA 107

[18] Wurzel H 'Foreign Investment and extraterritorial taxation' (1938) 38 Colum. L. Rev 809 at 812 – 814. Subsequent writers also followed this line of reasoning. See Norr 'Jurisdiction to tax and international income' (1962) 17 Tax L. Rev. 431 (No rule of international law exist to limit the extent of any country's taxing jurisdiction): Mann 'The doctrine of jurisdiction in international law (1968) III RdC 1 10; Hadari Y 'The choice of national law applicable to the nationality of such enterprise' (1974) 1 Duke L. J. 1 at 53 (..a country is free to adopt any theory of tax jurisdiction for suitable to its legal system); also Tillinghast D 'Tax aspects of international transactions (1978) see also Knechtle A 'Basic problem in international fiscal law' (1979) Kluwer, Deventer – asserts that national laws are not subject to any restrictions from international law. See also *Burnet V. Brook US 288 378 – ('*we determine national power in relation to other countries and their subjects by applying the principles of jurisdiction recognized in international relations.)

affairs of a state by any other state as established in the Lotus case.[19] However, this principle was established in cases involving issues other than monetary affairs (including taxation).[20] Therefore, it cannot be slavishly applied to all the domestic affairs of the state, especially the exercise of a tax jurisdiction.[21] Since the view adopted in the traditional approach on the first question has made tax sovereignty a sacrosanct, it follows that the second question may not be addressed.

A modern approach to both questions postulates that the state's taxing power stems from sovereignty and that sovereignty is a power vested in the state. [22] The co-existence of this power requires a principle of international law to give direction to these incompatible forces, hence the need for international norms regarding taxation, capable of distributing taxing power between states. Therefore, the taxing power of the state is subject to any limitation imposed by international law.[23] Also, in the course of raising revenue, the state could come

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[19] And other subsequent decisions: Nicaragua vs. United States (1986) ICJ (the principle of non-interference is an important aspect of sovereignty); Democratic Republic of Congo vs. Uganda (2005) ICJ see also Jamnejad M and Wood M 'The principle of non-intervention' (2009) 2 Leiden J. Int'l L. 345 at 346

[20] Hertogen A 'An unusual suspect? Monetary sovereignty and financial instability (2010) 2 Goettingen J. Int'l L. 243 (He argues that a state's exercise of monetary sovereignty through its monetary policies can affect financial stability of other countries. Therefore, the principle of non-interference of domestic affairs is not applicable in the regard)

[21] Christians A 'Networks, norms, and national tax policy (2010) 9 (1) Wash. Univ. Global Studies L. Rev. 1 at 5 ('that early decisions against multilateralism led to the soft global tax governance structure supported by the OECD today')

[22] Christians (2009) supra at 105 Ring, DM 'What's at Stake in the Sovereignty Debate' (2008) 49 Va. J. Int'l L. 1 Bruce G. et al 'Negotiating Globalization: Global Scripts and Intermediation in the Construction of Asian Insolvency Regimes' (2006)31 Law & Soc. Inq. 521 at 522; Stewart, M 'Introduction: New Research on Tax Law and Political Institutions' (2006) 24 Law in Context 1, 1; Cockfield, AJ 'The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenge (2006) 8 Yale J.L. & Tech. 136 at 169: Li, J 'Tax Sovereignty and International Tax Reform: The Author's Response, (2004)52 Can. Tax J. 141 at 144; Scholte JA 'Globalisation: a critical introduction' (2005) 2nd ed Palgrave Macmillan, New York, 519 Bräutigam, D 'Building Leviathan: Revenue, State Capacity, and Governance' (2002) 33 IDS Bulletin 10, 10 Michael J. Graetz, Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies (2001) 54 Tax L. Rev. 261 at 277

[23] For the purpose of imposing the limitation, sovereignty may be categorised into the personal and territorial. Martha RSJ 'The jurisdiction to tax in international law: Theory and practice of legislative fiscal jurisdiction (1989) Kluwer Netherland - while establishing the limit imposed on municipal tax jurisdiction by international law, introduced the concepts of personal and territorial jurisdiction ;

into conflict with other States, or require the assistance of those States in achieving its desired tax base. Thus, the states' divergence in defining the scope of their tax jurisdiction could lead to a situation where more than one state[24] seeks to exercise substantive tax jurisdiction over the same income, and where those states all rely on fiscal sovereignty to justify their stand. On the other hand, a state may require the assistance of other states to exercise its enforcement powers in respect of its tax jurisdiction. This approach aligns the concept of national sovereignty with taxation in an integrated world economy.

In most tax jurisdictional discourse states rely on their tax sovereignty to counter the influence of globalisation on their domestic tax regimes, especially when the subject matter involves a question of the definition of key terms.[25] Moreover, the connection between tax sovereignty and the impact of economic integration leads to an inconclusive debate among tax experts. Some commentators have claimed that raising revenue for the public good is an obligation imposed on the state, and that this duty cannot be severed from tax sovereignty, notwithstanding the impact of globalisation.[26] Thus, states are

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(the former gives the state the power to make and enforce its laws over any person that falls within its sovereignty by reason of his nationality, whereas the latter empowers a state to extend its laws over any alien who comes within the territory of the state) and from which he deduces the fundamental element that determines the extent of state tax jurisdiction – the elements are fiscal attachment, personal attachment and economic attachment.

[24] This can be the country where the recipient of the income resides or where the income was derived.

[25] Ring, (2008) supra at 9 (She identified quest for controlling revenue and fiscal policy as the functional rationales for grounding states' tax policies on sovereignty. Melo, G M 'Taxation in the Global Arena: Preventing The Erosion of National Tax Bases or Impinging on Territorial Sovereignty? A Critique of the OECD's Report," (2000) 12 Pace Int'l L. Rev. 183, 186

[26] Zou A 'International legal review of the relationship between international tax law and national tax sovereignty: Theoretical foundation and development practice (2014) Univ. of Hong Kong Faculty of Law Research paper No. 2014/010 Ring, DM (2008) 49 Va. J. Int'l L. (loss of tax sovereignty can undermine both revenue and fiscal policy of a no satisfactory method for balancing competing claims of tax sovereignty has not been articulated.); Bruce G. et al 'Negotiating Globalization: Global Scripts and Intermediation in the Construction of Asian Insolvency Regimes' (2006)31 Law & Soc. Inq. 521 at 522; Stewart, M 'Introduction: New Research on Tax Law and Political Institutions' (2006). 24 Law in Context 1, 1; Bräutigam, D 'Building Leviathan: Revenue, State Capacity, and Governance' (2002) 33 IDS Bulletin 10, 10 Graetz, MJ 'Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies (2001) 54 Tax L. Rev. 261 at 277; Melo, G M 'Taxation in the Global Arena: Preventing The Erosion of National Tax Bases or

entitled to reject any act that can reduce or take away their sovereignty. However, other commentators make the case for entrenching an obligation on the states to cooperate with each other in formulating tax rules and policies.[27] The reality of global economic integration raises a question as to whether tax sovereignty entitles a state to define its tax jurisdiction freely, and whether other states cannot insist on compliance with a minimum standard?[28]

No state can declare the tax law of another state void,[29] nor can it impose its tax law on another State as they all enjoy equality of sovereignty.[30] However, even those[31] insisting on the absolute sovereignty recognise the fact that no state can prevent another from levying a tax on any person within its territory or with whom it has personal or economic connections. It follows that the tax jurisdiction of each state implies a corresponding right vested in other States[32]

Impinging on Territorial Sovereignty? A Critique of the OECD's Report," (2000) 12 Pace Int'l L. Rev. 183, 186 ("The right to tax forms one of the most intimate relationships between the sovereign and its subjects …The decision to tax or not to tax and the manner in which to tax within domestic borders is one that has always been within the absolute discretion of each sovereign." See also Federal Board of Inland Revenue v. Nigerian General Insurance Company Ltd. (1966) LLR 88 at 95

[27] Hertogen (2010) supra; Christians (2009) (argued that an international social contract imposed a sovereign duty to have mutual respect for each other and to align its tax law and policies in conformity with that of other states). Jamnejad M and Wood M 'The principle of non-intervention' (2009) 2 Leiden J. Int'l L. 345 at 346; Kwiecien R 'Sir Hersch Lauterpacht's idea of state sovereignty – is it still alive (2011) 13 Int'l community L. Rev 23 at 25: Leon I 'when cooperation and intervention meet, sovereignty in the Mexico-United States relationship' (2011) Keinan Y 'The Case for Residency-Based Taxation of financial transactions in developing countries (2008) 9 (1) Fla Tax Rev. 3; Amsterdam L. Forum 54 Mann FA 'Further studies in international law' (1990) Clarendon press, Oxford 4

[28] The minimum standard envisaged here distilled from the idea of the social contract as Christians argued. (Christians, A 'Sovereignty, taxation and social contract' (2009) 18 MINN. J. INT'L L. 99 at 101) The social contract imposed a duty on the sovereign states to voluntarily and unilaterally abstain from designing tax policies that impede the tax policies of other states.

[29] Christians (2009) supra

[30] Section 501 (a) of the US Foreign Account Tax Compliance Act (FATCA) 2013 seems to have negate the above assertion. Because the section imposed a reporting obligation on all foreign financial institutions to furnish the US government will all relevant information on the US citizens' foreign account. For recent discussion on FATCA see Maxwell, J and Li, A 'FATCA: What it Is, What it isn't, and what's Next' (2015) 19 (2) Asia-Pacific Journal of Taxation. However, the provision of FATCA centred on the enforcement not on the substantive tax jurisdiction. Therefore, no state can exercise its substantive tax jurisdiction on another state.

[31] Melo (2000) supra Ring, DM (2008) Zou (2014) supra

[32] As a result of the increase in movement of persons from one state to another caused by globalisation, the corresponding exists even where there is no cross border trade between the states.

and that no state can implement its tax jurisdiction in isolation.[33] It can be concluded, therefore, that no state can claim exclusive tax jurisdiction. However, how to cooperate is a challenging issue.

It follows from the above that states need a forum where they can achieve co-operation in exercising their respective tax jurisdiction without forfeiting or diluting their sovereignty. This forum would need to be set up by an international tax regime or body.[34] It is submitted that co-operation in delimiting tax jurisdiction does not derogate from the sovereignty of the states but rather enhances it. Zou[35] views states' action in safeguarding their national sovereignty as a process of law-making revolution in taxation at an international level. The inconsistency of the European Court's position on the tax sovereignty of its member states has led to brewing tension on tax jurisdiction in the European Community (EC).[36] The jurisdictional conflict in the EC indicates that bilateral or multilateral treaties do not achieve the desired co-operation

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[33] Genschel, P 'Globalization and the Transformation of the Tax State' 13 EUR. REV. 53, 60 (2005) (The traditional idea that "all taxable events have a clearly identifiable place in space" within one jurisdiction or another "has always been a fiction.").

[34] It is worth noting that, no consensus as to whether there is an international tax regime, capable of extracting an international norm on tax issue. Rosenbloom, D The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System", (2000) 53 Tax L. Rev. 137, 140-1argued that what we claimed today to be the international tax regime comprises only the different tax laws of various countries exist and those laws vary greatly from each other. Avi-Yonah, RS 'International tax as international law (2007) Cambridge, Avi-Yonah, RS (2000) 'Commentary on David Rosenbloom's, The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System", 53 Tax L. Rev. 167, 169. It has been argued from other angle that the network of bilateral treaties that are largely similar in policy, and even in language, constitutes an international tax regime, which has definable principles that underlie it and are common to the treaties. This assertion is supported by Brauner A 'An international tax regime in crystallization (2003) 56 Tax L. Rev. 259 at 326; Sneirson JF 'Soft paterlism for close corporation: helping shareholders helping yourselves' (2008) Wis. L. Rev. 899; Trubek DM and Trubek LG 'New Governance and legal regulation: complementary, revalvary and transformation (2007) 13 Colum. J. Eur. L. 539; Cords D 'Let's get together: collaborative tax regulation' (2013)11 Pitt. Tax Rev. 47

[35] Zou (2014) supra

[36] See Faulhaber, LV Sovereignty, Integration and Tax Avoidance in the European Union: Striking the Proper Balance, (2010) 48 Colum. J. Transnat'l. L. 177 at 181; Isenbaet M 'The contemporary meaning of 'sovereignty in the supranational context of the EC as applied to the income tax case law of the ECJ (2009) EC Tax Rev: Bizioli G 'balancing the fundamental and tax sovereignty: some thought on recent ECJ case law on direct taxation (2008) 48 (3) European Taxation; Vanistendael F 'Denkavit international: the balance between fiscal sovereignty and the fundamental freedom (2007) 47 (2) European Taxation

objectives.[37] Apart from the EU co-operation regime, the Organisation for Economic Co-operation and Development (OECD) is also playing a role in that respect, but the anticipated co-operation amongst the states has not yet been achieved. This shows the inadequacy of the current co-operation mechanism.[38]

The difficulty of achieving the desired co-operation amongst the states may be a result of the peculiarities inherent in taxation.[39] As a result of the delicate nature of tax jurisdiction most states that have recognised the World Trade Organization (WTO) in order to co-operate in matters of trade, have refused to do so in matters of taxation. Rather, they have constituted themselves into various non-binding peer groups, such as the OECD, which generate soft laws. Also, the international tax regime acts more as a conflict resolution mechanism (mostly through the OECD and other organisational soft laws) than as positive law. The regime has only persuasive authority on domestic taxation. By its nature, as rules for conflict resolution, the international tax regime does not address the substantive issue of tax jurisdiction,[40] but rather, the enforcement of the tax jurisdiction of the states involved.[41] Thus, in analysing residence principles, the primary source is the domestic law of the selected jurisdictions as interpreted by case law.

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[37] *Saint-Gobain vs. Aechen-Innenstadt C-307/97 ECR 1-6161; Gilly vs. Fiscaux du Bas-Rhin C-336/96 ECR 1-2793; De Groot vs. Van financien C-385/00 ECR 1-5821*(the Member States arefree to unilaterally define the connecting factors for the allocation of taxation rights or to do so in tax treaties.). However*, in Bosal Holding BV v. Staatssecretaris van Financien, C-168/01 ECR 1-9409; Marks & Spencer C-446/03, ECR I-1083; Manninen's case C-319/02 ECJ* departed from the earlier notion of tax sovereignty of the member states.

[38] Rosenbloom HD et al 'The unruly world of tax: a proposal for an international tax cooperation forum' (2014) 15 (2) Fla. Tax Rev. 57 Avi-Yonah, R S. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State." (2000) 113 (7) Harv. L. Rev.

[39] Azam R 'Global taxation of cross-border ecommerce income' (2012) 31 Va. Tax Rev. 639 Palmer KL 'Toward unilateral coherence in determining jurisdiction to tax income' (1989) 30 Harv. Int'l L. J. 1 noted that historical antecedent, move to expand or protect jurisdictional based as well as having divergent views of the global integration led to this situation – absence of universal jurisdictional rule.

[40] Substantive and enforcement tax jurisdiction is explained later in this chapter.

[41] Martha (1989) 5

This thesis explores the possibility of achieving co-operation amongst states in defining the scope of their tax jurisdiction. What is required for such co-operation is a close examination of each state's tax jurisdiction. The examination ascertains the level of convergence and divergence of the States in defining their fiscal jurisdiction and how they extend mutual respect to each other's tax sovereignty. The analysis seeks to ascertain how the states balance their respective interests against the interests of taxpayers in defining the connecting factor. However, the need for an in-depth critical analysis limits the comparison to the concept of residence as a connecting factor in just two jurisdictions, namely, Nigeria and South Africa.

Hitherto, research of this kind has taken a broad approach with a disregard for the dichotomy between substantive and enforcement tax jurisdiction.[42] For instance, the problem associated with the definitional rule for determining individual residence for tax purposes (substantive) is less prominent than that of enforcing tax liability. However, the problems inherent in ascertaining corporate residency and of enforcing corporate tax liability are almost the same.[43] That is why this thesis looks at the residency issues involved in substantive and enforcement tax jurisdiction (for both individuals and corporate entities). Residence as an aspect of substantive jurisdiction will establish a framework for analysing all issues relating to definitional rules of residency for tax purposes and the tax consequences that follow the application of those definitional rules. On the other hand, the analysis of enforcement jurisdiction will focus on residency issues involved in the tax enforcement mechanism.

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[42] For discussion on the misalignment of substantive and enforcement jurisdiction to tax, see Swain JA 'Misalignment of substantive and enforcement tax jurisdiction in a global economy: causes and strategies for realignment (2010) 63 (x) National Tax Journal, Fox special issue

[43] Avi-Yonah RS 'The structure of international taxation: a proposal for simplification' (1996) 74 Texas L. Rev. 1311

Despite the aforementioned concerns regarding the international tax regime, that regime is highly relevant in limiting the scope of domestic tax systems in the current integrated global economy. These limitations are the parameters that determine the extent of the state's tax jurisdiction. These are the fiscal attachments; [44] that is to say, the relationship between the state and taxpayers. Such a relationship is deemed to exist when the same persons are subject to either the 'personal sovereignty' or the 'territorial sovereignty'[45] of the state. In other words, either personal fiscal attachment or economic fiscal attachment to the state. Thus, a state's tax jurisdiction can only be justified if it is exercised in respect of persons with some nexus, link, connecting factor[46] or closeness[47] to the state.

The fiscal attachments mentioned above, refer to the nexus and connections that link the taxing state with the persons sought to be taxed. The attachments serve as the basis for assuming tax jurisdiction. They are established through two fundamental principles that clothe the taxing authorities with jurisdiction to tax income. These principles are 'source' and 'residence.' Despite the interface between source and residence as a tax base, this research focuses only on the residence base. The residence-based principle is crucial to Nigeria and South Africa as they both adopt the same principle in their income taxation.

The concept of residence as a connecting factor in tax jurisdiction will be analysed from the perspective of the two discrete aspects of tax jurisdiction as formulated by Hellerstein.[48] He describes tax jurisdiction as comprising two

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[44] Martha RSJ 'The jurisdiction to tax in international law: theory and practice of legislative fiscal jurisdiction (1989) Kluwer Netherland

[45]Abraham B 'An economic analysis of territorial sovereignty in international law (2012) available at http://ssrn.com/abstract=2280746

[46] Danziger (1991) 13

[47] Martha (1989) 117

[48]Hellerstein W 'Jurisdiction to tax income and consumption in the new economy: a theoretical and comparative perspective (2003) 38 (1) Ga. L. Rev 1. See also Hellerstein W 'OECD – Jurisdiction to in the Digital Economy: Permanent and other establishments (2014) 68 (6/7) Bulletin for international

separate elements, namely ‘substantive’ and ‘enforcement’ tax jurisdiction.[49] The former relates to the power of the state to impose a tax on its taxable subjects and it encompasses the two fundamental principles mentioned above, source and residence. The latter relates to the power of the state to compel the collection of tax over which it has substantive jurisdiction, using its established legal and administrative mechanism for that purpose. The enforcement jurisdiction includes the jurisdiction of the state to impose an obligation on another person (the withholding agent, who is not the actual income earner) to collect the tax on behalf of the state. It also raises different residency issues from the one envisaged by substantive jurisdiction, hence the need for examining residency from both points of view.

Hellerstein[50] also argues that the question whether a state has jurisdiction to impose a tax is different from whether it has jurisdiction to compel the collection of the tax. These two powers are often exercised by different organs within the same tax jurisdiction.[51] This is the reason for analysing tax jurisdiction from these two different perspectives, which are important aspects in a comparative analysis of a residence-based system.

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taxation and Swain JA ‘Misalignment of substantive and enforcement tax jurisdiction in a global economy: causes and strategies for realignment (2010) 63 (x) National Tax Journal, Fox special issue – who traced the major causes of misalignment between substantive and enforcement jurisdiction and stated the strategies for achieving greater jurisdictional alignment include (1) reducing administrative and compliance cost, (2) adopting simplified compliance regimes for foreign taxpayers, (3) repealing the physical-presence test and (4) “reverse engineering” substantive jurisdiction rules in recognition of existing limits on enforcement capabilities, Cockfield AJ ‘ Jurisdiction to tax: A law and technology perspective (2003) 38 Ga. L. Rev. 85 – 118, Restatement of the law (Third), Restatement of the foreign relations law of the United States (1988) 2

[49] Restatement (Third) of Foreign Relations Law of the United States (1987) § 421 - Jurisdiction to enforce is defined as the authority of a state “to employ judicial or non-judicial measurers to induce or compel compliance or punish non-compliance with its laws or regulations, provided it has jurisdiction to prescribe”

[50] Hellerstein (2003)

[51] For instance, in a federal state like Nigeria, the federal government possesses substantive jurisdiction to impose income tax while the states possess the enforcement jurisdiction to compel the collection of the tax.

A state needs to evaluate the central focus of its sovereignty, using a statist political conception.[52] Thus, a state may consider population as the main focus of sovereignty. This entails imposing tax on all income of its residents based on the personal relationship with the state, irrespective of the source of that income (a residence-based system). Alternatively, a state could consider its territory as the primary focus, thereby imposing a tax on all income derived from within the territory, irrespective of the identity of the producer (a source-based system).[53]

The difficulty in this regard is that most countries use a hybrid system, adopting a residence basis together with some aspects of a source basis or vice versa.[54] The driving force for such an election is a policy decision by the state. According to Graetz, this decision should be made on the basis of the culture, economic and political capacity and history of the state.[55] Two definitional tests are being used to determine the residency of both individuals and corporations for tax purposes: That is the statutory criterion together with a facts and circumstances test. Each of these tests involves theoretical and policy issues.

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[52] Gliksberg D 'The effect of the statist-political approach to international jurisdiction of the income tax regime – the Isreal case" (1994) 15 Mich. J. Int'l L. 459

[53] Ibid, see also Musgrave PB 'Sovereignty, Entitlement, and Cooperation in International Taxation' (2001) 26:4 Brooklyn J. of Int'l L. that national right to tax the global income of residents is recognized in international law and the exercise of tax sovereignty over foreign source income is necessary to achieve equitable tax treatment of resident taxpayers by making all income, wherever earned, subject to tax, consistent with the accretion principle.

[54] Williams RC 'Income Tax in South Africa: Law and Practice (2006) 4th ed LexisNexis, Durban 56, Olivier L and Honiball M 'International tax: A South African Perspective (2008) 4th ed Siberink, Cape Town 51 – when a state adopt residence-based, an aspect of source is also adopted, in that non-residents are taxed on the income sourced within the state. Likewise, state that adopts a source-based use to extend their tax net by deeming certain income from domestic source. This is a shift from what was obtainable in 1980s - Avi-Yonah RS Tax coverage and globalization (2010) working paper No. 214, University of Michigan Law School, stated that in the 1980s the was divided into two group: the major group consisting of countries that tax both residents and non-residents on a territorial basis while exempting foreign source income. The other group tax their residents on a worldwide basis proving a foreign tax credit. Furthermore, the problems associated with choosing either residence or source-based systems is compounded by Australia. It adopted a hybrid system like other countries, but in 2006 it amended its law to exempt the foreign sourced income of a temporary resident as defined in section 768 – 900 of the Tax Laws Amendment Act No. 4 of 2006.

[55] Graetz MJ 'International taxation: inadequate principles outdated concepts and unsatisfactory policies (2001) 54 Tax L. Rev 261,279

For the statutory test, tax policy considerations come to the fore, while the facts and circumstances test involves both conceptual and judicial interpretation, as well as tax policy issues.

3.2 Underlying Principles and Policy Considerations of the Residence Base

The prevailing rules governing tax jurisdiction consist of constitutional norms, statutory provisions, tax policy and accepted legal principles of taxation. This research focuses primarily on a legal analysis of tax jurisdiction in Nigeria and South Africa. However, an analysis of principles and tax policy will also allow for an understanding of the issue of justification of residence-based taxation from the perspective of equity, efficiency, and administration. According to Roxam,[56] tax policy is the context in which a discussion of the structure and reform of a tax system should take place. It is a forum where those[57] with competing interests in the operation of the tax regime adduce arguments in support of their interests and seek to influence the resulting structure of the tax system as embodied in tax law. These different and competing policy interests are part of the problem hindering the formulation of appropriate jurisdictional rules for the income tax regime.[58]

In a tax policy analysis, the claims of these competing interests should be narrowed down to the central issues of equity, efficiency and administration.[59] Therefore, in determining the allocation of tax rights both law and economics

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[56] Roxan I " Limit to globalisation: Some implications for taxation, tax policy and the development (2012) LSE Law, society and Economy Working paper No. 3 available www.lse.ac.uk/collections/law/wps/wps.htm

[57] Such as government, taxpayers, legislators and academics

[58] Misey Jr, RJ 'Simplifying international jurisdiction for US transfer taxes: Rethinking citizenship and replace domicile with the green card test' (1992) 76 Marquette L. Rev. 77

[59] Palmer RL 'Toward unilateral coherence in determining jurisdiction to tax income (1989) 30 Harv. Int'l L. J. 1 at 64

have to interact.[60] Thus, a lawyer may embark on the tax policy argument using language derived from economics, but from a legal perspective. For instance, tax neutrality is considered to be an economic concept while tax equity, on the other hand, is a legal concept.

The residence-based system in the two countries under study, Nigeria and South Africa, have different antecedents. Nigeria adopted its residence-based system in 1906 when the income tax system was first introduced,[61] and it has been in operation ever since. South Africa, on the other hand, operated a source-based system from 1914[62] up to 2001 when it switched to a residence-based system. Hence, it is necessary to analyse the policy considerations that justified the introduction and retention of the residence-based system in Nigeria and ascertained why South Africa changed its system from a source to a residence basis.

This analysis highlights the lessons that each may learn from the other in terms of policy issues regarding a residence-based regime. The norm in the tax policy analysis[63] is that the analyst must identify the perspective from which it is intended to address the issue. The aforementioned basic policy issues are

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[60] Vogel, K., 'Worldwide vs source taxation of income A review and re-evaluation of argument' (part 1) (1988) 16 intertax

[61] It was first introduced in Northern protectorate via Native Revenue Proclamation No. 2 of 1906 and it was later extended to western and eastern protectorates via Native Revenue Ordinance of 1918 and 1927 respectively

[62] Section 4(2) of the Income Tax Act of 1914 define income as "any gain or profit from any source within the union … taxable income is any income received by any person whosesoever residing, from any source whatever in the union

[63] For the purpose of analysis, tax policies can be divided into three aspects, namely: a) Policies that are general for all tax purposes, which include raising revenue, equity, efficiency and progressivity; b) Policies that are unique to income tax like, policy discourse on benefit and ability-to-pay and choice between source and residence base; and c) Policies that are unique to international income taxation, namely, neutrality, foreign tax credit, exemptions and deductions and double taxation. See Leandra, L 'Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance' (2007) 60 Stanford L. Rev. 695

broadly categorised into equity/fairness and efficiency.[64] For the purposes of addressing residency issues from an enforcement tax jurisdiction perspective, efficient administration and simplicity will also be used as a benchmark for analysing the residence-based system. The analysis will bring to the fore the interface between tax policy and tax laws. Tax policy is a framework that provides the guidelines, principles and objectives to be achieved in the operation of the tax system, whereas, tax laws function, for examples, to create a tax base and the taxable person, to impose rates and to prescribe penalties for default.[65]

3.2.1 Equity and Fairness

An analysis of tax equity and fairness usually commences with the concept of horizontal and vertical equity.[66] Horizontal equity connotes that persons who are economically in the same situation be treated equally by the tax system and vertical equity connotes that persons who are relatively well off economically should bear a greater tax burden than those who are less well off.[67] The principle of equity can be applied to a residence-based system. It ensures that residents of the state who earn the same amount of income, either from within the state or from a foreign source should be taxed equally (horizontal equity).[68] Income

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[64] Notwithstanding the fact that, using efficiency in tax policy analysis has been challenged as it favours the developed countries that are capital exporters that require efficiency to enhance it while equity and fairness analysis favours developing countries – Cockfield A 'Purism and contextualism within international law analysis: How trading analysis fails developing countries' (2007) 5 (2) ejournal of tax research 199 While according to Greatz MJ 'Taxing international income: inadequate principles, outdated concepts and unsatisfactory policies' (2001) 54 Tax L. Rev. 261 the appropriate tax policy analysis required by developing countries (capital importers) is equity and fairness, while efficiency analysis is usually used for international taxation.

[65] Okauru I O 'Federal Inland Revenue Service and taxation reforms in democratic Nigeria' (2012) FIRS Safari Book Ltd, Ibadan 610 at 101

[66] Galle B 'Tax Fairness' (2008) 65 Wash. & Lee L. Rev. 1323Palmer RL 'Toward unilateral coherence in determining jurisdiction to tax income (1989) 30 Harv. Int'l L. J. 1 at 64; Bittker, B I. "Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities" (1979) 16 San Diego L. Rev.735 For criticism of the whole idea of equity see Repetti J and Ring D 'Horizontal equity revisited' (2012) 13 (3) Fla. Tax Rev. 135

[67] Williams RC 'Income Tax in South Africa: Law and Practice (2006) 4th ed LexisNexis, Durban

[68] Galle (2008) supra; Wood RJ 'Supreme Court Jurisprudence of Tax Fairness' (2006) 36 Seton Hall L. Rev. 421 (Horizontal is not controversial, the difficulty arises in its application rather than in its definition. The primary concern centres on the criteria that should be used to determine whether

tax lends itself to being levied on a person's income at increasing marginal rates and this is a mechanism that can be applied to achieve the desired vertical and horizontal equity. However, the concept of horizontal and vertical equity has been criticised as irrelevant in the context of tax policy analysis.[69] Some commentators base their criticism of horizontal and vertical equity on the inconsistency of the judicial application of these principles.[70]

Nonetheless, tax scholars generally accept and endorse the concept of vertical and horizontal equity.[71] These concepts, it is submitted, are relevant in assessing the fairness of a tax system, and the concept of vertical equity can be linked to tax rates. However, this thesis will not address issues relevant to determining the appropriate rate of tax.

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taxpayers are similarly situated.) Dodge JM 'Theories of tax justice: Rumination on the benefit, partnership and ability to pay principles' (2005) 58 Tax L. Rev.399 at 402, Elkins D Horizontal equity as a principle of tax theory (2006) 24 Yale L. &Pol'y Rev. 43 88, Musgrave RA 'Horizontal equity: A further note' (1993) 1 Fla. Tax Rev. 354.

[69] Repetti J and Ring D 'Horizontal equity revisited' (2012) 13 (3) Fla. Tax Rev. 135 Galle B 'Tax Fairness' (2008) supra The concept of HE may be incoherent when it comes to comparisons between taxpayers in different jurisdictions, or, at least, comparisons that require us to decide the worthiness of those other sovereigns' views.) Infanti AC 'Tax equity' (2008) 55 Buff. L. Rev. 1191(the notion of equity is not suitable for assessing the fairness of tax policy) Martinez, LP 'The Trouble with Taxes: Fairness, Tax Policy, and the Constitution '(2004). 31 Hastings Const. L.Q. 413 Bagaric M and McConvill, J 'Stop Taxing Happiness: A New Perspective on Progressive Taxation' (2005) 2 Pitt. TAX Rev. 65; Buchanan, NH 'The Case Against Income Averaging' (2006) 25 Va. Tax Rev. 1151; Dodge, JM 'Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principle' (2005).58 Tax L. Rev. 399; Kahn, JH 'The Mirage of Equivalence and the Ethereal Principles of Parallelism and Horizontal Equity' (2006) 57 Hastings L.J. 645, 652 (Each instance of different tax treatments must be examined separately to determine whether the difference is warranted); Miller, JA 'Equal Taxation: A Commentary (2000) 29 Hofstra L. REV. 529 (discussing challenges to the concept of horizontal equity); Kaplow L ' Horizontal equity: measures in search of principle' (1989) 42 Nat'l Tax J. 139

[70] Henry Ordower, H 'Horizontal and Vertical Equity in Taxation as Constitutional Principles: Germany and the United States Contrasted' (2006) 7 Fla. Tax Rev. 259 Wood, RJ Supreme Court Jurisprudence of Tax Fairness' (2006) 36 Seton Hall L. Rev. 421 Barker, WB 'The Three Faces of Equality: Constitutional Requirements in Taxation' (2006) 57 Case W. Res. L. Rev. **1** Martinez, LP 'The Trouble with Taxes: Fairness, Tax Policy, and the Constitution' (2004) 31 Hastings Const. L.Q. 413, 421, 427-38 (asserting that the U.S. Supreme Court has failed to employ notions of tax equity in determining the constitutionality of taxing statutes).

[71] I conducted a search on Hein Online on 8/11/2014 to find the number of article published between 2000 to 2014 in which the horizontal and vertical equity appeared. The search revealed that horizontal equity appeared in about 341 articles while vertical equity appeared in about 268 articles.

The concept of equity and fairness features in both Nigerian and South African tax policy[72] and is relevant in regard to both substantive issues of tax, and to issues of tax enforcement in these two countries. However, most writers[73] on this issue have examined the equity and fairness of the residence-based system from the perspective of substantive tax jurisdiction and have ignored the aspect of enforcement.[74]

For example, a state in exercising its substantive tax jurisdiction may impose tax on the global income of two of its residents. The determination of horizontal equity involves the question whether the tax so imposed is fair and the first issue in this regard is whether the two residents have the same amount of income.. The two residents may, for example, be working for the same employer and have the same seniority. However, one of the residents may incur deductible employment-related expenses and the other may incur the same amount of expenditure which, though business-related, does not meet the relevant statutory requirements for tax-deductibility. Consequently, the tax payable by one may be higher than by the other.

[72] See the Nigerian National Tax Policy of 2010 and the Sir Sidney Phillipson commission on revenue allocation 1946, Raisman's commission on revenue allocation 1954 the 3rd National Development plan 1975 -1980, the Shehu Musa task Force on tax administration of 1978 and Prof. Emmanuel Edozien's Study Group on the Nigerian Tax System. As to South Africa, see the Steyn Committee of Inquiry (1951), the Franszen Commission of enquiry into fiscal policy in South Africa (1970), the Margo Commission of inquiry into the tax structure of the Republic of South Africa (the Margo Commission) (1987) and the Katz Commission of enquiry into certain aspects of the tax structure of South Africa

[73] Repetti J and Ring D (2012) supra James R. Repetti, J R 'Democracy and Opportunity: A New Paradigm in Tax Equity, (2008) 61 Vand. L. Rev. 1129; Galle (2008) supra; Palmer RL 'toward unilateral coherence in determining jurisdiction to tax income (1989) 30 Harv. Int'l L. J. 1 at 64 (administrative convenience may not constitute a tax policy goal at all) Bittker, B I. "Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive out Inequities" (1979) 16 San Diego L. Rev.735 Schoenblum JA 'Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals' (1995) 12 Am. Tax. Pol'y 221.

[74] Swain JA 'Misalignment of substantive and enforcement tax jurisdiction in a global economy: causes and strategies for realignment (2010) 63 (x) National Tax Journal, Fox special issue at 4-5

The fairness issue will be compounded in a situation where, under a typical residence-based system, a State imposes a tax on both residents and non-residents but taxes only the domestic-source income of the non-resident.[75] Even if their respective incomes are the same, they will not pay the same amount of tax. Elkins[76] argues that horizontal equity only requires similarity in the taxpayers' respective situations, and not complete identity. From the perspective of enforcement, the determination of equity and fairness involves questions as to whether the state's tax administration mechanism is fair and equitable and is applied to all taxpayers in equal measure. For instance, under the Nigerian personal income tax regime, tax administrators assess and collect the tax of residents in formal employment through a Pay-As-You-Earn system. Under such a system, the tax is deducted from the salary of the residents by their employers who remit it to the tax authority. However, for other classes of residents, the regime applies direct assessment or a presumptive tax assessment. This may lead to treating two equal residents unequally in enforcing the collection of the tax.

Equity and fairness raise considerations of equality between similar taxpayers and also raise the issues of ability to pay the assessed tax and the benefit principle, discussed below.

3.2.1.1 Benefit principle

The benefits principle is that a person's contribution to the state by way of tax should take account of the benefits he received from that state.[77] In the 18th century, the concept of benefit in this regard was viewed from the perspective

[75] What he has earned in another state may not be taxable in the first state
[76] Elkins D 'Horizontal equity as a principle of tax theory' (2006) 24 Yale L. & Pol'y Rev. 43
[77] Dodge JM 'Theories of tax justice: Rumination on the benefit, partnership and ability to pay principles' (2005) 58 Tax L. Rev.399 at 402

of a social contract. Thus, the tax payable was considered to be the consideration furnished by the taxpayer in return for the provision by the state of security in respect of life, liberty, and property. In that era, the tax system was concerned only with real properties and excise on certain goods and services, since income tax was not based on the notion of benefits received from the state.[78] The second version of the benefits principle, as it arose in the 19th century, extended to income tax and the implicit assumption was that the benefits that a person was entitled to receive from government were linked to the amount of tax paid by that person – the more he paid, the greater the benefits to which he was entitled. This policy came under challenge as it implicitly required that the poor pay more in tax than the rich because it was the poor who most needed government benefits; but no attempt was made to accurately measure such benefits.[79]

The extended version of the benefits principle suggested that the measure of a person's benefits from the government should be based on his financial well-being. As the state established an enabling environment for wealth accumulation and set conditions for such accumulation, whoever satisfied the requirements would be required to pay tax, but without any linkage to any particular benefit he enjoyed from the state. The notion of the benefits principle could be traced to a report published under the auspices of the League of

[78] Ibid note 402
[79] Ibid note 71

Nations.[80] It also received judicial blessing in the locus classicus decision in Cook v. Tait by the US Supreme Court.[81]

Some authors[82] have argued that the benefits principle is more relevant in international than in national taxation. That is to say; a state can impose a tax on its residents without showing any benefit derived by those residents from the state. This assertion cannot be justified in the light of tax incentive regimes. Under a tax incentive regime, a high-income earner or even a multinational corporation (both of which enjoy the benefits of infrastructure provided by the host state) may be granted a tax holiday or even a total exemption from tax. Even those not exempted can enjoy government benefits without paying tax during the period that they utilise the infrastructure. For instance, an individual might escape tax if he failed a requirement of physical presence for tax residency. The difficulty in ascertaining the amount of benefit each person receives from the state makes the ability to pay principle a more appropriate fairness norm for residence-based taxation. Roxon[83] has said that one of the problems of the ability-to-pay principle is that it separates a person's liability to tax from the benefits he received from the state. However, it is submitted that he contradicts himself where he says that the benefits principle is not relevant

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[80] Committee of Technical Experts on Double Taxation and Tax Evasion, League of Nations, Double Taxation and Tax Evasion 5-9, 1927, available at www.law.wayne.edu/tad/Documents/League/League_Tech_Experts.pdf Avi-Yonah has stated that the benefit principle implies (in an international context) the taxation of active business income primarily at source, and passive investment income on the basis of residence; see Avi-Yonah,R.S. Tax Competition, Tax Arbitrage and the International Tax Regime, Bulletin for International Taxation (2007) 61 at 130.

[81] *Cook v. Tait, 265 U.S. 47, 56 (1924*) (where a U.S. citizen residing in, and apparently deriving all of his income from a foreign country may properly be taxed in the U.S. on his worldwide income "based on the presumption that government by its very nature benefits the citizen and his property wherever found"); see *National Paper & Type Co. v. Bowers, 266 U.S. 373, 376 (1924*) where reference was made to the "power of the United States to protect its interests and redress its wrongs in whatever parts of the world its business may take it".

[82] Avi- Yonah 'Globalisation, tax competition and the fiscal crisis of the welfare state (2000) 113 Harv. L. Rev 1572, Rixom (2012), Fleming (2001) supra.

[83] Rixom (2012),

to domestic taxation because of the difficulty of ascertaining the amount of benefit that a taxpayer has received from the state.[84]

3.2.1.2 Ability-to-pay principle

The ability-to-pay principle connotes that the amount payable by a taxpayer should reflect the quantum of the taxpayer's resources, measured by income, wealth, consumption or whatever criterion is considered appropriate.[85] The principles of ability to pay and the benefit principle can be applied in combination.[86] Some writers view ability-to-pay as an aspect of tax equity and fairness, encompassing both horizontal and vertical components of equity.[87] Fleming[88] has made a case for applying the ability to pay principle in taxing the worldwide income of a resident. He is of the view that the most important criterion for spreading the income tax burden amongst individual taxpayers is the proposition that the tax burden should be allocated on the basis of relative economic well-being. It has been argued that income may be a poor measure of economic well-being because people who start with equal ability may make different decisions about working and saving that affect their income.[89] Taking account of leisure and underachievement is an obstacle for the principle of ability to pay, since such manifestations of 'income' cannot be measured.[90]

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[84] Ibid

[85] Roxan I (2012) supra has noted that there is a debate as to whether economic well-being of a person should be measured by reference to income that is both saved and consumed or only by reference to consumption, see McNulty JK ' Flat tax, consumption-type income tax proposals in the US: A tax policy discussion of fundamental tax reform (2000) 88 Cal. L. Rev. 2095

[86] Kemmeren, E.C.C.M., Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach' (2006) Bulletin for International Taxation, November, 431

[87] Zolt EM 'The uneasy case for uniform taxation (1996) 16 Va. Tax Rev. 39 86, see also Greatz MJ and Schenk DH 'Federal income taxation: principles and policies' (1995) 3rd (ed) 31 Branford DF 'Untangling the income tax (1986) 53 150

[88] Fleming JC et al 'Fairness in international taxation: The ability-to-pay case for taxing worldwide income' (2001) 5 (4) Fla. Tax Rev.299

[89] Burman LE 'Taxes and inequality' (2013) 66 Tax L. Rev. 563

[90] Fried H 'The puzzling case for proportionate taxation (1999) 2 Chapman L. Rev. 157 182, Zolt EM (1996) supra

Other commentators have argued that there is a consensus that, in determining ability to pay, relevant items that cannot be measured; such as leisure and underachievement are to be omitted.[91] The ability to pay principle is a constitutional limitation on the taxing power in Germany, Spain, and Italy.[92] Seto has criticised the ability to pay principle from the perspective of people with disabilities, and makes a case for a revision of the principle.[93]

In discussing the relationship between the benefit principle and the ability to pay principle, Dodge has argued that the best basis for fairness is ability to pay. This is a less contentions concept than the benefit principle, because it separates tax fairness from social justice theory that tries to measure benefits.[94] However, it is submitted that he fails to realise that the measurement issues he raises will also be a problem in measuring ability to pay. It seems, therefore, that benefits and ability to pay should not be separated, since a person should pay tax on the benefits he has received from the state based on his ability topay. Avi-Yonah has said that the benefits principle was always part of the ability topay principle.[95] Roxon has described ability to pay as an extended version of the benefits principle, and says that:

> "… Appropriate price for a person to pay for the whole of general government services, including redistribution, is the amount determined by measuring the ability to pay. The appropriate measure of the total benefit received from general government services is taken to be the amount of the tax payable on the basis of ability to pay."[96]

[91] Lindsey VW 'The widening gap under the Internal Revenue Code: the need for renewed progressivity' (2001) 5 Fla. Tax Rev. 1
[92] Vanistendael F 'Legal framework for taxation in Thuronyi V, 'Tax design and drafting' (1996) 1 IMF
[93] Seto, TP and Buhai SL 'Tax And disability: ability to pay and the taxation of difference (2006) 154 Univ. Pennsylvania L. Rev. [Vol.: 1053
[94] Dodge (2005)
[95] Avi-Yonah (2007)
[96] Roxan I (2012)

The fusion of the ability to pay principle and the benefits principle in this statement, coupled with the immeasurability of government benefits (especially for non-residents) links the benefits principle with the concept of redistribution. There is consensus as to the legitimacy of redistribution in taxation, on the grounds of its social value.[97] However, a libertarian could argue that redistribution is a means of taking from those who are entitled to market rewards and giving to those who are not. It is worth noting that the distinction between the redistributive element and the benefits principles of tax may not be clear.[98] One may argue that redistributive taxes can be understood as 'benefits' in the sense that wealthy individuals pay such tax to secure a benefit, such as a lower crime rate and a better-educated workforce.

Thus, benefit and ability to pay are highly relevant to the determination of fairness in establishing a connecting factor between a potential taxpayer and the taxing authority on the grounds of residence. Thus, it is fair for the state to impose a tax on all the income[99] of residents on the ground of the benefits being received by them from the state. The same consideration can legitimise the extension of tax liability to non-residents for the income they have derived from the state. Stratford CJ says in this regard that:

> "…the privilege and protection of a resident can justly be called upon to contribute towards the cost of the good order and the government of the country that shelter him."[100]

The benefit principle and the ability to pay principle are aspects of equity and fairness in a tax system and provide a theoretical basis for an equitable

[97] Ibid
[98] Cappelen AW 'The Moral Rationale for International Fiscal Law' (2006) 15 (1) Ethic and International Affairs
[99] Both domestic and foreign.
[100] Kergeulen Sealing & Whaling Co. Ltd V CIR (1939) AD 487, 10 SATC 363

distribution of the tax burden. These principles are also relevant to issues of tax jurisdiction in that a state that functions within a globalised economy and chooses to adopt a residence-based system[101] will need to interact with other states to try to ensure fairness toward taxpayers, in regard to their overall tax burden, where they are resident in one state but derive income sourced in other state.

3.2.2. Efficiency Principle

The efficiency principle connotes that the prospect of tax should not be the dominant consideration when a taxpayer is making a decision to invest in a particular state.[102] The efficiency principle takes account of both economic and administrative considerations. For their part, states use tax to achieve their respective economic goals[103] and try to avoid violating the fairness principle in relation to the overall tax burden imposed on both residents and non-resident.[104] Thus, in determining the tax base and the taxable person or entity, decisions by states impact on taxpayers' decisions. In other words, the states must try to balance fairness to taxpayers with their own goals of achieving economic efficiency in relation to both residents and non-residents.[105] Ideally, the trade-off between equity and efficiency at a domestic level centres on the income

[101] That is taking both domestic and foreign source income of those residing in the state on one hand and taxing the domestic source income of the resident of another state. Tax credit (for foreign paid tax), deductions and exemptions may bee applicable.

[102] Hasen D 'Tax neutrality and tax amenities' (2012) 12 (2) Fla. Tax Rev. 62 see also Weisbach, DA 'Line drawing, doctrine and efficiency in the tax law' (1998) Chicago working paper in Law and Economics available at www.law.uchicago.edu/Publications/Working/index.html. assessed on 10/10/2014, see also Bittker, B I "Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities" (1979). *Faculty Scholarship Series.* Paper 2301.http://digitalcommons.law.yale.edu/fss_papers/2301 - to determine whether taxpayers or groups of taxpayers are equals or unequal, equity theorists compare their pretax economic incomes

[103] Palmer (1989)

[104] For example, the state may grant a tax holiday or incentives to certain class of residents or non-residents. It may also exempt them totally from the tax regime. This segregation violates the fairness principle but in order to achieve an economic goal the state may close its eyes to that aspect.

[105] Thus, there are two competing interests: the taxpayers (both residents and nonresidents) want to be treated equally and fairly, on the other hand the state wants to maximize its economic efficiency. Therefore, tax legislation must be designed to balance these interests.

derived from activities such as labour and active domestic businesses or passive capital investment.[106] However, the residence-based system calls for close interaction between the states, especially in respect of capital investment by their respective residents so that taxpayers are treated equally regardless of where they derive income. Lack of consistency in matters of fiscal definition may lead taxpayers to invest in states which offer greater certainty in this regard, even at the cost of a lower after-tax return .

Creating a balance between economic efficiency and tax fairness at the international level, requires that tax policy should centre on two fundamental questions: 1) from which perspective is the efficiency of the tax regime to be judged – globally or domestically? 2) Is Capital Export Neutrality (CEN)[107], Capital Import Neutrality (CIN)[108] or National Neutrality (NN)[109] the optimal benchmark to employ in assessing a tax regime?[110] Most writers[111] seem to support an analysis from a global perspective, with some[112] supporting CEN while others[113] support CIN; but some writers support neither.[114] CEN aims at

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[106] Knoll, MS 'Reconsidering international tax neutrality' (2011) 64 Tax L. Rev. 99; Shaheen F 'International tax neutrality: reconsiderations' (2008) 27 Va. Tax Rev. 203.

[107] Involves using foreign tax credits in order to provide relief from double taxation.

[108] That is using exemptions from domestic tax to relieve double taxation.

[109] That is tax policy of a state should have focused on the national interest rather than global. Shaviro introduced a theory titled 'prisoner's dilemma' in making case for cooperation between national and international interest which taking any tax policy decision. But he conceded that no country can purse global welfare at the expense of its own national welfare. Shaviro DN 'Why worldwide welfare as a normative standard in US tax policy? (2007) 60 Tax L. Rev. 155

[110] Kleinbard ED 'The lesson of stateless income' (2012) 65 Tax L. Rev 99

[111] Ibid, and Roxan (2012) Shaviro (2007) supra note 63

[112]Devereux MP 'Taxation of outbound direct investment: Economic principles and tax policy considerations' (2009) 24 Oxford Rev. Econ. Pol'y 698, Frisch DJ 'The economics of international tax policy: some old and new approaches (1990) 47 Tax Notes 581

[113] Knoll (2011) , Green RA 'The future of source-based taxation of the income of multinational enterprises' (1993) 79 Cornell. L. Rev. 18

[114]Shaviro DN 'Rethinking foreign tax credibility' (2010) 63 Nat'l Tax J. 709, Greatz, MJ 'Taxing international income: inadequate principles, out-dated concepts and unsatisfactory policies' (2001) 54 Tax L. Rev. 261 –The famous distinction between CEN and CIN was invented by Richard Musgrave and his wife Peggy Musgrave, and has been discussed endless in the literature. This 'battle of neutralities' has never shows a winner. For example, neither the OECD nor the ECJ has expresses a clear preference for a particularly method, there is and will probably never be sufficient evidence on what form of neutrality is in the best interest for the international community.

achieving neutral tax behaviour as between investing domestically and abroad and this can only be achieved through residence-based taxation.[115] By contrast, CIN aims at neutral tax behaviour between domestic and foreign investors by using exemptions, and this approach favours source-based taxation.[116]

There is some dispute as to the appropriateness of tax efficiency in a tax policy analysis. Developed countries tend to consider efficiency as appropriate to tax analysis while developing countries tend to view efficiency as a consideration that favours developed countries.[117] What all states require is to apply equitable principles that can check trading imbalances, in terms of capital flows and technology transfer.[118]

CIN and CEN are thus the means for improving tax efficiency on the international, not the domestic level. Greatz argues that neither CIN nor CEN plays any role in US international tax policy.[119] They are a framework for achieving efficiency in the global arena rather achieving tax-neutrality domestically (by doing away with all exemptions and foreign tax credits) and ought to be a focal point in tax policy analysis. He further states that international tax policy analysis concentrates on tax neutrality whereas equity and fairness hold centre stage in the domestic tax policy analysis.[120] He is of the view that it is wrong to say that globalisation signals the demise of national identity or national policies,[121] for economic globalisation does not lead to a

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[115] Roxan (2012) for contrary view see also Shaheen (2008) (The CEN and other neutrality theories are best and simultaneously satisfied by source-based taxation.)
[116] Ibid
[117] Cockfield A 'Purism and contexualism within international law analysis: How trading analysis fails developing countries' (2007) 5 (2) E-journal of tax research 199
[118] Ibid
[119] Greatz, MJ 'Taxing international income: inadequate principles, out-dated concepts and unsatisfactory policies' (2001) 54 Tax L. Rev. 261
[120] Ibid
[121] Yoo, J and Ku, J 'Globalization and Sovereignty' (2013) 31 Berkeley J. Int'l Law. 210 at 211

form of global government.[122] Cockfield[123]identifies theoretical, empirical and behavioural uncertainties as factors that reduce the utility of the efficiency principle. However, Shaviro argues, that criticism of US tax policy for focusing excessively on global norms such as CEN and CIN rather than on the interest of the American people is misguided.[124] He views CEN and CIN as tools for promoting national welfare in a broader setting.

National and international tax interests diverge, and no foreign body can reconcile the differing interests.[125] Hence, from the perspective of domestic taxation, both CEN and CIN are inferior to national neutrality.[126] National governments assign a tax burden and provide benefits to citizens and residents. At the international level, the issue of neutrality arises where two or more jurisdictions lay claim to be entitled to levy tax on income from an international transaction, the one jurisdiction on the basis of where the investment took place and the other jurisdiction on the basis of where the investor resides. In a domestic context, only one organ lays claim to tax, using either residence or source as the connecting factor.[127]

As noted earlier, the state can have a connection with the taxpayer either because the economic activity that generated income took place within its territory, or because the taxpayer resides in that state. However, the jurisdictional rules that define the economic activity or the income earner are characterised by inconsistencies and conflicts both at the domestic and the

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[122] Rosenbloom, HD ‘International Tax Arbitrage and the International Tax System’ (2000) 53 Tax L. Rev. 137 at 166

[123] Cockfield (2007) see also Hasen D ‘Tax neutrality and tax amenities’ (2012) 12 (2) Fla. Tax Rev. 62

[124] Shaviro, DN ‘Why worldwide welfare as a normative standard in US tax policy? (2007) 60 Tax L. Rev. 155

[125] Cockfield A ‘Purism and contexualism within international law analysis: How trading analysis fails developing countries’ (2007) 5 (2) E-journal of tax research 199

[126] Shaviro, DN (2007) at 155

[127] Hasen D ‘Tax neutrality and tax amenities’ (2012) 12 (2) Fla. Tax Rev. 62

international level.[128] These issues could affect the commercial decisions of the taxpayer. To avoid this predicament, the definitional rules as to the source of income and of residence should be designed in a neutral form. Economic efficiency as a policy issue always asks whether the tax system promotes or hinders economic efficiency and the extent to which the tax regime distorts the behaviour of the taxpayer.

Considerations of administrative efficiency, on the other hand, suggest that the state should have a tax system that can be efficiently administered and enforced at low cost.[129] Taxpayers, for their part, want the tax regime to be simple and certain in its application. Tax administrative efficiency as a tax policy issue relates to enforcement of the rules of the tax jurisdiction. The nature of the tax imposed determines the mechanism for such enforcement. States usually impose taxes without regard to the juridical or other nature of the taxpayer.[130] For instance, consumption tax system assesses and collects taxes regardless of the identity or circumstances of the taxpayer; by contrast, in an income tax system, the character of the taxpayer is crucial for both the imposition and the collection of tax. Thus, in the realm of enforcement jurisdiction, tax regimes

[128] The inconsistencies do occur in the national legal regime. For instance, the determination of residence rule as contains in sections 2, 8 (7), 15 and 27 of the Nigerian Personal Income Tax Act 2004 (as amended) amplified by the 1st schedule to the Act. (Detailed analysis of these provisions will be made later in this thesis) The conflicts, on the other hand, do happen at international as a result of different definitional rule adopted by various countries. That is to say, two or more countries can claim tax jurisdiction over the same income of one person, due to the divergence of definition of the income or the income earner as the case may be.

[129] Williams, RC (2006) at 4

[130] Zolt EM 'The uneasy case for uniform taxation' (1997) 16 Va. Tax Rev. 39 103; Substantive jurisdiction to impose tax relates to the power of the state to impose a tax on its residents and on the income sourced from its territory. Whereas enforcement jurisdiction relates to the power of the state to compel the collection of tax over which it has substantive jurisdiction. See Hellerstein W 'Jurisdiction to tax income and consumption in the new economy: a theoretical and comparative perspective' (2003) 38 (1) Ga. L. Rev 1.

can be either 'taxpayer-dependent'[131] (as in the case of income tax) or 'taxpayer-independent'[132] (in the case of consumption tax).

The tax enforcement jurisdiction aims at achieving tax compliance at low administrative cost. Achieving this goal depends on the character of the taxpayer (such as whether he is resident or non-resident) as well as the nature of the income earned by the taxpayer.[133] Administrative efficiency as a tax policy issue always centres on the fairness of compliance and enforcement and on the administrative cost of such enforcement.[134] To maximise revenue generation at a lowest cost, the State imposes collection and the supply of information obligations on classes of persons other than the earners of the income in question. The collection (or remission) of tax can beh achieved by a withholding tax regime[135] which can raise tax residency issues.

One of the problems associated with enforcement in a withholding system is that the system treats residents of the state unequally. Assuming, for example, that one resident works in either the public or private sector, and the other is

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[131] This type of regime requires knowing the personality of the taxpayer as well as the place where he derived the taxable income. Hence the taxpayer is obliged to furnish the taxing authority with information relating to his personality (especially where he resides) only or information relating to where he derived the income only or both depending on whether the taxing authority operate residence or source-based taxation.

[132] Under this regime, character of the taxpayer is immaterial in assessing and collecting the tax imposed. This where the regime appoints a withholding agent (in case of income tax) or collecting agent (in case of consumption tax)

[133] Zolt (1997) supra

[134] Schizer, DM 'Enlisting the Tax Bar' (2006) 59 Tax L. Rev. 331,

[135] Lederman, L 'Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance' (2007) 60 Stan. L. Rev. 695 (withholding uses both employee and employer as third party enforcer of their respective obligations). Withholding tax regime is an advance tax payment deducted and withheld from any income due to a taxpayer for onward remittance to the relevant tax authority as the final seeettlement income tax liability of the taxpayer. The deduction and remittance are obligations imposed on the person making payment to the taxpayer. Failure to withhold and remit to the tax authority attracts punitive fines and penalties. The withholding tax regime is administratively simple to implement as oppose to direct assessment and collection that attracts high compliance cost. It is the effective means of taxing passive income flows crossing State borders. See Zee, HH 'Taxation of financial capital in a globalized environment: the role of withholding taxes' (1998) 51 (3) National Tax Journal 587 at 596

self-employed, and they earn the same amount. The withholding system deducts tax from the former's earnings, but not from the latter's. According to Kahng, a withholding system is usually applied to income derived from labour rather than from capital investment.[136] Horizontal equity requires a justification for having different enforcement rules.

The literature[137] that argues against the different treatment given to income from labour and income from capital investment makes the point that the enforcement mechanism also treats the two form of income unequally. For example, the income of an independent contractor, trading business or partnership is not subject to the withholding mechanism. Consequently, where two residents of a state derive the same amount of income, the enforcement mechanism may be applied to them differently.

There could be a trade-off between equity and efficiency in a quest for a fair enforcement mechanism that has a higher compliance rate at low administrative cost. A taxpayer-independent tax regime may raise questions regarding the fairness of appointing a withholding or collecting agent to collect tax.

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[136] Kahng L 'investment income withholding in the United States and Germany' (2010) 10 (3) Fla. Tax Rev. 316

[137] Kahng (2010) Turnier, WJ 'Theory Meets Reality: The Case of the Double Tax on Material Capital, 27 Va. Tax Rev. 83 (2007) (He analysed the various ways in which income from capital and income from labor are treated differently); Buckley, J 'Tax Changes Since Woodworth's Time: Implications for Future Tax Reform' (2008) 34 Ohio N.U. L. Rev. 1 at 7 – 8; Lederman (2007); Cavetti, LU 'Automatic informatics information exchange vs the withholding tax regime globalization and increasing sovereignty conflicts in international taxation (2013) 5 (2) World Tax Journal

3.2.3 Certainty

Fairness and efficiency in a tax system cannot be achieved if the objectives of the tax policy are not certain. Certainty includes qualities such as simplicity, clarity and consistency.[138] In determining the tax liability of a person, the state may utilise both objective and subjective criteria, but shortcomings in the design of such tests, which results in their being less than clear and straightforward may leave a taxpayer in uncertainty as to his tax liability and result in a loss of confidence in the tax system. The certainty and simplicity of a provision are assessed by assessing its opposite quality, namely, its complexity.[139] The question is how to assess the complexity of a tax provision?

The usual methods for identifying the complexity of tax provisions are: 1) the ease of readability of the law; 2) the compliance cost to the taxpayer; 3) the volume of the statutory provisions. Inconsistency between the taxing provisions of the various state's fiscal legislation can lead to the undesirable outcomes of double or even multiple taxation of the same income. The rules, inter alia, for determining fiscal residence, ought therefore to be expressed in simple and clear language.

3.3 Residence-Based Taxation

There is broad agreement on the two general principles that underlie residence-based taxation. Taxpayers that have a sufficiently close nexus to the state are treated as 'residents' of that state, and are consequently liable to tax on their global income. Taxpayer who lack such a nexus are regarded as 'non-residents' and are liable for tax vis-à-vis that state only on the income they derive from or

[138] Cooper, G 'Themes and Issues in tax simplification' (1993) 10 Aust. Tax Forum. 417.

[139] Tran-Nam, B 'Tax Reform and tax simplicity: A new and 'simpler' tax system?' (2000) 6 UNSW Law Journal 6

which is connected with the state. As was noted earlier, where individual taxpayers are concerned, the ability-to-pay and the benefits they receive from the state provide the theoretical justification for residence-based taxation. Moreover, residence within a state enables that state to determine the capacity of the individual to pay tax on his overall income.

In the case of corporations, there is greater difficulty in ascertaining ability to pay, and the principle of ability to pay consequently has no role in tax policy, in that tax liability is determined simply on the basis of the quantum of taxable income; the ability to pay of its shareholders is of course not a consideration[140] because they have no liability for the corporation's tax, save where anti-avoidance statutory provisions provide otherwise.

Corporate tax must thus be justified on grounds other than ability- to-pay. [141] There are two competing methods of taxing a corporation. The first is the integration of both corporate and individual income tax into a single system. In the second method, a corporation can deduct the dividend it pays to its shareholders. The shareholders then pay tax on the dividend at the individual level.[142]Where a state adopts a residence-based system, the state must provide a

[140] K 'The Debt-Equity Distinction in a Second-Best World' (2000). 53 Vand. L. Rev. 1055, 1113 at 1114

[141] Fleming, J C et al 'Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income' (2001) 5 Fla. Tax Rev. 299

[142] For detailed discussion on this systems see: Graetz MJ and. Warren AC 'Unlocking business tax reform' (2014) Tax Notes 707 See also Graetz MJ and Warren, AC 'Integration of Corporate and Individual Income Taxes: An Introduction' (1999) Tax Notes, Sept. 27, 1767Graetz MJ and. Warren AC, 'Income Tax Discrimination and the Political and Economic Integration of Europe,' (2006). 115 Yale L. J. 1186; Amiram D et al., ''Tax Avoidance at Public Corporations Driven by Shareholder Demand: Evidence From Changes in Shareholder Dividend Tax Policy' (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2111467; Ikin C and Tran, A 'Corporate Tax Strategy in the Australian Dividend Imputation System,' (2013) 28 Australia Tax Forum 523; Vann, RJ 'Corporate Tax Reform in Australia: Lucky Escape for Lucky Country?' (2013) 1 Brit. Tax Rev. 59-75

framework for determining who its residents are. However, as has already been noted, states differ in their determination of 'resident' and 'non-resident'.

The distinction between residence and source-based systems is irrelevant to the person who earns and invests his income in the state he resides. The distinction becomes relevant where a person derives his income in a state other than where he resides, for in such a situation, the state where the person resides and the state from which he derives the income may both assert a taxing power over the same income. In resolving such conflicting claims, the state of residence may recognise the primary right of the source state to tax the income derived from within its territory.[143] This could be implemented through the instrumentality of a 'foreign tax credit'. Alternatively, the state of residence may recognise the exclusive right of the source state to tax the income through the mechanism of a 'foreign tax exemption'. The conflict occurs where one state adopts a residence-based tax sytem, and the other adopts a sourced-based system.[144]

Situations can occur where an overlapping taxing power occurs between two or more states that have both adopted a residence-based system. In resolving this kind of conflict, the affected states commonly resort to Double Taxation Agreements (DTA) to resolve the conflicting jurisdictional claims and enhance co-operation between them. A DTA is a bilateral treaty entered into by the two states involved. However, the point has already been made that, due to global economic integration, the network of bilateral tax treaties cannot serve the desired coordination objective. That is why many commentators[145] have called

[143] Dagan, T 'The Tax Treaties Myth' (2000) 32 N.Y.U. J. Int'l L. & Pol. 939 at 980
[144] This is outside the scope of this research.
[145] Cockfield, AJ 'International Tax Competition: The Last Battleground of Globalization' (2011) 63 (12) Tax Notes International 867; from the empirical research conducted there are more than 2600 DTA around the globe. See Braun, J and Zagler, M 'An economic perspective on double tax treaties with(in) developing countries' (2014) 6 (1) World Tax Journal 1. Sawyer, A 'Developing an international (world) tax organisation for administering binding rulings and APAs – the way forward (2006) 21 Austl. Tax Forum 287 (He examined the possible model of the international tax

for a shift from a bilateral treaty regime to a multilateral treaty[146] in order to address the issue of divergence of tax laws between states. As has already been noted, multilateral tax treaties may come under constitutional challenge on the ground of a diminution of states tax.[147]

3.4 Conclusion

The reality of global economic integration erodes the exclusive tax jurisdiction of states. In economic terms, the states' borders are fading, and the domestic laws of tax jurisdiction and the network of bilateral tax treaties[148] are being questioned. This can encourage taxpayers to exploit any ambiguity created by the divergence of the definition of tax residence between the States, hence the need for achieving inter-states co-operation in delimiting their tax jurisdiction without losing their sovereignty. This research explores the possibility of reaching cooperation amongst the states in defining the scope of their substantive and enforcement tax jurisdiction.

The usual approach to cooperation is bilateral tax treaties.[149] The tax treaties focus on protecting the tax base of the party-state, ignoring the taxpayers who face conflicting claims due to inconsistencies in the definitional rules of tax

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organisation, balancing between creating an independent body or to subsumed it into the existing international organisations like WTO or IMF.). see also Raad, KV 'International Coordination of Tax Treaty Interpretation and Application' (2001) 29 Intertax 212 Thuronyi, V 'In Defense of International Tax Cooperation and a Multilateral Tax' Treaty' (2001) 22 Tax Notes International at 1291; Pinto, D 'A Proposal to Create a World Tax Organisation' (2003) 9 New Zealand Journal of Taxation Law and Policy at 14. Hadida, J 'Prospects for Multilateral Cooperation in Taxation' (2006) unpublished LL.M Thesis submitted to the Institute of Comparative Law, Faculty of Law, McGill University Montreal, Canada.

[146] Which could be either regional (like Nordic countries tax treaty) or global tax treaty.

[147] XU, M 'Road forward to a multilateral tax treaty regime? ' (2014) Global Tax News available at hhtp://www.dlapiper.com/en/global/insights/publication/2014/10 assessed on 10/5/2015 (He observed that the proposed multilateral tax treaty would require significant changes to the domestic tax laws. Therefore, the states that are highly protective of their sovereignty such as US China Russia and the UK are not likely to endorse to the proposal. Thus, the proposal may end up remain at regional level.)

[148] That resolves jurisdictional conflict between two states.

[149] Or the recent call for multilateral tax treaty.

jurisdiction of the States.[150] This research argues that co-operation should be achieved through *comparative analysis of the definitional rules* to ascertain the extent of convergence and divergence and how they could extend mutual respect for each other's tax sovereignty and balance their interests against that of the taxpayers in defining the tax residence outside the realm of tax treaty regime.

The next chapter analyses the alternative cooperation mechanism envisaged by the thesis. This involves a shift from the tax treaty regime to a comparative analysis model. Chapter five has comparative analysis of the concept of fiscal residence as applicable in selected jurisdictions that are representative of global legal families. For the purpose of an in-depth analysis of the definitional rules, the research is restricted to Nigeria and South Africa as two pilot states. The research examines the level of convergence and divergence of the Nigerian and South African legal regimes in this regard.

[150] DTAs usually contain Mutual Agreement Procedure (MAP) provision. The MAP supposed to be a mechanism for resolving disputes arising from the DTA. However, the taxpayer involved in the dispute is not a party to the MAP. It is purely between the competent authorities of the party-states. This prove the assertion that the focus of the treaty regime is on the treaty partner not the taxpayer.

CHAPTER FOUR

FISCAL RESIDENCE: INTERNATIONAL TAX COOPERATION OUTSIDE TAX TREATY REGIME

Table of Contents

4.0 Introduction:

Historically, jurisdiction to levy tax was conceived as a national issue with exclusively domestic implications.[1] Consequently, sovereign states could devise their domestic tax rules, without regard for conflict with other states.[2] Consequently, there tended to be significant divergence between states in designing their respective tax systems, including their definition of key terms, such as that of residency, and the formulation of the power to levy and collect tax from taxpayers residing within its boundaries.[3] The domestic definition of fiscal residence determined resident or non-resident status. However, cross-

[1] Utz, SG 'Tax Harmonization and Coordination in Europe and America' !1994) 9 Conn. J. Int'l L. 767 at 768
[2] Avi-Yonah, RS 'International tax as international law' (2004) 57 Tax L. Rev. 483
[3] Martha RSJ 'The jurisdiction to tax in international law: Theory and practice of legislative fiscal jurisdiction (1989) Kluwer Netherland, 11

border business activities of course make it possible for the residents of one state to derive income from another or other states.[4] The interaction of the various definitional rules of fiscal residence could led to jurisdictional conflict between states and to double taxation. For their part, taxpayers could attempt to exploit conflicting rules to their advantage, to the detriment of revenue collection by the taxing states.

The need for avoiding such conflict makes it imperative for the states to co-operation with each other in fiscal matters. The co-operation mechanism could be by way of a unilateral approach, whereby a state may provide for the exemption of a certain class of income or provide a credit for foreign tax paid by a resident. This approach could be effective if it was reciprocated by other states. In a bilateral approach, the requisite reciprocity is secured by way of a binding agreement between two states, inter alia for the prevention of double taxation. Double Taxation Agreements (DTAs) generally follow one of two models: the OECD model or the UN model. The OECD model is the more widely used.

As was noted earlier, economic integration triggered by globalisation has impacted the viability of bilateral treaty regimes. The OECD has recognised the weakness of the bilateral treaty regime, hence the inclusion of multilateral initiatives in its Base Erosion and Profit Shifting (BEPS) project. The OECD-BEPS project set up fifteen action plans for the actualisation of the project.[5] The OECD recognised that the implementation of the BEPS Action Plans would

[4] Townsend, A 'The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition' (2001) 25 (1) Fordham Int'l L. J. 215 at 221

[5] For instance, Action Plan 2 inter alia recommended certain changes in both the domestic rules the OECD Model Convention to neutralise the effect of hybrid mismatch. Action Plan 14 recommended the improvement of the Mutual Agreement Procedure (MAP) which involve the inclusion of a mandatory binding MAP Arbitration.

take a long time if every bilateral tax treaty had to be amended individually. Therefore, Action 15 has created a process to develop a multilateral instrument. In the same vein, commentators have argued for the adoption of a multilateral approach to tackling double taxation and its associated problems.

Treaty regimes cannot provide a long-term solution to these problems. This thesis explores by way of a comparative analysis the resolution of potential conflicts caused by the interaction of different domestic rules for defining fiscal residence. This chapter has highlighted the nature of the current mechanisms for tax co-operation (the treaty regimes) and role played by the OECD. It has also shown the impact of globalisation on the regime as well as the nature and scope of the OECD-BEPS initiatives. This chapter has also explored the framework for the comparative analysis envisaged by the thesis.

4.1 Overview of the current International tax cooperation mechanism

Global economic integration paves the way for increased participation in cross-border business transactions which highlight the interaction of various domestic rules. These interactions inevitably engender conflicts between the definitional rules of residence designed by various states which may negatively affect both the states and the taxpayers. The states may lose revenue when the taxpayers explore the opportunities created by the conflicting rules to avoid or minimise their tax liability.[6]

For their part, taxpayers may be exposed to the danger of double taxation. Double taxation is of two types, namely, juridical and economic double

[6] Brauner, Y 'What the BEPS?' (2014) 16 FLA. Tax Rev. at 7-8; Avi-Yonah, RS 'Double Tax Treaties: An Introduction, In Karl P. Sauvant & Lisa E. Sachs eds. 'The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties and investment flows' (2009); Dagan, T 'Community Obligations in International Taxation' (2015) available at: http://ssrn.com/abstract=2736923

taxation. The former occurs where one person is subject to tax on the same income or capital by more than one state.[7] The latter occurs where two different persons are subject to tax on the same income or capital.[8] Domestic laws usually permit economic double taxation. For instance, where a corporation is taxed, and the shareholder is also taxed on the same income when the company distributes the profits as a dividend. Economic double taxation could be unilaterally avoided by adopting an integrated corporate and shareholder tax. Integration takes place when the law gives the corporate shareholder credit for all or a portion of the corporate taxes that have been paid.[9] The co-operation envisaged in this thesis focuses on the mechanisms for avoiding juridical double taxation rather than on economic double taxation.

Even if states design their tax residence rules with the same objective in mind, a failure to take the rules of other jurisdictions into consideration could frustrate the policy goals of both jurisdictions which may together have an effect on

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[7] Juridical double taxation occur when two States, with inconsistent definitions for determining the tax residence, impose a world-wide income tax on either individual or corporation. For instance, State A may adopt incorporation test in determining the corporate tax residence, whereas State B may apply CMC or POEM tests for ascertaining the corporate residence. In the same vein, State A may adopt physical presence test treat forrr determining the residence of an individual. However, state B may apply ordinary resident test for determining the residence of that same individual. This type of double taxation can be eliminated on the basis of tax treaties using the tie-breaker rules contained in Article 4 paragraphs 2-3 of the tax treaties, which determine the states, which would qualify as the only country of residence of the person in question. Dean SA 'Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation' (2007) 58 Hastings L.J. 911 at 939 see also Vogel, K 'Double Taxation Conventions' (3rd ed) Kluwer Law International, at 1124.

[8] Ibid at 1124

[9] For detailed discussion on this systems see: Graetz MJ and. Warren AC 'Unlocking business tax reform' (2014) Tax Notes 707 See also Graetz MJ and Warren, AC 'Integration of Corporate and Individual Income Taxes: An Introduction' (1999) *Tax Notes*, Sept. 27, 1767Graetz MJ and. Warren AC, 'Income Tax Discrimination and the Political and Economic Integration of Europe,' (2006). 115 Yale L. J. 1186; Amiram D et al., ''Tax Avoidance at Public Corporations Driven by Shareholder Demand: Evidence From Changes in Shareholder Dividend Tax Policy' (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2111467; Ikin C and Tran, A 'Corporate Tax Strategy in the Australian Dividend Imputation System,' (2013) 28 Australia Tax Forum 523; Vann, RJ 'Corporate Tax Reform in Australia: Lucky Escape for Lucky Country?' (2013) 1 Brit. Tax Rev. 59-75

taxpayers that neither jurisdiction foresaw.[10] Thus, the success of a state in enforcing its tax rules can depend on the impact those rules have in other states. Therefore, to avoid the consequences of double taxation, there is a need for co-operation among the states in designing their respective definitional rules for a fiscal residence. It has been argued that international cooperation in tax matters may serve the long-term interests of a state.[11] States can reduce the risks of double taxation through unilateral relief in their respective domestic laws or by way of bilateral relief in double taxation agreements (DTAs).

The co-operation may be in the form of a unilateral action of the states using their domestic laws.[12] The unilateral mechanism has been described as the most important means of resolving overlapping definitional rules.[13] Under the unilateral approach, a state may make provision in its domestic legislation for an exemption from tax for certain types of income that may be taxed by other

[10] Daine argued that "Those inconsistencies matter because taxpayers (and their capital) can cross borders with relative ease. In a sense, those tax conflicts are analogous to those that could be produced by the choice of driving on the left or right side of the street. There may be slight advantages to driving on a given side (say, if right-handed drivers drive more safely on the right side of the street). But so long as left-driving and right-driving vehicles find it more difficult to move from one jurisdiction to another than it is for capital to move around the globe, there will be relatively few accidents triggered by the differences among jurisdictions. Because taxpayers face little difficulty in moving assets around the globe, there is a significantly greater likelihood the equivalent of a left-driving car will find its way into a right-driving jurisdiction." Ring, DM 'One Nation among many: policy implications of cross-border tax arbitrage' (2002) 44 B.C. L. Rev. 79; see also Ring, DM 'International tax relations: theory and implications' (2007) 60 Tax L. Rev.

[11] Shaviro, D 'Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?' (2007) 60 Tax L. Rev. 155; see also Dagan, T 'The Costs of International Tax Cooperation' Working Paper No. 1-03, January 2003 (who argued that It is widely agreed that double taxation should be eliminated. It is also agreed that it is better for a state to eliminate double taxation unilaterally, even without cooperation from other states.)

[12] Unilateral cooperation effort generally by way of granting exemption to certain types of income that may be taxed by other countries, or by providing a deduction or credit against domestic taxes for the foreign taxes paid. See Shaviro, DN 'Rethinking Foreign Tax Creditability' (2010) 63 Nat'l Tax J. 709 at 710

[13] Christians, AD 'Tax Treaties for Investment and Aid to Sub-Saharan Africa A CASE STUDY' (2005) 71 (2) Brooklyn L. Rev. 639 at 650 ("most other countries imposing worldwide income taxation generally relieve double taxation on a unilateral basis under statutory law. The same result is attained under treaties.") Dagan, T 'The Tax Treaties Myth' (2000) 32 N.Y.U. J. Int'l L. & Pol. 939 at 980 (Arguing that "tax treaties play a negligible role or are not needed at all in relieving double taxation, if each state would unilaterally relieve double taxation in their domestic laws.")

countries. Alternatively, the state may to allow double taxation to take place but permit a deduction or credit against domestic taxes for the taxes paid by its residents in another state.[14]

However, unilateral solutions may negatively affect the revenue of a state where other countries do not reciprocate the concessions made or if the concessions are made even in the absence of overlapping definitional rule.[15] Thus, coordinated reciprocity is required if the two states are to share the benefits of unilateral tax concessions. For instance, state 'A' cedes its jurisdiction to tax its resident by way of granting foreign tax credit in its domestic law. However, state 'B' does not grant a tax credit or any other similar mechanism for relieving double taxation of their residents. In this situation, business and investment in state 'A' will be disadvantaged compared to doing business and investment in state 'B' country. Thus, the residents of state 'B' may prefer to do all their business and investment at home without engaging in any form of cross-border transaction. Therefore, the failure of the state 'B' to reciprocate what state 'A' has done curtails capital flow from state 'B' to state 'A'. This gives rise to a need for another mechanism for attaining the desired reciprocity in resolving the jurisdictional conflict. This mechanism is an international agreement that divides the taxing right among states and prevents overlapping or conflicting rules.[16] The international agreement referred to here is the tax treaty or double taxation agreement (DTA).

[14] Ibid at 170; see also
[15] Christian, AD 'How Nations Share' (2012) 87 (4) Indiana Law Journal 1407 at 1416
[16] Christians, AD 'Sovereignty, Taxation and Social Contract' (2009) 18 Minn. J. INT'L L. 99

4.1.1 Tax Treaty

The interaction of different definitional rules often raised the following questions on how to impose a tax on the income.[17] The questions are: who taxes the income? Whose rules apply? What happens when the states involved disagree? Which state is to prevail and why? In order to address these questions, states need to cooperate in designing a solution to the problems associated with the different rules.[18] As discussed above, tax treaty is currently the chosen mechanism for addressing the questions raised.

Double tax treaties are international agreements, generally between two states that serve as the instrument for designing reciprocal jurisdictional concessions.[19] The primary role of these treaties is to prevent the incidence of double taxation caused by the interaction of different definitional rules. DTAs limit the circumstances in which or the extent to which, one state's taxes will apply to residents of the other state. Tax treaties do not impose taxes or create an alternative joint tax regime. The DTA only coordinates the operative provisions of each treaty partner's tax rules.[20] Thus, the tax liability of a taxpayer is determined by reading the tax treaty in conjunction with domestic rules of each of the treaty partners.

Despite the significance of states' cooperation in remedying potential inter-jurisdictional conflict, states tend to be reluctant to surrender their tax

[17] Ring, DM 'International Tax Relations: Theory and Implications' (2007) 60 TAX L. REV. 83; Diane M. Ring, DM 'One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage' (2002) 44 B.C. L. REV. 79

[18] Despite the need for states' cooperation in remedying the potential inter-jurisdictional conflict, the states are quite reluctant to surrender their autonomy in this area. Rosenbloom, HD 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 Can.-U.S. L.J. 267 at 268

[19] Prussia and Austria tax treaty of 1899 was the first bilateral tax treaty. See Holmes, K 'International Tax Policy and Double Tax Treaties An Introduction to Principles and Application' (2014) (2nd ed) IBFD Publication, Amsterdam

[20] Dean SA 'Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation' (2007) 58 Hastings L.J. 911 at 942

sovereignty for the sake of tax cooperation.[21] That is to say state take different views on the appropriate terms to be inserted into their DTAs. Hence, the need for international co-operation.

Current efforts at international cooperation originated in the 1920s attempt by the League of Nations to eliminate juridical double taxation and to allocate taxing rights between states.[22] The committee set up by the International Chamber of Commerce (ICC) urged the League of Nations to eradicate the evils of double taxation by using a multilateral approach.[23] In 1920 the Provisional Economic and Finance Committee of the League of Nations reviewed this recommendation and in its final report of 1923, the committee rejected the idea of a multilateral convention. The recommendation of the League of Nations' Committee led to the 1928 model convention for the elimination of double taxation which left many details for bilateral negotiations.[24]

The model embodies an international consensus on the manner in which jurisdiction to tax should be divided between residence-based and source-based tax jurisdictions to prevent double taxation.[25] The consensus was that jurisdiction to tax active business income is accorded to the country of source, and jurisdiction to tax passive investment income is granted to the residence country.[26] The efforts of the League of Nations contributed substantially to the

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[21] Rosenbloom, HD 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 Can.-U.S. L.J. 267 at 268

[22] Rixen, T 'The Institutional Design of International Double Taxation Avoidance' available at http://mpra.ub.uni muenchen.de/8322/

[23] Morriss AP and Moberg, L 'Cartelizing Taxes: Understanding the OECD's Campaign against "Harmful Tax Competition" (2012) 4 Colum. J. Tax L. 1 at 33

[24] BRUINS, GWJ Et al. 'Report on Double Taxation: Submitted to the Financial Committee, of the League of Nations, Economic and Financial Commission (1923).

[25] Graetz, MJ and O'Hear, MM 'The "Original Intent" of U.S. International Taxation' (1997) 46 Duke L.J. 1021 at 1094-95

[26] Avi-Yonah, RS 'The Structure of International Taxation: A Proposal for Simplification' (1996) 74 Tax. L. Rev. 1301 at 1306

design of existing bilateral treaties and formed the basis for the current OECD and UN Models of tax treaties.[27]

4.1.2 The OECD Model Tax Convention as a baseline for DTA

The OECD model DTA allows pairs of nations to negotiate openly for taxing rights.[28] Most international tax conflicts arise between tax systems that are very similar.[29] Thus, the model takes two similar tax regimes and refines those similarities.[30] The main aim of the OECD model DTA is to provide guidance to states wishing to enter into a bilateral DTA with appropriate provisions inserted into the agreement.[31] Thus, the model DTA is the starting points for the states' DTA negotiations. However, there is, no binding obligation in this regard as the model is not enforceable. The efforts of the OECD in developing a system for the avoidance of double taxation picked up where the preliminary research of the League of Nations left off.[32] Thus, the OECD Model was based on a series of model treaties promulgated by the League of Nations. It has been updated several times to cope with the developments in technology and the international economy, and the impact of globalisation.[33]

[27] Vogel, K 'Double Tax Treaties and Their Interpretation' (1986) 4 Int'l Tax & Bus. Law. 1 at 10 (The League of Nations' fiscal committee developed two additional models: the Mexico Draft in 1943 and the London Draft, in 1946). See also Morriss, AR and Lotta Moberg, L 'Cartelizing Taxes: Understanding the OECD's Campaign against "Harmful Tax Competition' (2012) 4 COLUM. J. TAX L. 1, 33

[28] Dagan, T 'The Tax Treaties Myth' (2000) 32 N.Y.U. J. Int'l L. & Pol. 939 at 98o

[29] Brauner, Y 'An International Tax Regime in Crystallization' (2003) 56 Tax L. Rev. 259, at 290

[30] Dean, SA 'More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime' (2010) 84 Tul. L. Rev. 125

[31] Daurer, V and Krever. R 'Choosing between the un and OECD tax policy models: an African case study' WU International Taxation Research Paper Series No. 2014 – 16 available at http://ssrn.com/abstract=2499980
Owens J and Bennett, M 'OECD Model Tax Convention Why it works, published by OECD Centre for Tax Policy and Administration (CTP) Available at: http://www.oecdobserver.org/news/archivestory.php/aid/2756/OECD_Model_Tax_Convention.html#sthash.EgTTMUcf.dpuf

[32] Vogel, K 'Double Tax Treaties and Their Interpretation' (1986) 4 Int'l Tax & Bus. Law. 1 at 11

[33] The OECD Model Tax Convention has been updated in 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010 and 2014. While from 1980, the UN Model Double Taxation Convention between Developed

Although DTAs are negotiated individually, the product of the negotiations is usually similar to the OECD model.[34] Indeed, the OECD Model has had such an influence on tax treaties that "one can pick up any modern tax treaty and immediately find one's way around, often even down to the article number."[35] The OECD has facilitated the development of a network of more than three thousand DTAs.[36] It standardised the treaty structure and content, which has contributed greatly to the proliferation of the tax treaty network.[37] Its standard and universal coverage provides clarity in tax practice.[38] Thuronyi[39] argues that "the OECD Model has almost acquired the status of an international agreement." The OECD Model dominates current tax treaty law.[40]

However, the international tax regime promoted by the OECD has remained a primarily soft-law based regime.[41] In addition, geopolitical changes have

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and Developing Countries has been updated twice: in 2001 and 2012 respectively. See Qureshi, AH 'Coherence in the public international law of taxation: developments in international taxation and trade and investment related taxation' (2015) available at http://ssrn.com/abstract=2600132; see also Christians, AD 'Tax Treaties for Investment and Aid to Sub-Saharan Africa a case study' (2005) 71 (2) Brooklyn L. Rev. 639 at 653

[34] A research has shown that about 75% of the language of treaties is identical to the language of the OECD model. See Brauner, Y '*What the BEPS*?' (2014) 16 Fla. Tax Rev. 55,

[35] Jones, JFA 'The David R. Tillinghast Lecture: Are Tax Treaties Necessary?' (1999) 53 Tax L. Rev. 1 at 2

[36] Rosenbloom, HD 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 Can.-U.S. L.J. 267; Brauner, Y 'An International Tax Regime in Crystallization' (2003) 56 Tax L. Rev. 259 (arguing that the OECD is the key source of international coordination); see also Cockfield, AJ 'The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenges' (2006) 8 Yale J.L. & Tech. 136

[37] Townsend, A 'The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition' (2001) 25 (1) Fordham Int'l L. J. 215 at 221

[38] Ibid

[39] Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook. J. Int'l L. 1641; see also Salzman, J 'The organization for economic cooperation and development's role in international law' (2011) 43 The Geo. Wash. Int'l L. Rev. 101 at 102; Han, S 'The Harmonization of Tax Treaties and Domestic Law' (2011) 7 BYU Int'l L. & Mgmt. Rev. 29 (the OECD Model Convention "has achieved a consensus position as the benchmark against which essentially all tax treaty negotiations take place,")

[40] Lang, M et al 'The Impact of the OECD and Un Model Conventions on Bilateral Tax Treaties' (2012) Cambridge University Press, New York

[41] Christians, A 'Hard Law & Soft Law in International Taxation' (2007) 25 Wisc. Int'l L. J; Ring, D 'Who is Making International Tax Policy? International Organizations as Power Players in a High

thrown into question the dominance of the OECD in the tax system.[42] These changes jeopardise the future of tax treaties, which are the building blocks of the current tax system. Triangular situations also give rise to another challenge to the bilateral tax regime. This is the situation where the transactions involve multiple parties to a tax treaty and span more than two tax jurisdictions.[43] Most such situations are beyond the reach of the current bilateral treaty regime. For example, an individual or company might be found to be resident in more than two tax jurisdictions.

The OECD has been unsuccessful in transforming the network of DTAs into a multilateral treaty regime.[44] This failure was a result of the reliance of DTAs on the domestic legal framework and also the institutional framework of the treaty partners. The OECD model entrenches the dependence of the DTAs on domestic laws in interpreting undefined terms.

4.1.3 Relationship between Tax Treaty and Domestic Law

Theoretically, tax treaties and domestic laws are designed to work in harmony. Art. 26 of the Vienna Convention on the Law of Treaties established principles of international law that govern the relationship between treaties and the domestic law. It provides that “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.” Furthermore, Art. 27 of the VCLT provides that “A party may not invoke the provisions of its internal law

Stakes World’ (2010) 33 Fordham Int'l L. J. 649; Ault, HJ ‘Reflections on the Role of the OECD in Developing International Tax Norms’ (2009) 34 Brook. J. Int'l L. 757 (2009); Calderón, JM ‘The OECD Transfer Pricing Guidelines as a Source of Tax Law: Is Globalization Reaching the Tax Law?’ (2007) 35 Intertax 4

[42] Brauner, Y and Pistone, P ‘BRICS and the Emergence of International Tax Coordination’ (2015) IBFD Publication, Amsterdam.

[43] Fett, E ‘Triangular Cases: The Application of Bilateral Income Tax Treaties in Multilateral Situations’ (2014) IBFD, Publication

[44] Rosenbloom, HD ‘Sovereignty and the Regulation of International Business in the Tax Area’ (1994) 20 Can.-U.S. L.J. 267

as justification for its failure to perform a treaty." This an expression of *the pacta sunt servanda* principle.

However, compliance with the international law principle mentioned above depends on each state's Constitution, laws, and judicial decisions. In some countries, domestic legislation prevails over an inconsistent provision of a treaty.[45] In some states tax treaties are legally superior to domestic law. One consequence of the legal priority given to treaties is that the tools used to interpret those treaties implicitly receive that same priority. However, in other states, domestic legislation is required to implement tax treaty obligations. In these countries, treaties are subject to repeal by later legislation.[46]

DTAs are similar and always refer to concepts embedded in the OECD or UN model treaties and the domestic laws.[47] This has led to an interface between domestic legislation and the DTAs. Indeed, DTAs explicitly state that domestic law provides the meaning of any undefined term.[48] Article 3 (2) of both the OECD and UN Model Conventions provides that:

> "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

This provision allows each of the contracting states to define any term not defined in the tax treaty by a provisions of their respective domestic law at the

[45] Han, S 'The Harmonization of Tax Treaties and Domestic Law' (2011) 7 BYU Int'l L. & Mgmt. Rev. 29
[46] John H. Jackson, JH 'Status of Treaties in Domestic Legal Systems: A Policy Analysis' (1992) 86 Am. J. Int'l L. 310, 314 at 315
[47] Kysar, KM 'Interpreting Tax Treaties' (2016) 101 Iowa L. Rev. 1387 at 1390
[48] Ibid at 1390

time the treaty is applied. That is to say; the definition is based on the provisions of the domestic law as periodically amended.[49] Thus, the domestic legislation of the treaty partners is the ultimate source of the definitional rules.

Furthermore, given the nature of the definitional rules for tax residence, the incorporation of domestic law into the DTA is inevitable. For instance, when a DTA refers to the legislation of the party states in defining residency, the domestic residence rules must be consulted for the definition. The DTA only steps in to provide tie-breaker rules. Kyar[50] argues that the determination of residence is the main issue which the DTA has delegated to the domestic law. He asserts that the incomplete and uniform nature of DTAs, the technicality of the tax system and the reality of tax abuse make DTAs unsuitable as the single interpretative mechanism. Therefore, there is a need to rely on extrinsic sources of interpretation which include the domestic laws of the treaty partners.

Due to the divergence of the definitional rules under the domestic legislation of each treaty partner, the provisions of the tax treaty may be understood differently by them. Different perceptions of the terms used in a tax treaty may lead to a continuation of jurisdictional conflict and negate the rationale of a tax treaty.[51] Thus, the application of domestic laws in interpreting tax treaties could create conflict which may, in turn, lead to double taxation which the treaty sought to prevent. Furthermore, when the meaning of a term of a tax treaty is not defined in the DTA, paragraph 3, Article 25 of the OECD Model provides

[49] Hammer, RM 'The Continuing Saga of the PE: Will the OECD Ever Get it Right?' (2004) 33 Tax Mgmt. Int'l J. 472 (arguing that "treaties may deviate from the international consensus even if they closely follow the model treaties due to periodic updates to the models and commentary thereto.")
[50] Kysar, KM 'Interpreting Tax Treaties' (2016) 101 Iowa L. Rev. 1387 at 1437
[51] Postlewaite, PF and Makarski, DS 'The ALI Tax Treaty Study—A Critique and a Modest Proposal' (1999) 52 Tax Law. 731 at 741(arguing that "when countries take different approaches to treaty interpretation, serious consequences may result, such as double taxation or the avoidance of any taxation.")

that the competent authorities of the party States shall resolve any difficulties arising from the interpretation using Mutual Agreement Procedure (MAP).

DTAs are agreements entered into by two contracting states for the elimination of double taxation. However, the agreement involves the interest of a third party— namely, the taxpayer.[52] Therefore, a breach of that agreement can be easily detected because there is a third party involved. If one of the treaty partners violates a DTA, the taxpayer will notice this violation and notify the competent authorities in the taxpayer's home country. The states then enter into MAP negotiations in order to reach an agreement over the DTA violation. Article 25 of the OECD Model sets up the mechanism for the MAP:

> "Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation, not in accordance with the provisions of the Convention."

The core objective of a tax treaty is the mutual resolution of disputes between the taxpayer and the tax authorities. The parties are concerned as to how to resolve the jurisdictional conflicts. The tax treaties usually establish a dispute resolution mechanism, that is the Mutual Agreement Procedure (MAP). The tax treaties contain a provision defining the MAP, by which the competent authorities of the two States, are authorised to resolve disputes.[53] Therefore, the

[52] Rixen, T 'The institutional Design of international double Taxation Avoidance' (2008) MPRA Paper No. 8322, available at http://mpra.ub.uni-muenchen.de/8322/
[53] Rosenbloom, HD 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 Can.-U.S. L.J. 267 at 268

MAP is a very crucial aspect of the tax treaty network. To make a request for a MAP, the taxpayer must be a resident of one of the treaty partners and must establish that an action by one or both of the States results in taxation outside the provisions of the DTA. Once the taxpayer exercises his right under MAP, the remaining process is a government-to-government relationship. However, the MAP requires close co-operation between the taxpayer and the competent authorities. The taxpayer provides information to the competent authority in his State of residence which, in turn, communicates that information to the other State.[54] The legal status of the agreement and the actual steps necessary for its implementation will depend on the applicable procedural rules adopted by the two States.

The MAP serves as a mechanism to raise issues in dispute between the competent authorities in the treaty partners so they can resolve the jurisdictional conflict. The MAP ensures that the conflict will not frustrate the DTA's goal of eliminating double taxation.[55] It has been argued that the non-mandatory nature of MAP reduces the threat posed by the international tax regime to the fiscal sovereignty of the treaty partners.[56] However, it appears that the MAP may find it difficult or even impossible to resolve successfully most of the disputes arising from DTAs. The reason is that the application of the procedure hinges on the competent authorities of the party states, which derive their respective powers from domestic laws. As with the interpretation of undefined terms of the DTA, the MAP also rely on the domestic law.

[54] Ault, HJ 'Dispute resolution: the Mutual Agreement Procedure' in Trepelkov, A et al (ed) 'United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries' (2013) UN, New York 309 - 340
[55] Ault, HJ 'Reflections on the role of the OECD in developing international tax norms' (2009) 34 (3) Brook. J. Int'l L. 758
[56] Green, RA 'Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes' (1998) 23 Yale J. Int'l L. 79

The implementation of the provisions of DTAs depends on the relevant domestic legislation of the party states. Therefore, the OECD Model and the DTAs designed from it could not address the potential conflict arising from the interaction of the local legislation. The MAP requires the taxpayer first to communicate with his state of residence. If the state cannot resolve the problem unilaterally, it has an obligation under the treaty to communicate with the other state through the MAP in order to settle the issue. However, If the two countries follow the MAP but fail to reach a mutual agreement, the taxpayer is potentially left with unrelieved double taxation, thus thwarting the principal purpose of the treaty. Therefore, there is a need for exploring tax cooperation outside the tax treaty provisions.

The weaknesses mentioned above of the OECD model and the DTAs derived from it generates new opportunities for taxpayers to reduce their tax burdens through avoidance arrangements.[57] Thuronyi suggests that multilateral treaties could redress the problems posed by bilateral treaties.[58] Genuine reform of the international tax system requires multinational action as opposed to dissected bilateral agreements. He suggests the establishment of a World Tax Organization.[59]

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[57] Thuronyi, V 'In Defense of International Tax Cooperation and a Multilateral Tax Treaty' (2001) 22 Tax Notes Int'l 1291 at 1293

[58] Thuronyi, V 'Coordination Rules as a Solution to Tax Arbitrage, 57 Tax Notes Int'l 1053 (2010); Victor Thuronyi, 'Tax Treaties and Developing Countries' in Michael Lang, M. et al (eds.) 'Tax Treaties: Building Bridges between Law and Economics' (2010) IBFD Publications, Amsterdam 441 at 455 Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook. J. Int'l L. 1641;

[59]Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook. J. Int'l L. 1641; Pinto and Sawyer have similarly made case for a world tax organization; see Pinto, D and Sawyer, A 'Building Bridges between Revenue Authorities: Would a World Tax Organisation be a Key Facilitator?' (2011) J. Applied L. & Pol'y 25; see also Sharkey, N 'A South East Asian tax organisation, (2013) Brit. Tax Rev. 175;

4.1.4 The impact of globalisation on the OECD and UN Models Convention

Globalisation has been defined as the processes of economic, social, cultural, and political integration across national borders. It brings the laws of states into direct and frequent contact.[60] Globalisation has an effect on the concept of physical territory. A person physically present in a state may communicate, interact, or work with someone abroad. [61] Thus, physical territory has become less important in defining an individual's identity. The political pressures that influence the formulation of tax laws are principally domestic. However, the ability of taxpayers to relocate themselves, their activities, or their assets to other jurisdictions and the inability of the states to monitor such moves of their taxpayers, is a reflection of the impact of globalisation.[62] This creates an external threat to the integrity of a state's tax regime.[63]

Stressing the significance of international tax cooperation in a globalised economy, Christians states that:

> "The international tax regime is flawed because of the failure of states to agree on an increasingly lengthy list of key areas. In effect, the flaw is a series of unrelieved collective action problems among states, each multiplying the harm of the other. The need for revenue to address growing inequality and growing social needs and the increasing unease about the distributional effects of regulation in an economically integrated world require that this web of collective actions be addressed and, if possible, overcome. *Further, states cannot raise revenue effectively or fairly in the modern international economic regime without interacting with other states and their citizens, as people, goods,*

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[60] Ku, J and Yoo, J 'Globalization and Sovereignty' (2013) 31 Berkeley J. Int'l Law. 210

[61] Gerber, DJ 'Globalization and Legal Knowledge: Implications for Comparative Law' (1990) Tulane Law Review, 950

[62] Terrill, R 'What Does 'Globalization' Mean?' (1999) 9 Trans Nat'l L. & Contemp. Probs. 217 at 218 Higgins argued that ("Globalization represents the reality that we live in a time when the walls of sovereignty are no protection against the movements of capital, labour, information and ideas—nor can they provide effective protection against harm and damage.") Roslyn Higgins, R 'International Law in a Changing International System' (1999) 58 Cambridge L. J. 78 at 82

[63] Dean SA 'Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation' (2007) 58 Hastings L.J. 911 at 924

services, and capital increasingly crosses global borders."[64] (emphasis added)

Tax law reflects the national characteristic of states which includes their language, history, location, and natural resources, and explains the different nature of their laws.[65] However, despite the divergence of the tax rules, globalisation has increased the closeness of the states.[66] Thus, what happens in one state can cause a chain reaction, transcending traditional borders to shape and affect other sovereign states. As a result of globalisation, States draw closer either intentionally or unintentionally toward a homogeneous world. However, globalisation has led to the proliferation of tax competition,[67] which is the anti-thesis to the tax cooperation championed by this thesis. For instance, high tax rate encourages residents of developed countries to seek more favourable locations to hold their funds and transact business. The developing countries, on the other hand, can lower their tax rates to attract the residents of developed countries.

Given the above interface of globalisation on states' tax sovereignty, co-operation among states in designing their tax rules is crucial. However, there is a need to shift away from the traditional method of tax cooperation – the treaty-based mechanism. The traditional method is focused on bringing States with unequal bargaining power into an agreement. The parties with superior bargaining power dictate the form of the agreement through the OECD and UN model conventions. Empirical research shows that in negotiating tax treaties, the states usually rely on the two model treaties designed by the OECD and UN

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[64] Christians, A et al 'Taxation as a Global Socio-Legal Phenomenon' (2008) 14 ILSA J. Int'l & Comp. L. 303 at 305

[65] Avi-Yonah, RS 'Tax convergence and globalisation' (2010) available at http://ssrn.com/abstract=1636299

[66] Leviner, S 'The intricacies of tax and globalization' (2014) 5 Columbia J. Tax Law 207 at 212

[67] Townsend, A 'The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition' (2001) 25 (1) Fordham Int'l L. J. 215 at 231

respectively. While the OECD model assigns more taxing powers to developed countries,[68] the UN model reserves more taxing powers for the developing countries.[69] Avi-Yonah[70] is of the view that the OECD Model represents an international consensus that the appropriate jurisdiction for tax income arising from cross-border transactions is primarily the residence jurisdiction.[71].

4.1.5 Initiative for new international tax regime – The OECD-BEPS Project

Globalisation has increased the mobility of both human and capital thereby encouraging both individuals and corporations to circumvent the domestic tax rules of the states. At the other end of the spectrum, the emergence of BRICS countries erodes the dominance of the OECD in the promotion of standardisation and convergence of international tax rules.[72] As a result of these problems, some taxable income may escape the tax net of the states, thereby eroding their revenue base.[73] For their part, the states compete for revenue and investment.[74] The current treaty-based co-operation mechanism has proven incapable of addressing the twin challenges facing the international tax regime. The OECD has realised that the current bilateral treaty regime cannot address the revenue crisis outlined above, regardless of its concerted efforts in

[68] Avi-Yonah, RS and Lahav, Y 'The Effective Tax Rates of the Largest US and EU Multinationals' (2012) 65 Tax L. Rev. 375 (Argued that over ninety percent of multinationals are residents in OECD member-states.)

[69] Daurer, V and Krever. R 'Choosing between the un and OECD tax policy models: an African case study' WU International Taxation Research Paper Series No. 2014 – 16 available at http://ssrn.com/abstract=2499980

[70] Avi-Yonah, RS 'The Structure of International Taxation: A Proposal for Simplification' (1996) 74 Tax. L. Rev. 1301 at 1303

[71] Christians, A 'How Nations Share' (2012) 87 Ind. L. J. 1407 at 1411 (Arguing that "tax treaties are biased against developing countries and work in favour of the developed countries.")

[72] Dagan, T 'BRICS—The Potential of Cooperation' (2016) available at: http://ssrn.com/abstract=2538105

[73] Avi-Yonah, RS 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State' (2000) 113 Harv. L. Rev. 1573

[74] Brauner, Y 'What the BEPS?' (2014) 16 Fla. Tax Rev. 55,

promoting standards through the OECD model convention. Hence, the OECD Base Erosion and Profit Shifting (BEPS) initiative.

The OECD-BEPS project assumes that the current international tax regime is constructed around a competition framework. The regime is designed to enhance competition, not co-operation among tax jurisdictions. The principles embedded in the BEPS project envisage that a competition-based regime is no longer tenable. Thus, states cannot proceed to make completely independent tax rules due to the interdependence of their economies.[75] These challenges have tested the efficacy of tax treaties and further exposed the existing weaknesses of tax treaties. Therefore, BEPS is a response to failures of the current (OECD-led) international tax regime.

The core idea of BEPS Action Plan can be summarised as follows:

> "Taxation is at the core of countries' sovereignty, but the interaction of domestic tax rules in some cases leads to gaps and frictions. When designing their domestic tax rules, sovereign states may not sufficiently take into account the effect of other countries' rules. The interaction of independent sets of rules enforced by sovereign countries creates frictions, including potential double taxation for corporations operating in several countries. It also creates gaps, in cases where corporate income is not taxed at all, either by the country of the source or the country of residence, or is only taxed at nominal rates. In the domestic context, coherence is usually achieved through a principle of matching—a payment that is deductible by the payer is taxable in the hands of the recipient unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves plenty of room for arbitrage by taxpayers."[76]

[75] Brauner, Y 'What the BEPS?' (2014) 16 Fla. Tax Rev. 55

[76] OECD, Action Plan on Base Erosion and Profit Shifting 9 (2013), available at http://www.oecd.org/ctp/BEPSActionPlan.pdf

The OECD-BEPS initiative is aimed at designing a new international standard to ensure the coherence of income taxation at the international level.[77] Baker[78] opines that the dominance of the OECD in shaping the international tax system might only continue if the OECD-BEPS project succeeds in reforming the current regime. Brauner argues that the OECD-BEPS project is premised on three core principles thus:

> "(i) the necessity of establishing the international tax regime on a collaborative-based paradigm rather than a competition-based paradigm; (ii) the importance of taking a systematic or holistic approach to substantive international tax reform rather than an ad-hoc approach, acknowledging the interdependence of the norms of the international tax regime; and (iii) the inevitability of accepting completely new solutions to problems that could not be resolved by the applicable norms, contrary to the traditional conservatism of the international tax regime."

The goal of Action 15 is to design the framework for drafting a multilateral instrument that can modify the existing bilateral treaty regime.[79] Although, this Action represents a significant step towards multilateralism participation in developing the multilateral instrument is voluntary, and a participating country is not obligated to sign it. This tends to encourage more states to take part in the development process. However, it is uncertain how many states will sign it in the end. If the participating countries are obligated to sign the multilateral instrument, many countries will not be interested in participation.[80] This dilemma reflects inadequate multilateralism represented by the OECD. Therefore, the understanding of various domestic rules through comparative

[77] Goutam, S 'Critical account of the OECD's Action Plan on Base Erosion and Profit Shifting' (2014) 8 MLJ 9

[78] Baker, P 'Is There a Cure for BEPS', (2013) 5 Brjt. Tax Rev. 605 at 606

[79] Avi-Yonah, RS and Xu, H 'Global taxation after the crisis:why beps and maatmare inadequate responses, and what can be done about it' available at: http://ssrn.com/abstract=2716124

[80] However, the BEPS treaty-based initiative is structured to do so without abandoning the basic structure of bilateral of tax treaties. The OECD realised that changing the architecture bilateral regime may create fear of tempering with states tax sovereignty. See OECD/G-20 'Base Erosion and Profit Shifting Project, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties' (2014) OECD Publishing available at http://dx.doi.org/10.1787/9789264219250-en.

analysis is the most promising platform to develop a universally accepted tax co-operation mechanism.

The core principles embedded in Action Plan 15 of the BEPS, suggest that inclusiveness should be the driving force for meaningful reform of the current regime. There is a need for global leadership to achieve the tenets of the basic principles. It is arguable that "The gradual emergence of global tax governance is unavoidable in an ever more interdependent and globalised world."[81] The next question is – what will be the forum for negotiating the multilateral instrument? There have been several calls for establishing an International Tax Organisation to undertake the co-ordinating role in tax co-operation,[82] but there is no sign of such an organisation emerging.

It is worth noting that, there is some contradiction in BEPS Action plans. For instance, Action Plan 2 call for designing domestic rules to neutralise the effect double non-taxation, double deduction, long-term deferral in respect of hybrid instruments and entities. The Action Plan advocated for a domestic law solution to the problem of double non-taxation of hybrid mismatch entities. Any domestic law approach to a problem envisages unilateral action of each of the states. By contrast, the core principle of BEPS project, as illustrated by Action

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[81] Wouters, J and Meusissen, K 'Global Tax Governance: Work in Progress?' (2011) Leuven Centre for Global Governance Studies, Working Paper No 59.

[82] Pinto, D and Sawyer, A 'Building Bridges Between Revenue Authorities: Would a World Tax Organisation Be a Key Facilitator?' (2011) Journal of Applied Law and Policy, 25 at 40; Pinto, D and Sawyer, A 'Towards Sustaining the Future of Taxation: Is a World Tax Organisation Necessary and Feasible in Today's Globalized World?' (2009) 24(2) Australian Tax Forum, 179 at 205; Sawyer, AJ 'Developing a World Tax Organisation: The Way Forward' (2009) Fiscal Publications; Tanzi, V 'Is there a Need for a World Tax Organisation?', in Razin, A and Saka, E (eds), 'The Economics of Globalisation: Policy Perspectives from Public Economics' (1999), Cambridge University Press, 173–186; Pinto, D 'A Proposal to Create a World Tax Organisation' (2003) 9(2) New Zealand Journal of Taxation Law and Policy 145 at 160; Sharkey, N 'A South East Asian tax organisation, (2013) Brit. Tax Rev. 175; Avi-Yonah, RS 'Hanging Together: A Multilateral Approach to Taxing Multinationals' (2016) 5 Mich. Bus. & Entrepreneurial L. Rev. 137; Cockfield, A J 'The rise of the OECD as informal 'world tax organization' through national responses to e-commerce tax challenges' (2006) 8 (1) Yale Journal of Law and Technology; Brauner, Y 'An International Tax Regime in Crystallization' (2003) 56 Tax L. Rev. 259

Plan 15, is centred on developing a multilateral solution to the challenges facing the current regime.

Given the current OECD-BEPS initiatives and other issues discussed above, the bilateral treaty regime is being marred by global economic integration. The multilateral treaty regime would have been the best mechanism for the co-operation. A multilateral approach is both essential and feasible in the 21st century.[83] However, there are divergent views about the viability of multilateral tax treaties. Some commentators made a case for a global multilateral treaty that would replace the current bilateral tax treaty regime.[84] Other scholars have advocated a multilateral treaty that would address one or two very specific aspects of international taxation.[85] However, other commentators argue for regional multilateral tax treaty regimes that could be signed by regional or trading blocks.[86] Goldsmith, on the other hand, downplays the utility of a multilateral treaty as follows:

> "most multilateral treaties that are not purely hortatory are based on some form of embedded bilateral cooperation. What little genuine multilateral cooperation we might see is thin, in the sense that it does not require nations to depart much, if at all, from what they would have done in the absence of the treaty."[87]

[83] Avi-Yonah, RS 'Hanging Together: A Multilateral Approach to Taxing Multinationals' (2016) 5 Mich. Bus. & Entrepreneurial L. Rev. 137

[84] Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook. J. Int'l L. 1641.

[85] Dunlop, J 'Taxing the International Athlete: Working Toward Free Trade in the Americas Through a Multilateral Tax Treaty' (2006) 27 Northwestern J Int'l Law & Business 227 at 253; Graetz, M 'A Multilateral Solution for the Income Tax Treatment of Interest Expenses' (2008) Yale Law & Economics Research Paper No. 371 available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259847; Oliver, D 'Tax Treaties and the Market State' (2003) 56 Tax Law Review 587 at 608; McIntyre, M 'Options for Greater International Coordination and Cooperation in the Tax Treaty Area' (2002) 56 Bulletin for International Fiscal Documentation 250 at 253; Reinhold, R 'Some Things that Multilateral Tax Treaties Might Usefully Do' (2004) 57 Tax Lawyer 661

[86] Mattsson, N 'Multilateral Tax Treaties: A Model for The Future?' (2000) 28 Intertax 8 at 9

[87] Goldsmith, JL and Posner, EA 'International Agreements: A Rational Choice Approach' (2003) Virginia Journal of International Law 113 at 138.

Therefore, the states' reluctance to surrender their substantive jurisdiction to any multilateral body hinders any positive move toward having a multilateral treaty regime.

Furthermore, what advocates for multilateral tax treaty fail to realise is that entering into a multilateral treaty suggests the surrendering of some aspect of the states' tax sovereignty. Therefore, there is a need to treat the issue with caution – that is, to find a middle course between the multilateral approach and the states' tax sovereignty. The co-operation should not be in the form of a treaty (either bilateral or multilateral) with legally binding international commitments. Rather, the focus should be on a co-operation mechanism in which states can have some degree of assurance that restrictions on their tax sovereignty is extended to all other states in the forum.

The co-operation envisaged in this thesis should be gradual. At the initial stage of the development of this international cooperation, there is no need for any binding commitments in the form that a treaty would entail. The co-operation mechanism underscores the relevance of co-operation not necessarily having a formal treaty obligation. A typical example of this type of co-operation mechanism is the OECD Model Convention which was initiated by the OECD but is now adopted by non-OECD members.[88] The non-OECD members did not enter into any form of a multilateral treaty but considered themselves bound by the OECD model. Therefore, the most feasible step toward international cooperation[89] is to explore means outside the tax treaty regime. The co-operative method envisaged in this thesis involves a comparative analysis of the rules that define the scope of the states' substantive tax jurisdiction.

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[88] There are over 3000 bilateral tax treaties fashioned in line the OECD model…. Thuronyi, argued that "The OECD Model has almost acquired the status of an international agreement." See Thuronyi, V 'International tax cooperation and a multilateral treaty' (2001) 26 brook. J. Int'l L. 1641.

[89] In designing the definitional rules for fiscal residence.

4.2 Comparative model for tax cooperation

Comparative law is the most appropriate method of co-operation because it requires unilateral action by the state in reviewing and evaluating the tax rules adopted by other states. And thereafter to compare and contrast those rules in order to understand the level of their interaction. Thuronyi argues that the classification of tax systems posits "insight to the historical roots of any particular country's system, thereby providing a better understanding of the underlying legal culture."[90] He further makes a case for identifying the core structural features of the tax laws of states.[91]

The basic methodology of all comparative law is that of functionality.[92] The functional theory posits that similar problems produce similar solutions.[93] In adopting a functional approach to comparative analysis, the comparatist must identify the problem to be studied: "Incomparable cannot usefully be compared, and in law, the only things which are comparable are those who fulfil the same function."[94] He must choose the legal systems to be compared, which depends on the problem to be studied. The comparatist must also compare and contrast the legal systems selected for study in an effort to identify similarities among and differences between them.[95] Zweigert and Kötz also believe that the functionalist approach to comparative analysis will lead to the conclusion that different tax systems approach the same problems in the same or similar ways:

> "But if we leave aside the topics which are heavily impressed by moral views or values, mainly to be found in family law and the law of succession, and concentrate on those parts of private law which are

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[90] Thuronyi, V 'Comparative Tax Law' (2003) Kluwer Law International at 23
[91] Ibid
[92] Zweigert, K and Kötz, H 'Introduction to comparative law' (1998) (3rd ed) 34 Tony Weir trans
[93] Frankenberg, G 'Critical Comparisons: Re-thinking Comparative Law' (1985) 26 Harv. Int'l L.J. 411, 427 at 428
[94] Zweigert, K and Kötz, H 'Introduction to comparative law' (1998) (3rd ed) 34 Tony Weir trans.
[95] Ibid

> relatively 'unpolitical', we find that as a general rule developed nations answer the needs of legal business in the same or in a very similar way."[96]

Infanti argues that comparative analysis will assist in identifying the rules currently in place in other states. In this regard, comparative analysis will:

> "provide a much richer range of model solutions than a legal science devoted to a single nation, simply because the different systems of the world can offer a greater variety of solutions than could be thought up in a lifetime by even the most imaginative jurist who was corralled in his own system."[97]

The forces of globalisation have fuelled a resurgence in comparative legal analysis.[98] Thus, states must design their domestic tax rules and also navigate the intersections of their rules with that of other states. The main focus of comparative tax law has been the resolution of conflicts between states' tax jurisdictions and the development of domestic rules affecting cross-border transactions.[99] In some cases, the comparative analysis considers two or more tax regimes that are similar and refines those similarities. [100]

Comparative tax law should be based on the functions of tax rules. It is aimed at understanding the similarities and differences between domestic tax systems[101] and that should indicate potential alternative solutions to common

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[96] Ibid

[97] Infanti, AC 'Spontaneous tax coordination: on adopting a comparative approach to reforming the U.S. international tax regime' (2002) 35 Vanderbilt Journal of Transnational Law 1105

[98] Rodrik, D 'Globalisation paradox: Democracy and the future of the world economy (2011) W.W. Norton & Co 346

[99] Garbarino, C 'An evolutionary approach to comparative taxation: methods and agenda for research' (2009) 57 Am. J. Comp. L. 677

[100] Dean, SA 'More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime' (2010) 84 Tul. L. Rev. 125

[101] Livingston, MA 'From Milan to Mumbai, changing in Tel Aviv: Reflections on Progressive Taxation and "Progressive" Politics in a Globalized but Still Local World' (2006) 54 AM J. Comp. L. 555 at 582

policy issues.[102] The functional approach suggests that, after identifying a common problem, there is a need to examine the way in which the problem is solved in each of the compared jurisdictions.[103] The main focus of comparative tax law has been the resolution of conflicts between states' tax jurisdictions and the development of domestic rules affecting cross-border transactions.[104] However, it is important to compare legal rules that are narrow enough to be practically manageable and meaningful enough in terms of explaining the context in which the legal rules operate."[105]

The use of comparative analysis to achieve international co-operation outside of the tax treaty regime is more concerned with juridical rather than economic double taxation. Economic double taxation is more closely related to enforcement tax jurisdiction whereas the juridical in connected to the substantive tax jurisdiction of the states.[106] It is worth noting that there is significant multilateral cooperation on enforcement tax jurisdiction through a multilateral tax treaty.[107] For instance, as at 12th July 2016, there were over

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[102] Garbarino, C 'Comparative Taxation and Legal Theory: The Tax Design Case of the Transplant of General Anti-Avoidance Rules' (2010) 11 (2) Theoretical Inquiries in Law 765 at 766; Garbarino, C 'An evolutionary approach to comparative taxation: methods and agenda for research' (2009) 57 Am. J. Comp. L. 677

[103] Marian, MY 'Meaningless comparisons: corporate tax reform discourse in the united states' (2013) 32 Va. Tax Rev. 133 at 145

[104] Garbarino, C 'An evolutionary approach to comparative taxation: methods and agenda for research' (2009) 57 Am. J. Comp. L. 677

[105] Livingston, MA 'Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax' (2005) 18 Can. J. L. & Jurisprudence 119 at 122

[106] Reason being that the juridical double taxation centres on the issue of allocation of taxing right between two more state. Whereas, in economic double taxation the taxing right of particular state is recognised, but the issue for determination is whether the state can impose tax on a taxpayer both at corporate and individual levels.

[107] Sawyer, A 'Comparing the Swiss and United Kingdom cooperation agreements with their respective agreements under the Foreign Account Tax Compliance Act' (2014) 12 (2) eJournal of Tax Research 285 at 289 (Arguing that "International cooperation is now the norm on exchange of information and fiscal transparency.") Reinhold, RL 'Some Things That Multilateral Tax Treaties Might Usefully Do' (2004) 57 (3) Tax Lawyer

ninety states participating in the Convention on Mutual Administrative Assistance in Tax Matters (MAATM).[108]

The MAATM serves as a multilateral instrument that ensures mutual administrative assistance among States on the issues of assessment, collection and enforcement of their substantive tax rules. The MAATM is not a substitute for DTAs because its coverage is information exchange and assistance in the recovery of debts and servicing of documents.[109] On the other hand, DTAs (that are based on the OECD Model) primarily deal with substantive tax rules. They also provide mechanisms for avoiding double taxation, in addition to the exchange of information[110] and assistance in the collection of taxes.[111] However, the MAATM has the most extensive scope for exchange of information, but it cannot operate to eliminate double taxation as provided through a DTA.

The call for a multilateral tax treaty regime for juridical double taxation is not feasible. The reason is that juridical double taxation is closely connected with the substantive tax jurisdiction of the states. Substantive jurisdiction to tax denotes the power of the state to impose tax. Thus, it determines the persons[112] and income sought to be taxed as well as the tax rate. Enforcement jurisdiction in respect of tax, on the other hand, deals with the issues of assessment, collection and enforcement of the tax imposed by substantive rules. This

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[108] Jurisdictions participating in the Convention On Mutual Administrative Assistance in Tax Matters. available at Http://Www.Oecd.Org/Tax/Exchange-Of-Tax Information/StatusOfConvention.Pdf last assessed 12/07/2016; For detail discussion on the convention see Morgan, V 'Mutual Administrative Assistance in Tax Matters' (1988) 3 Canadian Tax Journal at 974; Tanzi, V and Zee, H 'Taxation in a Borderless World: the Role of Information Exchange' (2000) 28 (2) Intertax at 60.

[109] Sawyer, A 'The implications of the Multilateral Convention and the Foreign Account Tax Compliance Act: An Australasian perspective' (2015) 44 AT Rev 1 at 6

[110] Art 26 of the OECD MTC

[111] Ibid Art 27

[112] Which includes the design of the definitional rules of persons that are liable to tax.

explains the reason for achieving some degree of co-operation in respect of mutual administrative assistance in tax matters.

4.3 How Comparative Model for Fiscal Residence Work

There is a need for co-operation between states to eliminate double taxation. This thesis argues that such cooperation could be achieved outside the tax treaty regime. It is imperative to review the current mechanism for preventing double taxation, unilateral, bilateral and multilateral. The latter two are treaty-based mechanisms while the unilateral method is carried out by the states independently without entering into any form of a treaty. Globalisation has marred the effectiveness of the bilateral mechanism. In the same vein, states are reluctant to surrender their tax sovereignty (especially on substantive jurisdiction to tax) through a multilateral instrument.

Therefore, the failure of both the bilateral and multilateral methods of eliminating double taxation encourages states to revert to unilateral means.[113] The co-operation envisaged by this thesis leans toward the idea of allowing the states to preserve their tax sovereignty by designing their definitional rules unilaterally. However, in designing such rules, regard must be had to the rules devised by other states. Thus, the states are required to understand the implication of the domestic rules of other states on their rules. The need for understanding the different nature of the domestic rules calls for adopting a comparative approach. By this method, the states can compare their respective rules with those of others. This is a co-operation mechanism outside of a tax treaty. Rosenzweig[114] also makes a case for tax co-operation outside tax treaties.

[113] Dagan, T 'BRICS—The Potential of Cooperation' (2016) available at: http://ssrn.com/abstract=2538105' Dagan, T 'The Costs of International Tax Cooperation' Working Paper No. 1-03, January 2003

[114] Rosenzweig, AH 'Thinking Outside the (Tax) Treaty' (2012) Wisconsin Law Review 717

He argues that the main problem with cooperation in the current international tax regime is that it builds on the tax treaty model. He also proposes the creation of a non-treaty-based cooperation mechanism, incentivizing co-operation of the least co-operative states. However, he fails to suggest a clear model that could serve as an alternative to the tax treaty regime.

It could be argued that tax co-operation envisages a complete harmonisation of the different definitional rules. However, the unique structure of the international tax system requires that international cooperation initiative should not be all-or-nothing.[115] It must be carried out in a gradual process. The proposed comparative model hinges on the need for states to understand the intricacies of their respective definitional rules through a comparative study. Therefore, it has taken a middle ground between the proponents of harmonisation of all the definitional rules applicable in all states and those agitating for maintaining the status quo, that is to say the use of a unilateral solution that leads to tax competition. In pursuing this alternative, states need to understand the interaction of their different definitional rules. The comparative model has the significant advantage of improving compatibility between the different definitional rules that the states adopt. It could reinforce the investors' certainty and potential co-operation in tax enforcement among states. The comparative alternative aims at achieving gradual cooperation between States.

The success of designing a road map for the comparative analysis depends on the exposition of the context underlying the comparison and the main concept sought to be examined. It has been argued that "The comparative study of the tax law is not strictly theoretically oriented rather it is a study of what may indeed become a reality in the foreseeable future."[116] Thus, the starting point for

[115] Brauner, (2003) at 293
[116] Avi-Yonah, RS et al 'Global perspectives on income taxation law' (2011) (1st Ed) Oxford University Press, New York at 4

the alternative is the contextualization stage. At this level, a tax concept and specific jurisdictions are selected and analysed from a comparative perspective. For this thesis, the concept of fiscal residence is chosen. The concept is to be comparatively analysed using some selected jurisdictions. The jurisdiction chosen represents the natural candidates for comparative tax studies. They represent the major legal families in the world.[117] Chapter five of this thesis focuses on this segment of comparison. The comparative analysis at this stage serves as the benchmark on which the other level of comparison is based, which is captured in chapter six of the thesis.

The next stage of the comparative alternative is at the level of trading partners. At this level, the definitional rules of two or more trading partners could be comparatively analysed. Comparative analysis can pave the way to understanding the nature of their tax rules. The use of this method could be a forum to promote the joint interests of the parties with like minds. Rosenbloom analyses the advantages of such kind of cooperation thus:

> "First, cooperation among countries that share similar interests is beneficial because it reduces the "competitiveness" threat-a fear that investors will withdraw or that Domestic companies will be unable to compete against foreign companies. Second, cooperation among influential countries may be utilised to further tax policies and achieve consensus, and in the event consensus is not possible, to set a coordinated policy that may be preferable to either the status quo or acting unilaterally. Third, this proposed model would permit different groups of states that share similar interests to set their own tax policy agenda and cooperate on issues that may not have broad interest. Fourth, cooperation within a group of countries may help policymakers overcome domestic political pressures and lobbies against policy changes. Fifth, the proposed model, is practical, feasible, and within the current framework of international institutions".[118]

[117] Thuronyi proposes Germany, France, the United States, and the United Kingdom as natural choices for tax comparison. These countries can be regarded as leaders in influencing the tax laws of other countries. See Thuronyi, V 'Comparative tax law' (2003) Kluwer Law International, London

[118] Rosenbloom, HD et al 'The Unruly World of Tax: A Proposal for an International Tax Cooperation Forum' (2014) 15 Fla. Tax Rev. 57

The present treaty-based mechanism on which international tax co-operation is based does not provide an adequate platform in which states with similar interests can effectively promote the collaborative effort. Therefore, the proposed co-operation alternative will enable states that share similar interests to co-operate and reach understandings of their respective definitional rules. The advantage of the proposed co-operation mechanism cannot be over emphasised. As mentioned above, the current tax co-operation mechanism is encouraging competition among the states.[119] The competition is triggered by substantial variations in definitional rules across states.[120] Therefore, if a state designs its rules differently from the ones adopted by its competitors, the potential investors may shift their capital to the competing trading partners with favourable definitions, especially where the difference in the rules led to double taxation. Thus, co-operation among states having similar business interests may enable them to suppress undesired competition in an effective way.

Furthermore, states' cooperation outside tax treaties suggests an informal platform for collaboration among the states. By its informal and flexible nature, the envisaged co-operation preserves the tax sovereignty of the members of the platform. The comparative model allows the states with similar economic interest or states that are trading partners to reach a consensus in defining fiscal residence. Thus, it may be advantageous for such groups of states to cooperate even if there is no global consensus.

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[119] Dagan, T 'BRICS—The Potential of Cooperation' (2016) available at: http://ssrn.com/abstract=2538105

[120] Ndikumana, L 'International Tax Cooperation and Implications of Globalization' (2015) UN Department of Economic & Social Affairs available at http://www.un.org/en/development/desa/policy/cdp/index.shtml.

At the regional level, states are torn between two desires: the need to achieve tax co-operation and the quest to protect their respective tax sovereignty. Gradualism embodies a compromise between the need for fiscal co-operation and tax sovereignty concerns. Therefore, the success of the co-operation mentioned above of the trading partners could strike a balance between the tax cooperation and tax sovereignty at the regional level. The comparative approach at the regional level of, the member states needs to develop an enhanced understanding of how their tax regimes interact through a comparative analysis of their respective rules.

The comparative process could be carried out by a Working Group of tax experts from each member state. The Group would present a forum for developing a fuller understanding of the intricacies of the definitional rules of the members. A comprehensive knowledge of these rules would ease the process of co-operation among the members outside any tax treaty. Gradualism in comparative analyses would pave the way for the interaction of the definitional rules of states who are members of a regional body as dictated by globalisation while preserving their tax sovereignty. The alternative would permit the members to enjoy the benefits of tax co-operation without rapidly sacrificing taxing powers. The absence of uniform tax treaties among the members of a regional bloc proves the undesirability of a tax treaty regime in achieving international co-operation. The success of the comparative model at one particular regional bloc could lead other similar regional bodies to follow the same line. The adoption of this model by most of the regional organisation could lead to its extension to the international level. That is to say; the model may become an international norm for tax co-operation.

4.4 Conclusion

The current international tax regime allows states to impose tax and define the tax base. Where two states assert jurisdiction to tax, the regime identifies the residence or other jurisdictional links of the persons to be subject to tax in a state. It also provides a rule for resolving inter-jurisdictional conflicts, thereby preventing double taxation by more than one state. The main building block of the regime is domestic law, unilaterally enacted and implemented by a State subject to the limitations imposed by weak bilateral tax treaties.

As a result of the growing weakness of the bilateral treaty regime, there has been a call for a multilateral tax treaty to address the definition of residence and other relevant issues.[121] The proponents of the multilateral treaty did not take into cognisance that the fiscal sovereignty of the state comprises both substantive and enforcement jurisdiction over the taxpayer. Therefore, it is possible for states to surrender enforcement jurisdiction as a result of any multilateral treaty. However, it could be difficult for the states to surrender their substantive tax jurisdiction because it impacts on their sovereignty. Thus, the multilateral treaty option is not feasible. This thesis explores a tax co-operation mechanism from a comparative perspective.

It is trite that different States adopt various different sets of definitional rules. To understand how such rules converge and diverge is a crucial step toward crystallising necessary mechanisms for international co-operation without

[121] From the empirical research conducted there are more than 3000 DTA around the globe. See Braun, J and Zagler, M 'An economic perspective on double tax treaties with(in) developing countries' (2014) 6 (1) World Tax Journal 1. See also Cockfield, AJ 'International Tax Competition: The Last Battleground of Globalization' (2011) 63 (12) Tax Notes International 867 (argued that while trade and investments becomes international, taxation remains national as the states are unwilling to surrender their tax sovereignty to multilateral tax treaty.) Ring. DM 'Prospects for A Multilateral Tax Treaty' (2001) 26 (4) Brooklyn Journal of International Law 1699 at 1710; Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook. J. Intl L. 1641

derogating from the sovereignty of the states involved.[122] An understanding in this regard is best achieved by an in-depth comparative analysis.

This chapter has analysed the rise and fall of the current cooperation mechanism and provided an exposition of the methodology to be used to achieve the alternative envisaged in this thesis. The next chapter (chapter five) gives a comparative analysis of the concept of fiscal residence. Chapters six and seven focus on the definitional rules applicable in the two jurisdictions selected as a case study in this thesis, namely the Federal Republic of Nigeria and the Republic of South Africa.

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[122] Rosenzweig, AH 'Why Are There Tax Havens?' (2010) 52 Wm. & Mary L. Rev. 923 (arguing that understand and distinguish the various rules applicable across the states could inhibit any form of cooperation).

CHAPTER FIVE

A COMPARATIVE ANALYSIS OF THE DEFINITIONAL RULES OF TAX RESIDENCE

5.0 Introduction

The concept of tax sovereignty suggests that a state could impose a tax on any person or entity within the scope of its jurisdiction. The preceding chapter discussed the dynamics of fiscal jurisdiction and how states' tax sovereignty is affected by the current economic integration. The analysis of the challenges foisted by globalisation on the states' efforts to define their residents for income tax purposes, always proceeds from two perspectives,[1] namely, the views of the states and of the taxpayer. The states aspire to design their definitional rule in a way that protects the tax base and impedes manipulation from the taxpayers. Moreover, the states need to be in tune with the reality of globalisation, by taking into consideration the rules applicable to other states. Taxpayers do not question their liability to pay tax on their income, but they fear that the divergence of the definitional rules may expose them to being regarded as tax residents of more than one state. Therefore, taxpayers argue that if they must be taxed, then the states must co-operate with each other in defining 'resident' for tax purposes.[2]

This research proposes a comparative analysis of various definitional rules as a route toward achieving cooperation between states in defining the scope of their tax jurisdiction. This chapter sets the stage for such a comparative analysis by comparing and analysing the various rules for the determination of the residence of both individuals and corporations for income tax purposes. The chapter scrutinises the definitional rules through the lens of the substantive tax jurisdiction of the selected common law and civil law jurisdictions.[3] These

[1] The determination of the residence status of the taxpayers is crucial because it affects all other aspects of the tax system. It determines the scope of the taxable income, the rate of the tax, the level of allowable deductions, the availability of exemptions and the obligation to withhold tax.

[2] RL 'Palmer Toward unilateral coherence in determining jurisdiction to tax income (1989) 30 Harv. Int'l L. J. 1 at 2

[3] Such as the United Kingdom, United States of America, Canada, Australia, New Zealand and some civil law jurisdictions notably, France, Germany, Netherland, Belgium, Switzerland, Austria and

jurisdictions were chosen because of the influence of their legal regime in Nigeria and the Republic of South Africa.

5.1 Meaning and Nature of Residence

Nationality and territoriality are two grounds for exercising jurisdiction under the general international law.[4] The former ground is usually understood as equivalent to citizenship and gives the state the power to make and enforce its laws in respect of any person falling within its sovereignty on account of the latter's nationality. The latter ground empowers a state to extend its laws to any activity that has or is intended to have an effect within its territory. For tax purposes, the concept of nationality has been broadly and differently defined by different states. States can redefine nationality to mean something less than its ordinary meaning under public international law. The redefined nationality comprise both citizens and non-citizens having the requisite territorial link with the state or having a physical presence for a specified period in the state.[5] This concept is then redefined as constituting 'residence'.[6] The adoption of a general notion of nationality could defeat the policy objectives of the residence-based system. Hence, a person could be physically present in and derive benefit from one state, while still claiming to hold nationality in another state.

Spain. The reason for selecting these states is that the selected states belong to civil law and common law legal family. According to Nikolakakus, the current trend is that, both states do not slavishly confine themselves to the general notion of residence earlier adopted by the legal family they belong. Instead, they view the concept of residence as a connecting factor, which is the tool used to make a distinction where the laws are not intended to speak to or about everyone. However, the significance of residence as a connecting factor depends on the precise conception of residence being employed by a state. See Nikalakakus, (2009) A 'Civil law and common law perspectives: a view from the left' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication. However, Thuronyi proposes Germany, France, the United States, and the United Kingdom as natural choices for tax comparison. These countries can be regarded as leaders in influencing the tax laws of other countries. See Thuronyi, V 'Comparative tax law' (2003) Kluwer Law International, London *See also* Thuronyi, V 'Tax law design and drafting' (1996) 1 International Monetary Fund, xxiii-xxxv (Thuronyi, V. ed.).

[4] Martha RSJ (1989)

[5] Avi-Yonah, RS 'International tax law as international law' (2004) 57 (4) Tax L. Rev. 482

[6] Ibid

In exercising income tax jurisdiction, a state can choose to invoke the link to the person of the income earner who resides[7] within its territory, whether or not the income was derived from a source within its territory. The principle of residence is a central concept in both domestic tax law and the international tax rules[8] of many states throughout the world.[9] A resident for income tax purposes could thus be either a citizen or a non-citizen with the requisite territorial link as defined by the state. There are no universal rules for determining the residence of a person (either natural or juristic) for tax purposes that apply in all circumstances. The concept of residence posits that, for tax purposes, the taxpayer's residence is the place where that person (natural or juristic) is subject to unrestricted tax liability.

5.2 Concept of Individual Residence

The definition of residence in respect of an individual for income tax purposes varies between states. However, the definitions generally fall under any combination of the following:

1) Definitions that depend on the facts and circumstances in determining the connection of individuals with a particular state. The terms 'residence', 'ordinary residence' or 'permanent place of abode' are used for this purpose;

[7]Or in the case of the United States of America, if the person is a citizen even if he is not a resident

[8] The concept of residence features in almost all tax treaties and the OECD Model Tax Convention on Income and on Capital and the United Nations Model Double Taxation Convention between Developed and Developing Countries.

[9] Apart from Hong Kong and Eritrea that adopt purely source-based income tax system. Followed by countries like; Bolivia, Costa Rica, El Salvador, Guatemala, Nicaragua, Panama, Paraguay and to some extent Kenya, Malaysia, Singapore and Uruguay, that operate the source-based tax system to varying degrees. See Thuronyi, V 'Comparative Tax Law' (2003) Kluwer Law International 287.Almost all the countries today adopt residence-based system, which is usually in the form of residence-minus. That is taxing residents of a state on their worldwide income subject to some relief on their foreign income being taxed abroad while non-residents are only taxed on their income sourced in that territory.

2) The definitions based on the general legal concepts (that are applicable in other areas of the law) such as domicile and citizenship;[10]
3) The definitions based on the physical presence of the individual determined by the number of days the individual has spent in the state. The assessment of the number of days can either be based on a calendar year or a tax year. It could also be a cumulative period within a year or it could or span a number of years.

5.2.1 The definitions that depend on the facts and circumstances

Various conceptions of individual residence such as; 'residence', 'ordinary residence' and 'permanent place of abode' are commonly used in ascertaining the residence of an individual based on fact and circumstances. Other types of individual connecting factors (such as 'domicile' and 'citizenship') are used differently by states to denote the residence of an individual. The diverse approaches taken by states in determining individual residence are not restricted to a single connecting factor. Such divergence extends to the specific purpose of choosing a particular term. Thus, states differ in considering the degree and nature of individuals' physical presence in the state that is sufficient to constitute a connection with the taxing state. Hence, two states may adopt a similar term, but the definitional rules of that term may differ significantly between states.

Where the concept of 'residence' has not been defined statutorily, it is necessary to take account of what the courts consider to be the residence of an individual for income tax purpose. The meaning adopted by the courts may not be in line with what lay persons consider as residence. Thus, the court may hold an individual to be a resident of a state in circumstances that no lay person would

[10] However, unlike the citizenship, domicile is usually determined by way of fact intensive analysis.

done.[11] In arriving at the meaning of residence, courts apply the rules of statutory interpretation or rely on the facts and circumstances of each case.[12] However, the infinite variations in 'facts' and the 'circumstances'[13] has led to inconsistencies in judicial decisions[14] in attributing a meaning to the term 'residence'.[15] Furthermore, while arriving at their various decisions, the courts have formulated some guiding principles to determine the residence of an individual for tax purposes.[16]

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[11] For instance, in England, the court in the case of Reid v. IRC (1926) 10 TC 673 considered residence as something beyond any particular building. Lord Clyde stated that: "Take the case of a homeless tramp, who shelters tonight under a bridge, tomorrow in the greenwood and as the unwelcome occupant of a farm outhouse the night after. He wanders in this way all over the United Kingdom. But will anyone say he does not live in the United Kingdom? – and will anyone regard it as a misuse of language to say he resides in the United Kingdom?" see also the dictum of Lord Viscount summer in Lysaght v. IRC (1928) 13 TC 511 at 528

[12] Rowlatt, J in Loewenstein v. De Salis (1926) 10 TC 424 at437 stated that "when you are considering a question like residence, you are considering just a bundle of actual facts…" ; "The legal test of residence has a substantial factual component": per Sharlow J.A. in The Queen v. Laurin (2008) FCA "It has frequently been pointed out that the decision as to the place or places in which a person is resident must turn on the facts of the particular case": per Cartwright J. in Beament v. Minister of National Revenue (1952) 2 S.C.R 486.

[13] The fact refers to actual fact that led to the litigation, which could the duration of the individual in a state or how regular and frequent he visits the state. The circumstances on the other hand refer to the peculiarities of the parties involved. Therefore, whether or not an individual is resident depends on the individual circumstances. See FCT v. Miller (1946) 73 CLR 93. Thus, two different case (involving different parties) may have similar sets of facts but the peculiar circumstances of the parties such as: place of birth, family and business ties and the nature of the visit could significantly differ. As the determination of residence is dependent upon the circumstances of the individual involved, it is possible for two courts in the same state to give different decisions in the two cases before them that shared similar facts. Since the circumstances of the individual party before them may differ.

[14] Even under the same legal system and based on the same facts.

[15] For instance, a state may individual resident as a person who resides in the state for six months. The other state, from where that individual came, may provide that such individual remains its resident one year after he left the state. The inconsistency in such definition may expose the taxpayer to the risk of being tax twice.

[16] It should be noted that, since the determination of residence is a question of fact, in formulating the guiding principles most of the courts recognized and adopted the findings of facts (based on evidence) made by the Revenue Authorities or the Tribunal of facts. For instance Lord Viscount Summer in Lysaght v. IRC stated that"It is well settled that, when the Commissioners have thus ascertained the facts of the case and then have found the conclusion of fact which the facts prove, their decision is not open to review, provided (a) that they had before them evidence, from which such a conclusion can properly be drawn, and (b) that they did not direct themselves in law in any of the forms of legal error which amount to misdirection."

5.2.1.1 Residence

In the absence of a statutory definition, the starting point for interpreting any legal concept is often taken to be ascertaining the literal meaning of the word.[17] The term then is given the meaning as ordinarily understood by the language of the time. The everyday meaning of the word 'residence' implies the place where a person actually resides. A literal construction of a taxing legislation attempts to discern the so-called 'intention of the legislature'.[18]. On the relevance of ascertaining the ordinary meaning of the word 'residence' from an English dictionary Viscount Cave LC said:

> "My Lords, the word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place.' No doubt this definition must for present purposes be taken subject to any modification that may result from the terms of the Income Tax Act and Schedules; but, subject to that observation, it may be accepted as an accurate indication of the meaning of the word 'reside..."[19]

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[17] Even though modern principles of interpretation have moved away from literal method of interpretation. See Tretola, J 'The Interpretation of Taxation Legislation by the Courts - A Reflection on the Views of Justice Graham Hill' (2006) 16 (5) Revenue Law Journal 73; Silke, J 'The interpretation of fiscal legislation- canons of construction, recent judicial comments and new approaches' (1995) Acta Juridica 123.

[18] Burton, M 'The rhetoric of tax interpretation – where talking the talk is not walking the walk' (2005) 1 (3) Jour. Aust. Tax Teacher Assoc; Hill, DG 'A judicial perspective on tax law reform' (1998) 72 Aust. L. J. 685; Allerdice, RC 'The swinging pendulum: Judicial trends in the interpretation of revenue statute' (1996) 19 UNSW L.J. 162; Mason, A 'Taxation policy and the Courts' (1990) 2(4) CCH J. Aust. Tax 40

[19] Levene v Inland Revenue Commissioner, (1928) AC 217, Wilcox, J in Hafza v Director-General of Social Security (1985) 6 FCR 444, 449 stated "there is a plethora of decisions arising in various contexts relating to the legal concept of residence. As a general concept residence includes two elements, physical presence in a particular place and intention to treat that place as home at least for the time being not necessarily forever." See also Applegate v F C T (1979) 9 ATR 899, 905; 79 ATC 4307, 4313 where Northrop J relied on the Shorter English Oxford Dictionary. Williams, J in Koitaki Para Rubber Estate Ltd v. FCT (1941) 64 CLR 241 stated that "The place residence of an individual is determined ... by reference to where he eats and sleeps and has his settled or usual abode." Residence in a place means some degree of permanence, some degree of continuity or some expectation of continuity. See Fox v Stirk [1970] 2 QB 463, 477; Goodwin v Curtis (1998) 70 TC 478, 510; it where an individual eat and sleep - Cesna Sulphur Co. Ltd v. Nicholson (1876) 1 TC 88. On what constitute "home" see Olowofoyeku, AA '"Where is my home" reflection on the law of residence' (2003) 4 British Tax Review 306 -323

The English courts have considered the concept of 'residence' in several cases[20] and set out various factors for establishing the residence of an individual.[21] In Roger v. IRC,[22] the appellant had a house in which his family lived but he was not physically present in the United Kingdom throughout the year of assessment. Nonetheless, he was was held to be a UK resident for tax purposes. The court considered the physical presence of the wife and family of the appellant as a factor in determining his country of residence. However, in Turnbull v. Foster[23] the court held that some physical presence (no matter how brief) is required to establish UK tax residence. Thus, when an individual was physically absent from the UK for the whole year, he ceased to be a resident of the UK.

In Levene v. IRC[24] a UK citizen lived abroad but returned to the UK every year for less than six months. The question was whether or not he was a UK resident for tax purposes. The court considered various factors in arriving at the conclusion that Levene was a resident and ordinarily resident in the UK. The court examined the history of his past and present mode of life. It was held that Levene had lived a nomadic life for many years before he bought a flat at Monte Carlo, where he had stayed for the whole year of assessment. Similar factors were considered in Reid v. IRC.[25] In both cases, the court found that taxpayer's mode of life was the same before and after departure from the UK, and they were therefore held to be UK residents for tax purposes.

[20] Lemos observes that as at 2005 there were about forty reported cases on the issues of residence and ordinary residence. See Lemos, M 'United Kingdom' in Miasto, G (ed) Residence of Individual under tax law EC law' (2010) IBFD Publication at 603.

[21] No one or more group of factors are conclusive and decisive in determining the residence status of an individual..

[22] (1879) 1 TC 225 see also Re Young (1875) 1 TC Rowlatt J in Pickles v Fulsham (1923) 9 TC 261 at 275 stated that a sailor resides at the port where his wife and children live.

[23] (1904) 6 TC 206. The same position was taken in Reed v Clark [1985] STC 323

[24] (1928) AC 217 at

[25] (1926) 10 TC

However, in the cases of IRC v. Brown[26] and IRC v. Zorab,[27] the court took a different line of reasoning. In the former case, the respondent gave up his house at Folkestone and lived with his relatives or in a hotel whenever he visited the UK, and he also lacked any business in the UK. The court found that he had the habit of spending two to three months of the winter even before the period in dispute, and held that he was a UK resident because there had been no break from his previous habits in this regard. In the latter case, the court held that, despite the taxpayer's prior habit of spending five to six months every year in the UK, he was a mere visitor to the UK. The court held that the respondent did not have any business interests in the UK and had no intention of setting up a permanent home in the UK. The court also considered the purpose of his visit and resolved that issue in his favour. However, in Lysaght's case, the taxpayer's purpose was regarded as an adversely influence in the outcome of the case.[28] In deciding whether or not the physical presence of an individual established residence, the courts consider the amount of time spent in that place, the nature of his presence there and his connection with the place.[29]

The nationality of the parties seems to influenced the decisions in Brown and Zorab's cases and to have been taken into account in Levene and Reid. The significant distinction, it seems, is between a UK national who had UK residence, but later absented himself from the country, and an individual who has never been a UK resident. This distinction is drawn in the dictum of Lord Cave where he stated that:

> "The most difficult case is that of a wanderer… if such a man is a foreigner who never resided in this country, there may be great difficulty in holding that he is resident here. But if he is British subject the

[26] (1926) 11 TC 292, 6 ATC 486
[27] (1926) 11 TC 289, 6 ATC 68
[28] Lord Viscount Sumner stated that "I see no ... fundamental antithesis between 'residence' and 'temporary visit' as would prevent Mr. Lysaght's visit, periodic and short as they are, from constituting a residence in the United Kingdom."
[29] IRC v Zorab (1926) 11 TC 289, 291;

> Commissioners are entitled to take into account all the facts of the case, including facts such as those referred to…"[30]

In Cooper v. Cadwalader, [31] the court held that the taxpayer was a UK resident because his presence in the country was not casual but a regular habit of his life. In this case, the nationality of the individual was not regarded as a significant factor. The court relied the taxpayer's retention of a house in the UK by the taxpayer; the same principle was influential in Loewenstein v. De Salis[32]

In some reported decisions, UK residents who lived abroad and those who had never been UK resident claimed that they were mere visitors in the UK and should not be regarded as residents. In such situations, the courts in Levene, Lysaght and Kinloch v. IRC[33] considered the regularity and duration of their visits as the main factor for consideration. This was particularly evident in Lysaght's case where the court held that physical presence, no matter how brief, is, may be a basis for residence if it is regular.[34]

To sum it up, in determining an individual's place of residence the English courts have considered factors such as:

- physical presence[35] in the UK and its frequency,[36]
- regularity and duration of visits[37],

[30] Lysaght v Commissioners of Inland Revenue (1928) 13 TC 511 at 529

[31] (1904) 5 TC 101,. where an American citizen based in New York leased a house in the UK for three years, he lived there for only two months every year and in the rest of the time it remained empty, even though it was kept ready for his return by his two servants.

[32] (1928) 10 TC 424, where a Belgian citizen based in Brussels used his company's house situated in the UK and which he visited regularly for the hunting. The court held that the ownership of the place of abode in the UK is not essential for the application of the factor.

[33] (1929) 14 TC 736

[34] Mr. Levene sold his only house and place of abode in London and moved to Ireland. But he kept visiting the UK and staying there for a week every month to attend board of directors meeting of their company. The maximum numbers of days he spent in the UK in the assessment year was 101 days.

[35] Rogers v. IRC, Re Young (the position of wanderer who had no other home abroad) Turnbull v. Foster and Reed v. Clark

[36] Cooper v. Cadwalader

[37] Gaine-Cooper' case

- the purpose [38] or intention of visits to or absences from the UK,
- the maintenance of a home in the UK, and family ties;
- business[39] and employment[40] ties with the UK;
- the present habits and way of life of the individual; [41]
- the nationality of the individual.[42]

The same trend is evident in judgments of the Australian courts.[43] where decisions on fiscal residence have adopted the approach of the English courts in the defining residence. The Australian tax system does not utilise the concept of 'ordinary residence'.[44] In Gregory v. Deputy Federal Commissioner of Taxation,[45] Dixon J emphasised that the Australian courts should define residence in the same way asthe English courts. Also in FCT v. Miller[46] and Applegate v Federal Commissioner of Taxation, [47] the courts echoed the views of Viscount Cave LC in Levene.[48] Therefore, In establishing the residence of an individual, the Australian courts also consider factors similar to those considered by the English courts, as mentioned above. For instance, they

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[38] IRC v Zorab

[39] Lysaght's case, Cooper v. Cadwalader, Hankinson v. HMRC (2009) UKFTT 384 (TC)

[40] HMRC v. Grace [2008] EWHC 2708 (Ch)

[41] Gaine-Cooper' case, IRC v Zorab and HMRC v. Grace

[42] Once an individual becomes a UK resident, he will have presumed to remain so until he proves that he is no longer a resident. See Tuczka v. HMRC (2011) UKUT 113 (TCC)

[43] Section 6(1) of the Australian Income Tax Assessment Act 1936, upon which the earlier case was based, provided that "In this Act, unless the contrary intention appears – 'resident' or 'resident of Australia' means ..." Therefore, it did not mention 'ordinary resident' and even if 'resident of Australia' is taken to mean ordinary resident, the section did not treat it separately.

[44] By the combined effect of section 995-1 of the Australian Income Tax Assessment Act 1997 and section 6 (1) of the Australian Income Tax Assessment Act 1936, "a resident or Australian resident is (a) a person other than company who resides in Australia and includes a person: i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia..." It has not mentioned ordinary resident. Also, the Australian non-resident has not been defined by the Act. It only made a cross-reference to the definition of the resident. That is whoever is not a resident, then he is a non-resident.

[45] (1937) 57 CLR 774

[46] (1946) 73 CLR 93

[47] (1979) 9 ATR 899 see also F.C.T. v. Miller (1946) 73 C.L.R. 93

[48] Levene v. IRC at

consider the taxpayer's physical presence,[49] the nature of his business and social ties, the nature of the terms of his employment,[50] the nature, frequency and purpose of visits to the UK. The completion of a passenger card has also been regarded as a relevant factor in determining the Australian resident status of an individual for tax purposes; see in this regard FCT v. Wong,[51] where the court took cognisance of the completion of a Passenger's Card[52] and held that the respondent as was not an Australian resident. However, the Canadian courts have determined the questions of 'residence' and 'ordinary residence' conjunctively and it is difficult to discern the separate positions of these courts on the issues of 'residence' and 'ordinary residence'.[53]

The UK notion of residence tends to be premised on the physical presence of the taxpayer in the UK. [54] In most jurisdictions that group the concepts of 'residence' and 'ordinary residence' together, the physical presence aspect of

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[49] Gregory v. Deputy Commissioner of Taxation (1937) 57 CLR 774; FCT v. Efstathakis (1979) 9 ATR 86; FCT v. Subrahmanyam (2002) 49 ATR 29; Joachim v. FCT (2002) 50 1072 See also Applegate v. FCT (1979) 9 ATR 899 and FCT v. Jenkins (1982) 12 ATR 745; In Iyengar v. Commissioner of Taxation (2011) AATA 856 factors such as: history of residence and movements, habits and mode of life and maintenance of a place of abode were considered.

[50] FCT v. Pechey (1975) 5 ATR 322

[51] (2002) ATC 4538, see also Sneddon v. FCT (2012) ATC 10-264 and Ellwood v. FCT (2012) ATC 10-287

[52] which indicated that the Respondent made only three visits to Australia, and that stated that he was a 'visitor and temporary entrant departing.

[53] This is because Section 9 of the Canadian Income War Tax Act of 1922 (upon which the earlier decisions like Thomson v. Minister of National Revenue (1946) SCR 209) clearly merged the concepts of 'resident' and 'ordinary resident' together. It stated that "There shall be assessed levied and paid upon the income during the preceding year of every person (a) *residing or ordinarily resident* in Canada during such year..." Also sections 2(1) of the Canadian Income Tax Act 1985 stated that "An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person *resident* in Canada at any time in the year." Section 250(3) of the same Act state that "In this Act, a reference to a person *resident* in Canada includes a person who was at the relevant time *ordinarily resident* in Canada." Furthermore, New Zealand regime did not make reference to the concept of residence at all let alone mentioned 'ordinary resident'. Section YD (2) of New Zealand Income Tax Act 2007 "Despite anything else in this section, a person is a New Zealand resident if they have a permanent place of abode in New Zealand, even if they also have a permanent place of abode elsewhere."

[54] Thus, by the combined effect of sections 831 and 832 as well as the judicial established principles, the IR20 and subsequently the HMRC6 the principles embodied in those factors have been summarised into the twin objective tests, that is the 183 – day and 91 – day tests. The nature and the antecedents of these tests have been discussed in 5.4 below

the individual tax residence regimes is couched in the form of an objective test. Thus, the factors mentioned above for establishing 'residence', as considered under the UK regime[55] are not applicable. Therefore, the analysis of the concept of 'ordinary residence' is the most appropriate criterion for those jurisdictions.

5.2.1.2 Ordinary Residence

An individual whose peculiar circumstances falls within one or more of the factors for determining residence, will be treated as a resident for tax purpose. Before 2013, the concept of 'ordinary resident' was an important connecting factor for the determination of individual residence in the UK. The concept remains relevant in jurisdictions like Canada, Nigeria and South Africa. Given the influence of the UK courts' decisions on almost all the common law jurisdictions on the issues of ordinary residence, it is necessary to analyse the UK cases on the subject. The discussion of ordinary residence is premised on two basic questions: *how and when did an individual acquire ordinary resident status?* If he has acquired such status, then *how and when has such status ceased to exist?*

In dealing with the concept of ordinary residence, the English courts have focused on a determination of the resident status of the individuals living abroad. Thus, they are more concerned with the second question.[56] Most of the

[55] From 2013most of the principles embodied in those factors were ceased to apply.

[56]For example, IRC v. Combe (1932) 17 TC 405 Gaine-Coopers v. HMRC (2011) UKSC 47, HMRC v. Grace (2008) EWHC 2708 (Ch), Turberville v. HMRC (2010) UKFTT 69 (TC), Reed v Clark (1985) 58 TC 528, 556 Shepherd v. HMRC (2006) STC 1821, Barrett v HMRC (2008) STC (SCD) 268. None of these cases concentrated on the issue of acquisition of ordinary residence. One may argue that in the cases of Tuczka v, HMRC (2011) 113 UKUT 1 at 9 (TCC)[56] and Genovese v HMRC (2009) STC (SCD) 373

[56]The individuals involved conceded that they were residents of the UK. Therefore, issue before the courts was whether they were also ordinarily resident in the UK. Yes, the question on the establishment of ordinary residence seemed to have been arisen in those cases. But by closer look at the decisions, both courts relied, to some extent, on the HMRC's guidance on the establishment of ordinary resident (IR20) which stated that "If you are resident in the UK year after year, you are treated as ordinarily resident here..."[56] This guidance emanated from the judicial principles set out for

decision that analyse the concept of ordinary residence revolve around the provisions of sections 829 and 831 of the UK Income Tax Act 2007. These sections are crucial provisions that serve as the starting point for analysing ordinary residence under the UK regime. Section 829 provides that:

> "(1) This section applies if— (a) an individual has left the United Kingdom for the purpose only of occasional residence abroad, and (b) at the time of leaving the individual was both UK resident and ordinarily UK resident. (2) Treat the individual as a UK resident for the purpose of determining the individual's liability for income tax for any tax year during the whole or a part of which the individual remains outside the United Kingdom for the purpose only of occasional residence abroad."

Section 831 provides that:

> "(1) Subsection (2) applies in relation to an individual if— (a) the individual is in the United Kingdom for some temporary purpose only and with no view to establishing the individual's residence in the United Kingdom, and (b) during the tax year in question the individual had actually resided in the United Kingdom at for a total period equal to 183 days (or more)."

Section 829 deals with a situation where an individual who has satisfied the requirement of being a resident or ordinary resident has left the UK for the purpose of occasional residence abroad. The issue for determination in this circumstance is whether or not that individual is a resident or ordinary resident of the UK as the time he left the UK. However, Section 831 deals with a situation where a UK resident[57] enters the UK for a temporary purpose. Equally, the issue here is whether or not the presence of the individual in the UK is for a temporary purpose. The words 'resident' or 'ordinary resident' is mentioned but not defined. These sections focus on the situation where a UK resident or

the establishment of resident. In Tuczka's case, the tribunal acted on the notion that residence is a prerequisite of ordinary residuary residence.

[57] Either on grounds of common law principles or he falls within the meaning of section 829 above or he has never been to the UK.

ordinary resident ceased to be such, not when a foreigner becomes a UK resident or ordinary resident.

Two leading cases addressed the first question, but they only analysed the meaning and features the concept of ‘ordinary residence’. Lord Viscount Cave LC in Levene’s case stated that:

> “The expression “ordinary residence” is found in the Income Tax Act of 1806 and occurs again and again in the later Income Tax Acts, where it is contrasted with the usual or occasional or temporary residence; and I think that it connotes residence in a place with some degree of continuity and apart from accidental or temporary absences. So understood, the expression differs little in meaning from the word “residence” as used in the Acts...”[58]

In the same vein, Lord Viscount Sumner in Lysaght’s case stated that:

> “My Lords, the word "ordinary" may be taken first. The Act, on the one hand, does not say "usually" or "most of the time" or "exclusively" or "principally", nor does it say on the other hand "occasionally" or "exceptionally" or "now and then", though in various sections it applies to the word "resident", with a full sense of choice adverbs like "temporarily" and "actually". I think the converse to 'ordinarily' is ‘extraordinarily’ and that part of the regular order of a man’s life, adopted voluntarily and for settled purposes, is not ‘extraordinary’.”[59]

Lord Scarman in Shah v. Barnet LBC re-echoed the above statement of Viscount Cave and summarised the meaning and nature of the ordinary resident as follows:

> “Following *Levene* and *Lysaght*, the words are to be construed in their natural and ordinary meaning as words of common usage in the English language …The words are not to be interpreted as comparable with domicile …They do not imply an intention to live in a place permanently or indefinitely … Unless the statutory framework or legal context requires a different meaning, the words refer to a person's abode in a particular country which he or she has adopted voluntarily as part of the regular order of his or her life for the time being, whether of short or long duration … The mind of the individual is relevant in two (and only two)

[58] Levene v. IRC at 225
[59] Lysaght v. IRC at 243

> particular respects. The residence must be voluntarily adopted, and there must be a degree of settled purpose, having sufficient continuity to be described as settled... The purpose, while settled, may be for a limited period, and common reasons for a choice of regular abode include education, business or profession, employment, health, family, or mere love of the place… The "real home" test is wholly inconsistent with the natural and ordinary meaning of the words as construed in *Levene* and *Lysaght*.”[60]

The trend of the English courts in the cases of Levene and Lysaght and Shah, cited above, is that they accord the terms ‘ordinary resident’ a natural and ordinary meaning. Thus, the facts and circumstances of each case determine whether or not an individual is a UK ordinary resident. These cases did not provide any guidance as to the factors to be considered in deciding whether or not an individual becomes a UK ordinary resident.[61] Despite the importance of the concept of ordinary residence, it has not been defined statutorily in the UK. The courts deal with the question whether or not a UK resident or ordinary resident has ceased to be such, not on how and when a foreigner becomes a UK ordinary resident. The non-binding statements of the HMRC are the only guidance. That is IR20 and HMRC6, which claim to give guidance on how to apply the judicially established principles on an ordinary resident.[62] The reliance of the HMRC’s guidance on ordinary resident is tend to equate the concepts of ordinary resident and resident. However, the UK regime envisages the separation of the two concepts.

The distinction between the concepts is evidenced by the fact that whenever an individual becomes a UK resident, ordinary resident or domiciliary he is liable to worldwide taxation on the basis of income arising. However, a UK resident

[60] (1983) 2 AC 309 at 343

[61] The only case that seemed to established the degree of duration of stay that can constitute ordinary resident is found in the case Reed v Clark (1986) Ch 1 where the considered the length of time Mr. Clark spent in the USA without setting foot in the UK as indicia that Mr. Clark had established himself as both resident and ordinary resident of the USA not the UK.

[62] And by the above argument there was none for the ordinary resident.

simpliciter is entitled to elect that his foreign income shall only be taxed in the UK if he did not bring it into the UK or enjoy it in the UK. This choice is not available to the UK ordinary resident or domiciliary.[63] Despite this statutory provision, the UK courts taken a different direction on the issue of 'resident' 'ordinarily resident' dichotomy. Stressing the thinness of the distinction between 'resident' and 'ordinary resident,' Lord Viscount Cave in Levene's case[64] said that ordinary residence is predicated upon residence, in other words, that an individual cannot be an ordinary resident without being a resident. He stated that "I find it difficult to imagine a case in which a man while not a resident here is yet ordinarily resident here." Roth J. in Tuczka v. HMRC[65] accepted the proposition that there can be no question of ordinary residence without considering whether the individual is a resident.

The above proposition explains the reason behind the English courts' failure to give clear guidance on how ordinary resident status is acquired. Instead, the courts made the determination of ordinary residence dependent upon the determination of resident. Lord Buckmaster in Lysaght's case[66] said that once the residence of an individual is established, the ordinary residence is no more than an adjective qualifying the residence to be more than casual.

[63] Section 25 The UK Income tax (Earning and Pension) Act 2003 provides that "(1) This section applies to general earnings for a tax year in which the employee is resident but not ordinarily resident in the United Kingdom if they are—(a)general earnings in respect of duties performed in the United Kingdom ... (2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year." Section 26 of the same Act provides that "(1) This section applies to general earnings for a tax year in which the employee is resident, but not ordinarily resident, in the United Kingdom if they are neither—(a)general earnings in respect of duties performed in the United Kingdom … (2) The full amount of any general earnings within subsection (1) which are remitted to the United Kingdom in a tax year is an amount of "taxable earnings" from the employment in that year." See also Paragraph 1.3 and 1.5 of the RDR 1 2013.

[64] At 507

[65] (2011) 113 UKUT 1 at 9 (TCC)

[66] Lysaght v. IRC (1928) at 535

The English courts have taken a different direction from the English statutory provisions on the dichotomy between 'resident' and 'ordinary resident'. The area of concern here has to do with the possibility of an individual being an ordinary resident of two states at the same time. On the other hand, almost all the English cases have concentrated on determining whether a UK ordinary resident becomes an ordinary resident of another country. However, they have failed to give guidance on how an individual becomes a UK ordinary resident in the first place. It is submitted that the examination of the resident status of an individual in another state cannot supplant that of the state that claims the taxing right. Finally, it is arguable correct to say that the UK regime considers the same set of factors in establishing both the 'resident' and 'ordinary resident' status of an individual. The only area of distinction is to be found in the case of the second question, that is to say, the cessation of the ordinary resident status.

From the decisions cited above, the physical presence of an individual in the UK is the focal point for the determining whether or not that individual is a UK resident. On the other hand, the question of ordinary residence has focused on both the physical presence coupled with the quality of the physical presence. Thus, the intention of the individual to live (either for a short or long duration) in the UK voluntarily for a settled purpose and as part of the regular order of his life is relevant.[67] Thus, an ordinary UK resident could be liable to pay income tax even if he is not physically present in the UK. Moreover, an individual could be a UK ordinary resident without being resident in the UK.[68]

Furthermore, an individual can easily sever his UK resident status by the duration of his physical absence from the UK. For instance, if an individual is absent from the UK throughout a tax year, his UK resident status may be cut off. However, as

[67] Shah's case (1983) 2 AC 309 at 343 - In determining the settled purpose, factors such as education, business, profession, employment, health, family or even love of the place was held to be relevant. Furthermore,

[68]

the acquisition of the ordinary resident status is premised on the quality of the presence rather than its duration, it is always difficult for an individual to sever his ordinary resident status. In addressing the second question, the common trend taken by the UK courts is that they consider whether or not the individual's absence from the UK is sufficient to sever his ordinary resident status. In such situations, the UK courts look to the first limb of section 829[69] to determine the nature and purpose of the absence. That is whether or not the individual in question left the UK and if he did, whether his absence constitutes a distinct break from his UK mode of life. For instance in IRC v. Combe,[70] the court considered the question as to whether the absence amounts to a severance from the UK and abandonment of the UK ordinary resident status. The court held that whenever an individual has a residence in the UK, the court may only treat him as non-resident if he has left the UK and established a definite break from his UK mode of life.

In Reed v Clark,[71] the respondent was a UK resident and ordinary resident who moved to the USA in 1978 and established a home and business there. He later returned and resided in the UK, without visiting the UK in the interim. The vital question was whether or not the respondent was a UK resident for the tax year at issue. While affirming the findings of the special commissioner, the court held that Mr Clark was not a UK resident because he *left* the UK for a purpose that was not *occasional* in nature. Hence, he was not liable for UK tax during the period of his absence (that is the 1978-79 tax year). Hence, Mr Clark had acquired ordinary resident status in the US because the court held that "occasional residence was the converse of ordinary residence." Therefore, since Mr Clark had not established an occasional residence in the US, he had

[69] Section 829 of the Income Tax Act 2007 which stated that "...if— (a) an individual has *left* the United Kingdom for the purpose only of *occasional residence abroad..."* which is in pari material with section 334 of the UK Income and Corporation Taxes Act 1988

[70] (1932) 17 TC 405

[71] (1985) 58 TC 528, 556

established an ordinary residence. The court did not set out the criteria for establishing a UK ordinary residence, but formulated guidance on how a person can establish an ordinary residence in the US. What was required under the notion of having a defined break, as enunciated in IRC v. Combe, was that even a discernible change in the lifestyle of the individual in question is enough to constitute a break. The subsequent cases misconceived this proposition in deciding what constitutes the break. In some of the cases, the distinct break required is akin to a complete breaking of ties with the UK if an individual wants to sever his UK ordinary resident status.

For instance, in the case of Shepherd v. HMRC,[72] the key issue was whether Shepherd had done sufficient to constitute a distinct break from his UK mode of life. The court held that the presence of Shepherd in Cyprus was for an occasional purpose and did not constitute a distinct break from his UK mode of life. However, in Turberville v. HMRC, [73] the HMRC argued that the appellant's departure from the UK only lasted for sixteen months and was subject to a frequent return visit to the UK. Thus, the absence did not constitute a distinct break in the pattern of his UK life. The court considered all the events as they appeared at that time and held that there was a sufficient break that made Mr Turberville to cease to be a UK resident as at July 2001. This was held to be so notwithstanding the fact that Turberville has retained his UK house. This case supports the notion of a defined break enunciated in the IRC v. Combe.

The court in HMRC v Grace[74] emphasised the need for conducting a multifactorial inquiry in deciding whether or not an individual has made a distinct break from the UK. Unlike Shepherd,Grace had left the UK; therefore

[72] (2006) STC 1821 Mr. which is also premised on section 334 of Income and Corporation Act 1988was British citizen who jointly owned a house in London with his wife and the .
[73] (2010) UKFTT 69 (TC)
[74] (2009) EWCA Civ 1082

the issues before the court were whether or not Grace had left the UK for an occasional purpose and, if so, whether his subsequent return was for a temporary purpose only or was no more than a gap measure.[75] The special commissioner found that Grace was not a UK resident or ordinary resident within the meaning of sections 334 and 336. On appeal to the High Court, the findings of the Special Commissioner were set aside and it was held that Grace was a resident. However, the Court of Appeal transferred the case back to the first tribunal for reconsideration of whether or not the absence of Grace from the UK was for a temporary purpose.

The case of Gaines-Cooper and Davies & Anor v HMRC[76] is very instructive on the issue of a distinct break. The held, among other things, that an individual requires a clean break with the UK before he can be accorded a UK resident or ordinary resident status as a result of his departure from the UK. The individual must have substantially loosened his social and family ties with the UK required. The same was the result in Lynette Dawn Yates v. HMRC[77] where the court held that in determining the extent to which the family and social ties had been loosened for the purpose of establishing a distinct break, a multifactorial inquiry is required, which is intended to evaluate what the individual did to alter his mode of life from the previous mode. The court also considered the appellant's repeated return trips to the UK and the evidence of her close family ties and other factors.[78] In Hankinson v. HMRC,[79] it was held that the individual's intention to return to the UK is relevant in deciding whether or the absence is an occasional one. Moreover, in Reed's case it was held that there is

[75] Goodwin v Curtis (1998) 70 TC 478, 510 "Physical presence in a particular place does not necessarily amount to residence in that place where, for example, a person's physical presence there is no more than a stop gap measure." The Grace's case involved questions under both sections 334 (829) and 336 (831).
[76] (2011) UKSC 47
[77] (2012) UKFTT 568 (TC)
[78] See also Barrett v HMRC (2008) STC (SCD) 268; Darrell Healey v HMRC(2014) UKFTT 889
[79] (2009) UKFTT 384 (TC) 32

no clear time period for an occasional absence. In Glyn v. HMRC,[80] despite the fact that the appellant retained his London house and visited the UK several times during the year, he was held to have distinctly broken his ties with the UK. Mr Glyn convinced the Tribunal that he had broken from his UK business completely and adopted a new way of life in Monaco.

The Canadian courts have recognised 'residence' as an integral part of 'ordinary residence', and addressed both the first and second questions collectively. In other words, they provide for the legal consequence of acquiring Canadian resident or ordinary resident status and the cessation of such status.[81] However, as in the UK, the expressions 'resident' or 'ordinary residence' have not been statutorily defined, and require judicial interpretation. The Canadian Supreme Court summarised the nature of both 'resident' and 'ordinary resident' in Thomson v. Minister of National Revenue as follows in the words of Rand, J:

[80] (2013) UKFTT 645 (TC)

[81] The Canadian Income Tax Act 1985 provides; Section 2. (1) "An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year." (3) "Where a person who is not taxable under subsection 2(1) for a taxation year (a) was employed in Canada, (b) carried on a business in Canada, or (c) disposed of a taxable Canadian property, at any time in the year or a previous year, an income tax shall be paid, as required by this Act, on the person's taxable income earned in Canada for the year determined in accordance with Division D." section 250 (3) "In this Act, a reference to a person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada."

For discussions of the nature of Canadian individual tax resident regime see P Lefebvre 'Canada's Jurisdiction to Tax: Residency and the Thomson Decision 60 Years Later' (2006), 54 (3) Canadian Tax Journal 762; Hogg, PW et al 'Principles of Canadian Income Tax Law' (2007). [6th Ed] Thomson Carswell, Toronto see also Krishna, V 'The Fundamentals of Canadian Income Tax' (2006) (9th Ed) Carswell, Toronto.

> "The gradation of degrees of time object intention continuity and other relevant circumstances shows, I think, that in common parlance "residing" is not a term of invariable elements all of which must be satisfied in each instance. It is quite impossible to give it precise and inclusive definition It is highly flexible, and its many shades of meaning vary not only in the contexts of different matters but also in different aspects of the same matter... The expression "ordinarily resident" carries restricted signification … It is held to mean residence in the course of the customary mode of life of the person concerned and it is contrasted with special or occasional or casual residence. The general mode of life is, therefore, relevant to the question of its application… The ordinary residence can best be appreciated by considering its antithesis occasional or casual or deviatory residence. The latter would seem clear to be not only temporary in time and exceptional in circumstance but also accompanied by a sense of transitoriness and of return … so-called "permanent residence", "temporary residence", "ordinary residence", "principal residence" and the like, the adjectives do not affect the fact that there is in all cases residence and that quality is chiefly matter of the degree to which person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations interests and conveniences at or in the place in question."[82]

In the same case, Estey J. described the nature of resident and ordinary resident as follows:

> "A reference to the dictionary and judicial comments upon the meaning of these terms indicates that one is 'ordinarily resident' in the place wherein the settled routine of his life he regularly, normally or customarily lives. One 'sojourns' at a place where he unusually, casually or intermittently visits or stays. In the former the element of permanence; in the latter, that of the temporary predominates. The difference cannot be stated in precise and definite terms, but each case must be determined after all of the relevant factors are taken into consideration, but the foregoing indicates in a general way the essential difference. It is not the length of the visit or stay that determines the question…"[83]

[82] (1945) SCR 209 at 224-225 in this case a Canadian resident left Canada for Bermuda with intention of settling there. He stayed there for over 183 days in a year. But within the interim, he made frequent visit to Canada and live in his own house. It was held that he was a Canadian resident for tax purposes. See also Beament v. Minister of National Revenue (1952) 2 S.C.R. 486; Schujahn v. M.N.R., 62 DTC 1225 (Ex. Ct.);

[83] Ibid, see also Fisher v. Canada, (1995) 1 C.T.C. 2011,

The establishment of Canadian resident status (other than deemed resident status) or ordinary resident status is a question of fact.[84] The courts have set out various factors such as the past and present habits of life; regularity and length of visits in Canada, personal and economic ties in Canada and elsewhere and the permanence of otherwise of purposes of stays abroad.[85] These factors are applicable not only for the cessation of resident status but also for the establishment of residence as well. While stating the difference between the Canadian and the UK approach to questions of 'resident' and 'ordinary resident' Bowman, J. in Kadrie v. Canada,[86] stated that:

> "It is, I believe, apparent from the decision of Schujahn v. M.N.R. 62 DTC 1225 and the Thomson case that one should treat with some caution the decisions under the United Kingdom taxing statutes."

The Canadian cases on the questions of the resident or ordinary resident fall into three categories:

1. The cases where the individual has been a Canadian ordinary resident and claims to have terminated his ordinary resident status because he left Canada and established a residence in another country. The issue for determination in these type cases is whether or not the individual severed his relationship with Canada;
2. The cases where an ordinary resident of another country acquires resident status in Canada. The issue for determination is whether or not he has become a Canadian ordinary resident eligible for all the deductions and other benefits available to an ordinary resident;

[84] The Queen v. Laurin (2008) FCA 58

[85] The Queen v, Reader 75 DTC 5160 at 5163, Kadrie v. The Queen (supra). But the main factor being considered in determining the residence or ordinary residence of an individual is sufficient residential ties with Canada. That is the location of a dwelling place in Canada.

[86] (2001) T.C.J. No 601 (Q.L.)

3. The cases where a Canadian resident emigrates to another country and cuts all his relationship with Canada, but later re-acquires his ties with Canada. The issue is at the point at which he resumed his Canadian resident status.

The trend of the Canadian Courts is to consider the temporary absence of the individual as insufficient to terminate Canadian ordinary resident status. In Beament v. MNR,[87] Beament left Canada in the UK for an overseas job. However, before he left, he terminated his tenancy and stored all his belongings in a room of his parent's house. He married and established a matrimonial home in the UK. The court held that, irrespective of the appellant's intention to return to Canada; he was neither resident nor ordinarily resident in Canada during the portion of 1946 before his return to Canada.[88] In the somewhat similar case of The Queen v. Bergelt,[89] while leaving Canada, the respondent left his wife behind to monitor the renovation of their house before its intended sale. He also deposited his U.S. pay cheque into his Canadian bank account, and he made several trips to Vancouver. The court held he ceased to be a Canadian resident at the time he left for California for an overseas job, In the case of Griffiths v. The Queen,[90] the court held that a retired Canadian executive who amicably separated from his wife and moved to a Caribbean Island ceased to be a resident of Canada despite the fact that he made occasional visits to Canada and retained substantial investments there.

On the second category mentioned above, there are various cases involving the question of residence where it was the individuals[91] who wanted the Revenue

[87] (1952) 2 S.C.R. 486
[88] However, this decision has been overruled by section 250(1) (b) of the Canadian Income Tax Act 1985 that provides that all members of Canadian Forces are deemed to be Canadian resident to tax purpose.
[89] (1986) 1 CTC 212 (FCTD)
[90] (1978) CTC 372 (FCTD)
[91] For the purpose of enjoying certain benefits under the Income Act,

Authority to treat them as ordinary residents. In these cases, the question has always been one of establishing the ordinary resident status of the individual. In Perlman v. Queen,[92] the court held the appellant to be a Canadian resident for 2003 and 2004 and eligible for the Child Care Tax Benefit[93] even though he had been absent from Canada since 1994. The court considered the length of the appellant's stay in Israel, but was inclined to attach more weight to the appellant's social and economic ties with Canada.

Furthermore, in the case of Fatima v. The Queen,[94] the appellant, had not acclimatised to the Canadian life within her first six months in Canada before she left Canada for a temporary visit to Pakistan. The court held that she was a Canadian resident and entitled to the benefit at issue. The court also found that her ties with Canada had been acquired when she arrived in Canada because her husband had been settled in Canada for several years. The court considered the nature of the appellant's husband's stays in Canada in arriving the decision. Thus, it applied the rule in Re Young and Rogers' cases in another form. However, in Nedelcu v. The Queen, (2010) FCA 156 the appellant immigrated to Canada and became a Canadian resident, then left Canada without signifying any intention to return to Canada and did not return. She argued that all the factors that tied her with Canada had continued to be present up to 2003, 2004 and 2005 and that there was no reason for the Minister to issue a Notice terminating her Canadian ordinary resident status. The court decided that she was not a Canadian ordinary resident because her mode of life was more Romanian rather than Canadian.

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[92] (2010) TCC 658

[93] Pursuant to section 122.6 of the Canadian Income Tax Act 1985 only a Canadian resident is entitled to the CCTB. Mr. Perlman wanted to benefit from the scheme but he was denied on the ground that he was not a Canadian resident. He challenged the decision of the Minister of Revenue on that ground.

[94] (2012) TCC 49

For the third category, the courts look at the issue from the perspective of dual residency and consider whether there is any applicable Double Taxation Agreement between Canada and the country where the individual resides. Thus, even if the Court decided that the individual did not sever his ties with Canada, the courts go further to examine the applicability of any existing DTA between Canada and the other country. The Court discussed this issue in the case of Allchin v. The Queen,[95] where the appellant was born in Canada but moved to the US with her parent, obtained a Green Card and also worked as a nurse there. She moved back to Canada, but still maintained her job and the US Green Card. She commuted from Canada to the US for the work. The Tax Court held that since the appellant did sever her tie with Canada, she remained an ordinary resident and liable to Canadian tax. However, the Court of Appeal considered not only the issue of severing relations with Canada but also the issue of whether the individual can establish a residence in another state without necessarily severing his Canadian ordinary resident status. It set aside the decision of the Tax Court and ordered a retrial of the case to reconsider the issue of the Canada – US Tax Treaty.

The US notion of individual residence is worthy of consideration. In the US both citizens and permanent residents (Green Card holders) are liable to tax on their worldwide income.[96] Moreover, individuals who are neither citizens nor permanent residents (resident aliens) are considered as a non-resident alien. Before 1984, the terms 'resident alien' and 'non-resident alien' had not been statutorily defined. However, the Treasury Regulation defined a resident as an individual who was not a mere transient or sojourner in the US. The intention

[95] (2004) FCA 206 see also Black v. The Queen, (2014) TCC 12; Gaudreau v The Queen, (2005) CTC 2702 Smith v. The Queen (2000) CanLII 352 (TCC); Huh v. The Queen, 2000 CanLII 229 (TCC)

[96] What makes an individual a US citizen or Green Card holder is entirely governed by the US Immigration laws

of the individual to stay in the US[97] was the key factor determining the residence status of individuals by the Internal Revenue Service and the courts have intervened in disputed cases.

In ascertaining the actual intention of an individual, the courts have considered the physical presence of the individual in the US as well as his intention to reside in the US with some degree of permanence. For instance, in Ingram v. Bower[98] the court held that living and working in the US for six months per year was not enough to establish an intention to stay in the US. The court was persuaded by the domicile of the individual in arriving at the decision. However, in Commissioner v. Nubar,[99] the court held that the domicile of a person should not be a factor in determining the intention of a person to stay; therefore, the respondent was a US resident.[100] In Adams v. Commissioner,[101] the court maintained the test for determining the residence of individuals to be the physical presence and the intention to say in the US. The US courts inferred the intention to stay from the purpose and character of the visit;[102]acquisition of US home;[103] social, cultural and business ties;[104] relocation of families;[105] bank account[106] and type of visa.[107] However, in Part v. Commissioner,[108] the court held that the residence of an individual is a question of fact to be decided based

[97] Which is measured by the length of time and the nature of the stay. If an individual entered the US with the intention to accomplish something promptly or with a limited visa, he would be presumed as a non-resident. But the presumption could be rebutted by the intention of the individual.
[98] (1931) 47 5 DNY 925
[99] (1951) 341 US 925
[100] However, in Constantinescu v. Commissioner (1948) 11 T.C. 37 which share similar fact with that of Nubar's case, the court held the appellant not US resident. In both cases the individuals were forced to stay in the US due to the World War II situation in the Europe at that time. But in Constantinescu's case the court concentrated on the facts and circumstances of the case, while in Nubar's case, the court considered similar facts but arrived at different decision.
[101] (1966) 46 TC 352
[102] Siddiqi v. Commissioner (1978) 70 TC 553
[103] Adams v. Commissioner (1966) 46 TC 352
[104] Schoneberger v. Commissioner (1980) 74 TC 1016
[105] Maclean v. Commissioner (1980) 73 TC 1045
[106] Hoskins v. Commissioner (1983) 52 TC 508
[107] Escobar v. Commissioner (1977) 68 TC 304; section 1.871-2(b) Treasury Regulation 1960
[108] (1982) 79 TC 252

on all relevant facts and circumstances. Hence, only the unique personal situations of the individual could provide the needed guidance. The court was not persuaded by the judgments cited by both parties.

Due to the complexity and uncertainty inherent in the subjective test developed by the courts in determining the residence of individuals, a committee was set up to address the issue.[109] The committee recommended an objective definition of US residence for income tax purposes. This recommendation culminated in the enactment of the Tax Reform Act of 1986, and section 1810 (1) of the Act which amended section 7701(b) of the Internal Revenue Code of 1960. The amended section set out the framework for a statutory test for individual residents in the US for both federal and states income taxes.[110]

The above discussion reflects on the nature and meaning of 'residence' and 'ordinary residence' in the UK tax regime. The judicial analyses of the two expressions were carried out by way of a facts and circumstances inquiry as they were not statutorily defined. The courts considered various factors in determining the question as to how an individual acquires and loses UK resident status.[111] However, for ordinary residence, the courts seemed to have focused

[109] House Committee on Ways and Means – HR 4170

[110] See Rothschild Jr and Schinner, M 'United States: Determining Residency for Federal Income Tax Purposes' (1993) 47 BFID Publication 85, Williams, D ' Back to the future: A time for rethinking the test for resident alien status under the Income Tax Laws' (1988) 21 Vand. J. Trans. L. 965. What is not clear from the committee's report as well as the amendment is whether the earlier cases that dealt with the issue of intention of the individual to stay in the US remains valid under the new objective test as the UK 'Statutory Resident Test' regime did to the pre-2013 cases? This question is very important due to the number of exception attached to the substantial presence test introduced by the amendment. The individual tax residence discussed above is about the US federal income tax only. The states of the US are empowered by the US Constitution to impose an income tax on their residents and non-resident. Although the states use the statutory definition of both resident and non-resident, the definition is premised on the concept of domicile, which has been defined statutorily by all states of the US. Therefore, in the US context domicile is a very important concept, though not at the federal level. See Hashmi, A 'Is home really where the heart is?: State taxation of domiciliaries, statutory residents, and nonresidents in the District of Columbia' (2012) 65 Tax Lawyer 797.

[111] That served as models followed in most of the common law jurisdictions.

on its cessation rather than its acquisition. The courts have inclined toward a proposition that 'residence' is a prerequisite of 'ordinary residence', and there was a little difference between the resident and ordinary resident. However, the UK statutes have recognised the distinction between the two concepts.[112] On the issue of cessation of ordinary residence, the courts haveevolved the idea of a distinct break as the core requirement for the termination of ordinary residence. From the above analysis, the establishment of the UK ordinary resident status was governed by the combination of the various principles formulated for the purposes of resident simpliciter as well as the non-binding IR20 and HMRC6.

5.2.1.3 Permanent Place of Abode

The Australian and New Zealand tax regimes have introduced the concept of 'permanent place of the abode' to determine the residence of an individual for income tax purposes. Under the Australian regime, two definitions of residence involve the facts and circumstances inquiry,[113] the common law residence test and the domicile test. The presence of 'permanent place of abode' in Australia involves a sine qua non as regards the domicile test.[114] That is to say, even if an individual is domiciled in Australia, he will not be considered as an Australian resident if he satisfies the Commissioner that his 'permanent place of abode' is outside Australia.[115] In determining whether or not the 'permanent place of abode'

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[112] See section 829 and 831 of Income Tax Act 2007 and section 25 and 36 of the Income Tax (earning and Pension) Act 2003.

[113] By the combined effect of section 995-1 of the Australian Income Tax Assessment Act 1997 and section 6 (1) of the Australian Income Tax Assessment Act 1936, "a resident or Australian resident is (a) a person other than company who resides in Australia and includes a person: i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia..." It has not mentioned ordinary resident.

[114] "The Act is not concern with domicile except to the extent necessary to show whether a taxpayer has an Australian domicile. What is importance is whether the taxpayer has abandoned any residence or place of abode in Australia" Northrop J. In FCT v. Applegate "

[115]Alley,C et al 'In Need of Reform? A Trans-Tasman Perspective on the Definition of "Residence"'(1995) 5(1) Revenue Law Journal

is in Australia, the Commissioner and the courts conduct a facts and circumstance inquiry. Thus, the determination of 'permanent place of abode' is a fact-intensive inquiry.

The New Zealand system, on the other hand, has adopted the concept of 'permanent place of abode' as the facts and circumstances test for the determination of individual residence.[116] However, unlike the Australian regime, it does not link the concept of 'permanent place of abode' to that of domicile. Thus, domicile has no relevance in New Zealand's notion of a 'permanent place of abode'. However, despite the importance of the concept of 'permanent place of abode', it has not been statutorily defined under either of the two regimes. Hence, the concept is being defined by the courts.

The Australian court in Applegate v Federal Commissioner of Taxation explained what constitutes a 'permanent place of abode'. The court considered whether or not the establishment of 'permanent place of abode' outside Australia requires an intention to live outside Australia indefinitely and whether the word 'permanent' should be given its ordinary meaning. The court held that even though the respondent ultimately intended to return to Australia this did not stop him from establishing a permanent place of abode outside Australia. It was also held that the word 'permanent' should be defined within the context of the Act. That is to say, it does not mean everlasting or forever as the liability for tax (especially the rate payable) is determined annually. Justice Fisher succinctly explained the nature of 'permanent place of abode' as follows:

> "…the word "permanent" is used to qualify the expression 'place of abode' i.e. the physical surroundings in which the person lives, and to describe that place. It does not necessarily direct attention to the taxpayer's state of mind in respect of that or any other place… the proper construction of place upon the phrase 'permanent place of abode' is that

[116] Section YD(2) of New Zealand Income Tax Act 2007 "Despite anything else in this section, a person is a New Zealand resident if they have a permanent place of abode in New Zealand, even if they also have a permanent place of abode elsewhere."

> it is the taxpayer's fixed and habitual place of abode. It is his home, but not his permanent home… Material factors for consideration will be the continuity or otherwise of the taxpayer's presence, the duration of his presence and the durability of his association with the particular place."[117]

In this case, the court gave a broad meaning to 'residence', but applied a contextual approach to defining 'permanent' in the phrase 'permanent place of abode.' In analysing the concept of 'permanent place of abode' both the Australian and the New Zealand courts considered the expression 'place of abode' to mean an individual's residence as defined in Levene and Lysaght, that is to say, the dictionary meaning. However, Australian courts defined 'permanent' in the context of section 6 of the Income Tax Assessment Act.

The central issue under the Australian regime is that, for an individual to lose or abandon his Australian domicile, he needs to satisfy the commissioner that he has established a place of abode outside Australia. The tax regime does consider the possibility of an individual's becoming a dual resident of Australia and the other country. For instance, in AAT Case 12551,[118] the appellant had been overseas for almost five years. The Tribunal held that she was still a resident because she had not abandoned her domicile nor established a 'permanent place of abode' elsewhere. The next question was whether it was possible for her to stay overseas for about five years without becoming a tax resident there.

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[117] Applegate v. FCT (1979) 79 ATC 4307 at 4317 See also FCT v. Jenkis (1982) 82 ATC 4098 (where the issue for determination was whether or not fixed term of stay overseas and the early termination of the overseas stay prevented an individual from establishing permanent place of abode overseas. Hence, there is no limit of period that an individual must stay outside Australia before he can establish a permanent place of abode there.) The same line of reasoning was followed in the case of Mayhew v. FCT (2013) AATA 130. However, in Iyengar v, Commissioner of taxation (2011) AATA 856 the Tribunal found that the terms of the appellant's overseas employment was fixed and more specific than that of Jenkins.. It was also found that he maintained all his social, family and business ties with Australia. Therefore his stay in Dubai was temporary and transitory and it does not amount to permanent place of abode.

[118] (1998) 37 ATR 1263; cited in Dirkis M '...Nowhere man sitting in his nowhere land': The continuing saga of cross border arbitrage,' (2012) 22*Revenue Law Journal* 1 at 6.

The early New Zealand decisions viewed the concept of a permanent place of abode in the case of Geothermal Energy New Zealand Ltd v CIR[119] as a place around which the individual's domestic life revolved, that it so say, a place that makes the individual have an enduring domestic relationship with New Zealand. As Alley put it, the permanent place of abode of a married man (or woman) is where his wife (or her husband) or their children reside at that particular time. In the case of a single person, it is the place that is the centre of their interests and affairs.[120] However, subsequent cases have enunciated other notions of a permanent place of abode as meaning a place where an individual normally or habitually lives, but it does not require that a residence is always vacant and available for the person.[121]

A fundamental difference between Australia's and New Zealand's notion of a permanent place of abode is that the availability of a permanent place of abode in another country is not relevant to the inquiry as to whether the individual also had a permanent place of abode in New Zealand. Thus, the New Zealand regime focuses on the whether or not an individual has a 'permanent place of abode' in New Zealand. The availability of place of abode in New Zealand is a condition precedent for treating an individual as a resident. Moreover, once he ceases to have a permanent place of abode in New Zealand, he ceases to be a resident. The fact that the individual has a permanent place of abode abroad is immaterial. The New Zealand model of permanent place of abode is thus a mechanism for establishing the residence of individual for tax purposes.

The Australian regime, on the other hand, focuses on the question whether the individual has a 'permanent place of abode' outside Australia. Thus, the

[119] (1979) 4 NZTC 6478.
[120] Clinton, A et al 'The New Zealand definition of "residence" for individual: Lessons for Australia in a "Global" environment '(2002) 4 (1) J. Aust. Taxation 40 at 53.
[121] Case Q55 (1993) 15 NZTC 5313

availability of a place or abode abroad will make an individual a non-resident of Australia for tax purposes. It follows, therefore, that an individual could revert to his Australian resident status as soon as he relinquishes his established permanent place of abode even though he is yet to return to Australia. For instance, an Australian expatriate can create a permanent place of abode outside Australia and relinquish it upon the completion of his overseas job. However, he may decide to take a retirement leave in another country without establishing a permanent place of abode there. Under the Australian regime, that individual is liable to tax in that year, even though he did not set his foot in Australia. The Australian model of 'permanent place of abode' is a means of rebutting the presumption of continued Australian-domiciled status imposed on an individual.

An analysis of the subjective approach to the determination of residence and ordinary residence of individual by the five common law jurisdictions[122] reveals that the leading UK decisions are the cases of Levene v. IRC and Lysaght v. IRC. The leading Canadian authority on the subject is the case of Thomson v MNR, [123] where the Canadian Supreme Court recognised and applied the principles enunciated in the UK cases of Levene and Lysaght. The leading Australian cases on residence are Gregory v. Deputy Commissioner of Taxation,[124] and FCT v. Miller[125] which also followed the principles in Levene and Lysaght. The UK decisions have influenced cases of common law jurisdictions. Both the Nigerian and South African courts make reference to those judicial decisions. Despite the influence of the UK decisions, in 2013 the

[122] The United Kingdom, United States of America, Canada, Australia, New Zealand.

[123] By the research conducted from November, 2014 to June 2015, there is no Canadian Tax case (which involves the question of residence or ordinary residence) that did not cited and of the principles formulated in the Thomson v. MNR

[124] (1937) 57 CLR 774 From a survey conducted in May, 2015 through an Australian search engine, this case has been cited in more than fifteen Australian cases that discussed the issue of individual residence. The most recent cases include; Micheal Shord v. Commissioner of Taxation (2015) AATA 355

[125] (1946) 73 CLR 93 As at May 2015, this case has been cited in about sixty-two Australian Tax cases.

UK completed changed its individual residence regime. It introduced a statutory residence test that eschews all the judicial principles cited above.

The jurisdictions discussed differ in both the statutory framework and the judicial approaches to the determination of an individual's residence based on facts and circumstances. The underlying need for subjective tests arises from the inability of the objective test to adequately account for the divergent interests of potential taxpayers. However, due to the variations in an individual circumstance, this test is prone to fail the tax equity evaluation. Some common law jurisdictions such as the Republic of Ireland have adopted the same set of terms used by the UK for determining individual residence. However, the Irish tax regime has clearly defined both 'resident' and 'ordinary resident'. It has adopted an objective test based on the physical presence of the individual in the state. Thus, an individual becomes an Irish resident if he has spent at least 183 days in Ireland in the year of assessment.[126] Also, a resident for each of the three years preceding the year of assessment becomes an ordinary resident.[127] The converse applies if an individual has ceased to be an ordinary resident and he has not been residing in Ireland for each of the three years.[128] The UK has followed Ireland's path by abandoning all the facts and circumstances test it hitherto applied.

5.2.2 The definitions may depend on the general legal concepts

In the search for a suitable method of determining individual residence for tax purposes, some states use legal concepts that are applicable in other areas of law, such as domicile and citizenship.

[126] Section 819 of the Ireland Income Tax Act 1997 (as amended)
[127] Ibid section 820 (1)
[128] Ibid section 820 (2)

5.2.2.1 Domicile

Domicile is a legal relationship between a person and a country by which the person can invoke the country's laws as their own.[129] Domicile means an individual's fixed and permanent place of abode in which he intends to remain indefinitely, or if he has left the place, he maintains an intention to return.[130] It is considered as an individual's permanent home as opposed to where he resides. Thus, an individual could be a resident of the state he currently lives but remains domiciled in another state to which he has the intention to return. As a rule, no individual can live without a domicile, and he cannot have two domiciles at the same time.[131] That is why the domicile of an individual could be either the 'domicile of origin' or 'domicile of choice'. The individual acquires the domicile of origin at birth. It could be the domicile of the father or that of the mother, depending on whether the individual is a legitimate or illegitimate child at birth.[132] The latter is acquired upon the attainment of full age, capacity and the intention to make the new domicile his permanent base. Therefore, the law presumes all individuals to have a domicile of origin in their place of birth. It is the acquisition of a new domicile (the domicile of choice) as well as the termination of the domicile of origin or former domicile of choice that generates controversy.

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[129] Henderson v. Henderson (1965) All ER 179

[130] However, the Australian notion of domicile as a means of establishing individual residence for tax purposes has brought another dimension to the concept of domicile. The Australian regime provides that even if an individual is domiciled in Australia, he can escape the tax liability if he can satisfy the Commissioner that his permanent place of abode is outside Australia. Thus, the Australia regime does not consider domicile as an individual permanent home.

[131] Mark v. Mark (2006) 1 AC 98; IRC v. Bullock (1976) 1 WLR 1178 at 1184. For discussion on the significance of the parent domicile to the determination of an individual domicile see Lollman, J 'The significance of parental domicile under the citizenship clause' (2015) 101 Va. L. Rev. 455

[132] Udny v. Udny (1869) 1 Sc & Div 441 at 457

The focal point for determining the domicile of an individual is his intention to either remain in the domicile of choice or return to his domicile of origin, or to acquire a new domicile and abandon the former one. Is there a universal criterion for ascertaining the intention of a person? The determination of such intention is a question of fact and the rules as well as the case law in each state may differ. One commentator[133] has argued that whenever residence is defined as domicile, both residence-based and citizenship-based systems overlap, as both take account of the intention of an individual to remain in or to return to his state of domicile rather than his physical presence. Domicile resembles citizenship in that both embody permanent allegiance of an individual to a particular state even if he is not physically present. But an individual may acquire a domicile in a state different from the state where he is a citizen. The new state of domicile may not accord him all the privileges available to its citizens. Thus, it may not expect him to have any political allegiance to the state. The individual may decide to abandon the domicile so acquired and return to his domicile of origin. Therefore, domicile and citizenship are two different concepts because the acquisition of the former does not alter the position of the latter. However, the question is whether the notion of domicile is a suitable test determining individual residence.

For an individual to be considered as domiciled in a state, he must have the intention to remain in that state indefinitely. If he has the intention to return to his state of origin, then he remains domicile of that state,[134] notwithstanding the fact that he resides for a long period in a particular state, enjoying all the benefits and protections from the new state. Thus, staying in a state for an extended period is not determinative for establishing domicile. Also, long absence from

[133] Zelinsky, EA (2011) at 1324
[134] IRC V. Bullock (1976) 3 ALL ER 353.

a state may not terminate the domicile status of an individual. The rigid nature of the concept of domicile renders it unsuitable for determining tax liability.

Two questions are often asked in assessing the justification for taxing individuals based on their personal relationship with the state. Is it proper to tax an individual who is temporarily present in a state, without enjoying any benefits from that state? Is it justifiable for an individual to stay in a state for a long time[135] without paying tax, on the ground that his domicile in another state and he has no intention to abandon it and establish a new one in the current status? The concept of residence answers these, because it renders the individual liable to tax based on the length and quality of his stay in the state.

The notion of domicile applies to the civil law jurisdictions and is similar to the concepts of 'ordinary residence' applicable in the UK, Canada, and other common jurisdictions. It is also analogous to the 'permanent place of abode' under the Australian and New Zealand tax regimes. The French tax regime adopted the concept of 'tax domicile' which provides that an individual becomes a French resident if his permanent home or principal abode is in France. Alternatively, if he performs his professional activity in France, or his centre of economic interest is in France.[136] All these criteria are based purely on the facts and circumstances of each case. Thus, there is no physical presence test involving the number of days in France. Conversely, the German tax regime has adopted the concepts of 'domicile' and 'habitual abode'[137], and the two terms have been defined statutorily. Domicile is defined as a fixed

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[135] Enjoying the benefits provided by the state to the same extent as the citizens.

[136] See Art.4B of the French Tax Code 1977. See also Message, N 'France' *in* Maisto, G (ed) 'Individual residence under tax treaties and EC Law' (2010) IBFD Publications, Netherland 329; Juilhard, P 'Towards a New Definition of Tax Residence in France – A Critical Analysis of the Larcher Case' (1996) 50 Bull. Int'l Fiscal Doc.141.

[137] See section 1(1) of the German Income Tax Act 2000. The same concepts adopted and defined by Austria – section 26 of the Austrian Federal Fiscal Code 2009.

accommodation available for frequent use of an individual in Germany.[138] Habitual abode is defined as a place where an individual is physically present and is deemed to be present in that place if he stays for more than six months. The place need not be fixed.[139] Both definitions are premised on the objective test as the intention of the individual is irrelevant. The same trend is followed by other civil law jurisdictions.[140]

5.2.2.2 Citizenship

Citizenship is a general concept that can be viewed from political, social and legal perspectives.[141] From the legal perspective, citizenship is connected with certain rights which the law of a state guarantees to all citizens of the state in exchange for a political allegiance to the state by the citizens. Thus, it serves as a strong link between the state and individual. However, for the purpose of

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[138] Section 8 of the German Fiscal Code 1986

[139] Ibid section 9 see also Rust, A in *in* Maisto, G (ed) 'Individual residence under tax treaties and EC Law' (2010) IBFD Publications, Netherland at 361.

[140] For instance, by Article 2(1) of the Belgium Income Tax Code 1992, Belgium has adopted the concepts of 'residence' and 'seat of wealth' to determine the individual residence. But two concepts were not defined, hence, they are determined by the fact and circumstances test. Factors such as place of individual's main residence and place from which the individual's property is managed are considered. By Article 4 of the Dutch General Taxes Act 2001 defines the residence of individual as "where someone lives is assessed on the basis of circumstances" see Gunn, A 'The Netherland' *in* Maisto, G (ed) 'Individual residence under tax treaties and EC Law' (2010) IBFD Publications, Netherland at 470 (According to Gunn The Netherland adopted an open norm as it is difficult to identify, with precision the factors to be considered in determining individual residence.). The Spanish regime adopted the concepts of 'habitual residence' and the 'main centre of economic interest'. By section 9 of the Natural Persons' Income Tax Act habitual residence is defined as staying in Spain for 183 days, while the determination of main centre of economic interest is determined by fact and circumstances. The Swiss regime also adopted both personal and economic relationship as the criteria for imposing income tax liability. For the personal relationship criteria, the regime adopted the concept of domicile (which determined by fact and circumstances) and residence based on number of days spent in Switzerland; which is either 30days (where the individual stays and conduct gainful activity) or 90 days (where he stays in Switzerland without any interruption). See Article 3 and 4 of the Federal Tax Harmonization Act. See also Pfister, RA and Obrist, T 'The Netherland' *in* Maisto, G (ed) 'Individual residence under tax treaties and EC Law' (2010) IBFD Publications, Netherland at 541; Rossi, MQ 'Italy's Supreme Court rules on establishing tax residency' (2014) Tax Notes Int'l 557- The recent Italian Supreme court decision, an individual can be treated as non-resident if he produces copies residential lease agreement, utility bills and bank account details.

[141] Iija, VI 'An analysis of the concept of citizenship: Legal Politocal and Social Dimensions' (2011) Master's Thesis submitted to Faculty of Social Sciences, University of Helsinki 4

exercising tax jurisdiction, only a few countries recognise citizenship as a connecting factor for tax jurisdiction. Among those states that have adopted the concept, it is only the United States of America that taxes its citizens on a worldwide basis.[142]

The US regime adopts two independent methods for determining the resident status of individual for income tax purposes. It relies on the immigration status of an individual as well as the length of his physical presence in the US. The former is solely determined under the US immigration legislation. Thus, all US citizens and permanent residents (Green Card holders) are taxed on their worldwide income.[143] The justification for taxing citizens on their worldwide income has been upheld in the case of Cook v. Tait[144] where the US Supreme Court stated that:

> "The power to tax does not depend on the situs of property or domicile of the citizen but is instead based on his relation as a citizen of the US and the relation of the latter to him as a citizen."

Most of the commentators[145] that justify citizenship-based also base their arguments on the benefits of US citizenship which the citizens enjoy while living abroad. They argue that even though US citizens living abroad may not receive the benefit immediately they will take advantage of the prior infrastructure put in place if they return to the United States.[146] Other defenders

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[142] For example, section 23 (A) and (B) of the Phillippines National Revenue Code 1997 provide for separate mode taxation for both citizens who reside in Phillippines and those citizens who are not residing therein. The former are liable to worldwide taxation while the latter are liable to sourced-based taxation.

[143] Section 7701 (b) of the US Internal Revenue Code

[144] (1924) 47 US 265

[145] Kirch, MS 'Revisiting the tax treatment of citizens abroad: reconciling principle and practice (2014) 16(3) Fla. Tax Rev. 117; (He argued that the United States should retain its citizenship-based taxation regime, but it should take steps to ameliorate unnecessary burdens faced **by** overseas citizens); Michael S. Kirsch, MS 'Taxing Citizens in a Global Economy'(2007) 82 N.Y.U. L. Rev. 443; Sobel, RJ 'United States Taxation of Its Citizens Abroad: Incentive or Equity'(1985) 38 Vand. L. Rev. 101; Colon, JM 'Changing US tax jurisdiction: expatriates, immigrants and the need for a coherent tax policy (1993) 34 San Diego L. Rev. 1

[146] Kirch, MS (2014) at 221

of citizenship-based taxation reject benefits as the justification, but rather consider it as an administrative proxy of domicile.[147]

However, the rationale for the US citizenship-based taxation regime has been criticised by many commentators.[148] The criticisms of citizenship as a connecting factor for taxation is premised on the rationale for taxing the foreign-sourced income of a non-resident US citizen on a worldwide basis. The US tax regime imposes obligations on US citizens living abroad to report details of their foreign financial accounts and assets. It also imposes a reporting obligation on foreign financial institutions to furnish the US with all information about the overseas accounts of a US citizen.[149] Under citizenship taxation, the residence of the individual is irrelevant while, in residence-based taxation, residence is

[147] Zelinsky, EA 'Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile' (2011) 96 IOWA L. Rev. 1289(Who stated that "An individual's citizenship is an administrable, if sometimes overly broad, proxy for his domicile, his permanent home. Both citizenship and domicile measure an individual's permanent allegiance rather than his immediate physical presence.");

[148] Mason, R 'Citizenship Taxation' paper presented at the New York University School of Law, Colloquim on Tax Policy and Public finance, Spring (2015) (Arguing that the US citizenship-taxation regime may subvert immigration law goals of attracting wealthy and highly skilled immigrants.); Avi-Yonah, RS 'The case against taxing citizens' (2010) Univ. of Mich Working Paper No. 190; Avi-Yonah, RS 'International tax as international law' (2004) 57 Tax L. Rev. 483; hervey JR 'Schneider, B 'The End of Taxation Without End: A New Tax Regime for U.S. Expatriates' (2012) 32 Va. Tax Rev. 1 (proposing a "departure tax regime" that would apply to residence changes); Blum, C and Singer, PN 'A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals' (2008) 41 Vand. J. Transnat'l L. 705 (proposing replacing citizenship taxation with an extended tax-residence rule). Worster, WT 'The constitutionality of the taxation consequences for renouncing U.S. citizenship' (2010) 9 (11) 923 at 930; Fleming, JC et al 'Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income' (2001) 5 Fla.Tax Rev. 299, 309; Ault, HJ and Arnold, BJ 'Comparative income taxation: a structural analysis' (2010) 429; Postlewaite, PF and Stem, GE 'Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for Its Repeal, 65 VA. L. REv. 1093 (1979); Sobel, RJ 'United States Taxation of Its Citizens Abroad: Incentive or Equity, 38 Vand. L. Rev. 101 (1985); Gann, PB 'The Concept of an Independent Treaty Foreign Tax Credit' (1982) 38 Tax L. Rev. 1 58-69

[149] Section 501(a) of the Foreign Account Taxpayer Compliance Act ("FATCA"), 2010; See Harvey, JR 'Worldwide Taxation of U. S. Citizens Living Abroad Impact of FATCA and Two Proposals' (2013) Villanova Univ Public Law and Legal Theory Working Paper No. 2013-3057 available at http://ssr.com/abstract=2318463; For the historical antecedent of FATCA, see Harvey, JR 'Offshore Accounts: An Insider's Summary of FATCA and Its Potential Future' (2012), 57 Vill. L. Rev. 471 available at http://ssrn.com/abstract=1969123. Harvey, JR 'FATCA – A Report From the Front Lines' (2012) 136 Tax Notes 713available at http://ssrn.com/abstract=2122491. ("many foreign financial institutions are blaming FATCA's reporting obligations for their refusal to provide necessary financial services to U.S. citizens")

the determining factor. Unlike the citizen-based system, a residence-basis reflects both the equitable notion of benefit that the individual enjoys from the state and the enforceability of the tax. Citizenship-based tax is not based on benefits and enforcement.

Therefore, citizenship-based taxation treats two similarly situated US citizens differently. Thus, it fails to satisfy the horizontal equity criteria. For instance, if one of the citizens lives in the US, and another stays abroad. The one in the US will be in a better position to benefit from the state's infrastructure. The citizenship-based regime also fails the administrative convenience criteria from the perspective of both the individual taxpayer and the government. Thus, even if the government can trace all non-resident citizens and exercise substantive tax jurisdiction over them, it will face the problem of exercising the enforcement jurisdiction over non-resident citizens. However, Zelinsky[150] opines that citizenship is better than residence as a tax basis because a state that adopts citizenship does not require an establishing nexus like that of residence. This argument fails to consider the fact that the substantive jurisdiction of a state may be rendered nugatory if it lacks enforcement jurisdiction over the individual involved. From a tax efficiency perspective, adopting citizenship as a connecting factor for tax will distort the behaviour of the individuals as some citizens may decide to renounce their citizenship to escape tax.

The current global economic integration is a serious challenge to the justification of using citizenship as a connecting factor for tax jurisdiction.[151] If citizens are taxed on the basis of their individual relationship with the US, then it could be possible for the individual to have relationships with many states.

[150] Zelinsky EA (2011) at 1291

[151] Kirch (2007) and Kirch (2014) supra (it was argued that globalization strengthen rather than weaken the notion of taxing citizens living abroad. especially with the current legal mechanism for mandatory reporting of foreign incomes.)

For example, the person could be born in one state, could be a citizen of other two states and he could be a resident of several. Why should one of these relationships be regarded as stronger than the others?

5.2.3 The definition that depends on the objective test

The facts and circumstances tests are characterised by complexity and uncertainty, due to the diverse nature of individual facts and circumstances as well as the judicial approach in formulating the guiding principles. The quest for certainty led to the introduction of the objective test. However, the formulation of the test could lead to diminishing tax fairness. There is always a trade-off between fairness and certainty while formulating objective criteria. Arnold[152] argues that combining subjective and objective tests can provide a balance between simplicity and equity.

5.2.3.1 Physical Presence

The physical presence test is premised on the quest for certainty in the definition of residence. This test dictates that an individual is resident or non-resident in particular circumstances for specific tax provisions, irrespective of the physical residence of that individual.[153] The objective test is usually formulated on the physical presence of the individual in the state, measured by the number of days spent by the individual in the state during the tax year. Since it is based on the number of days spent within the taxing state, this test appears to be simple and easy to analyse. There are many divergent issues surrounding the physical presence test, because the states differ on;

A) What constitutes a 'day'? Does it mean a period of 24 hours? Alternatively, does it refer to part of a day? Is the date of arrival or departure included?

[152] Arnold (2010) supra at 22
[153] Kamal, S 'Individual tax residence' (2011) Sweet & Maxwell, London at 15.

B) The number of days that can trigger the application of the test. Many states use 183 days,[154] others 91 or 30.[155]

c) The time-frame in which the days are counted. In other words, what constitutes a 'year? – a calendar year, the tax year, or simply any period of 365 days?

D) Whether the number of days must be consecutive, or can be interrupted and if so, the nature of the interruption.

Some tax regimes[156] make reference to a previous period of physical presence by the individual to determine resident status.

5.2.3.1.1. The United Kingdom:

The statutory test applicable in the United Kingdom can be examined from two perspectives: before and after 2013. Before 2013, the extent to which an individual was subject to income tax depended on whether the individual was a 'resident', 'ordinary resident' or 'domiciled' in the UK.[157] These expressions were not defined in the UK Income Tax Act. The courts determined their respective meaning based on the facts and circumstances of the particular case. The diverse nature of the possible facts and circumstances called for the provision of guidance on how to apply the principles established by the court in practice.[158] Hence, in 1939, the first set of guidelines was incorporated into the Income Tax Codification Committee's Report. In 1973 the Her Majesty's

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[154] For instance, in Wilkie v IRC (1952) 1 All ER 92. the court held that the 183-day rule is not satisfied even if the individual spent 182 days and 20 hours in an income year of 366 days in the UK. Therefore, he is not a UK resident.

[155] Switzerland – Art. 3(3) of the Federal Income Tax Act RS 642.11 (stay for 30 days or 90 days without interruption in Switzerland).

[156] Like the US, Malaysia and South Africa

[157] Lemos M 'Individuals and private international law – United Kingdom' *in* Maisto, G (ed) 'Individual residence under tax treaties and EC Law' (2010) IBFD Publications, Netherland 583. See also Kamal S (2011).

[158] Freedman, J and Vella, J 'HMRC'S management of the UK tax system: The boundaries of legitimate discretion' WP 10/22 Oxford Centre for Business Taxation, 4.

Revenue and Customs issued an elaborate statement[159] known as 'IR 20.[160] In 2009, new Guidance was published by the HMRC clarifying when residence and ordinary residence is established or terminated. It repealed and improved the framework provided by the IR 20. By the combined effects of sections 831 and 832 and the judicially established principles, the IR20 set out twin objective tests for the determination of when an individual becomes a UK resident or ordinary resident by way of a 183 day test[161] and a 91day test [162]

[159] on how the main factors that are taken into account in determining the residency of individual as set out by various courts.

[160] The HMRC formulate by the IR 20 and HMRC6 pursuant to a considerable discretion given to it by the combine effect of sections 5, 9 and 51(3) of the Commissioner for Revenue and Customs Act 2005 (as amended). In particular section 9 states that "to do anything which they think (a) necessary or expedient in connection with the exercise of their functions, or (b) incidental or conducive to the exercise of their functions." Although the discretion is bounded by the primary duty of the HMRC of collecting taxes. See Wilkinson v Inland Revenue Commissioner (2005) 1 WLR 1718. Each of the two Guidance statements stated that: "The notes below are not binding in law and do not affect rights of appeal about your own tax….. You should bear in mind that the booklet offers general guidance on how the rules apply, but whether the guidance is appropriate in a particular case will depend on all the facts of that case." see IR 20 and HMRC6. Thus, the guidance statements are not binding. However, they still serve as the reference point for the determination of whether or not an individual is present in the UK for certain number of days to warrant the application the relevant judicial principle on it. The concern is that these statements they hinge on the judicially established principles that interpreted residence and its allied words. The HMRC is always one of the parties to the cases that produced such decisions. That is why some commentators argued that HMRC based the statements on the decisions that favoured them and ignored those that favoured the taxpayers. See Schwarz J 'Booth and Schwart: Residence, domicile and UK' (2014) Bloomsbury, London; see also Tiley J and Loutzenhiser G 'advanced topics in revenue law (2013) Hart Publishing, Oxford; Freedman, J and Vella, J 'HMRC'S management of the UK tax system: The boundaries of legitimate discretion' WP 10/22 Oxford Centre for Business Taxation.

[161] Under this test, an individual who spent 183 days or more in the UK during a tax year, becomes a UK resident for income tax purposes for that tax year. Tax year starts from 6 April to this year to 5 April of next year. See Schwarz J (2014) This test is explained the principle in Re: Young (1875) 1 TC;Reid V. IRC (1926) 10 T.C. 673 where it was held that a significant amount of time spent in the UK may suffice to establish residence. The HMRC considered 183 days as sufficient enough to establish residence.

[162] The test provided that when an individual arrives the UK with the intention to spend 91 days, and he did stay in UK up 91 days, then he is deemed a UK resident from the date of arrival. As a corollary to this, if an individual spends an average of 91 or more per tax in the UK for a period spanning from the tax year of arrival up to a period of four years, then becomes an ordinary resident of UK from the fifth tax year in the absence of definite intention, on his arrival, to spend the 91 days in UK.This test emanated from the principles in Pittar v. Richardson (1916) 116 LTR 823; Levene v. IRC (1928) 13 TC 486 HL; Lysaght v. IRC (1928) 13 TC 511; Kinloch v. IRC (1929) 14 TC 736; R. v. Barnet London Borough, ex parte Shah (1980) 3 All ER 679; R v Barnet LBC ex parte Shah [1983] 1 All ER 226 (Ordinary residence is established based on a regular, voluntary habitual mode of life in a particular place whether of short or long duration, the continuity of which has persisted apart from temporary or occasional absences.) Both the 183 – days and 91 – days must be in the tax year as a whole commencing from 6 April to 5 April of Another. See Lemos (2009).

The guidance statements contain the objective tests for individual tax residence in the UK. The UK objective criterion was characterised by uncertainties from two perspectives. Firstly, the HMRC statements, especially the HMRC6, set out factors to be considered in ascertaining the UK residence or ordinary residence of an individual.[163] It restated the uncertainty inherent in judicial decisions. Therefore, the HMRC6 did not solve the problems it sought to resolve.

The HMRC was a party to almost all the decisions that established the principles. It was accused of issuing statements based on the decisions that favoured them whilst ignoring those that favoured the taxpayers. The unreliability and inconsistency of the HMRC in formulating and applying guidance statements were manifested in the joined cases of Davies & Anor and Gaines-Cooper.[164] In the first case, the appellants, Davies and James, were born in the UK and lived and worked in Wales. In March 2001, they moved to Brussels and resided in a rented apartment. At the same time, they incorporated a Belgian company in which each held one-third of the share capital. On 1 April 2001 they took a three-year full-time job with the company they had established. They frequently returned to see their families, attend to their UK business interests and their ties to local sporting institutions. In December 2001 the appellants disposed of their shares in a UK company and HMRC treated them as UK residents and required them to pay tax. In the second case, the appellant (Gaines-Cooper) was born, lived and worked in the U.K. until 1975 when bought a house in the Republic of Seychelles. From 1976 up to 2004 he spent, on average, several weeks a year in the Seychelles. He also had international business interests in several countries. However, the appellant maintained a house in the UK throughout the period. Thus, he had an available residence in

[163] Paragraph 1.5,22; 2.2 and 8.1 of the HMRC6
[164] *Gaines-Cooper v The Commissioners for Her Majesty's Revenue & Customs* (2011) UKSC 47

the UK, and he spent about three months a year in the UK. He married in 1993 and in 1998 had a son, who was born in the UK. The appellant's wife and son lived in the UK during the school year but joined him in the Seychelles during school holidays.

The HMRC refused to apply the 91 days test it had earlier formulated which favoured the appellants in the two cases. The appellants had relied on the statements issued by the HMRC andhad brought themselves within the ambit of paragraphs 3.1 of the IR20 as well as section 832 of the Income Tax Act 2007. Their visits to the UK during the years after their departure were for less than six months in any tax year and averaged less than 91 days in each such year.[165] However, the HMRC treated them as UK residents.The appellants challenged the decision of the HMRC in the UK Supreme Cour which dismissed their appeal. The appellants argued that the content of IR20 raised a legitimate expectation that the guidance statement would bind the HMRThe court upheld the appellants' argument. However, it was held that the appellants were liable to UK tax because what is required to become UK non-resident is a distinct break in the appellants' pattern of life in the UK.

It is submitted that before 2013, there was no clear statutory test for an individual's residence in the UK. The UK Income Tax Act based the determination of an individual's income tax liability on 'residence', 'ordinary residence' and 'domicile', but did not define any of those terms. The courts played a role in interpreting these expressions. However, the diverse nature of factual situations rendered some of the decisions of the courts very cumbersome for an ordinary taxpayer to understand, which was the reason cited for introducing the HMRC guidance statement.

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[165] as envisaged by paragraphs 2.2, 2.8 and 2.9 of the IR20; Gaine-Cooper's case (2011); see also Mock P and Dodwell B 'Gaine-Coopers: The decision' (2011) 1098 Tax Journal; Goodall, A 'Gaines-Cooper decision highlights need for certainty on residence' (2011) 1098 Tax Journal

The HMRC issues statements on how judicially established principle will be applied in specific cases. Complex legal issues arose in the cases of Gaines-Cooper and Davies & Anor and triggered demands for a statutory test of individual residence for tax purposes. Hence, the combined effects of section 218 of the UK Finance Act 2013 and Schedule 45 of the same Act set out a comprehensive statutory test for the UK residents and non-residents. Furthermore, the concept of ordinary residence has been removed from the determinants of individual income tax liability.[166] The Finance Act came into effect on the 6th April 2013.

The statutory test is applicable under three broad circumstances:[167]

1) **The 'automatic overseas test'**: In this test an individual is considered as a non-resident if:
   i) He was not resident in the U.K. in all of the previous three tax years and was present in the U.K. for less than 46 days in the current tax year;[168] or
   ii) He was resident in the U.K. in one or more of the previous three tax years and was present in the U.K. for less than 16 days in the current tax year;[169] or
   iii) He spent "sufficient hours" working overseas, and he or she is present in the UK for a period less than 91 days in the tax year and fewer than 31 days are spent working in the United Kingdom.[170]

[166] Section 219 of the UK Finance Act 2013 abolished the concept of ordinary residence a connecting factor for individual income tax. Thus, an individual who is not an ordinary resident can only be taxed on his foreign employment income if he remits it to the UK.
[167] See generally schedule 45 of the UK Finance Act 2013
[168] Paragraph 12, Schedule 45 of the UK Finance Act 2013
[169] Ibid para 13
[170] Ibid para 14

2) **The 'automatic UK test':** In this test an individual is considered as a UK resident for the tax year in issue if:

   i) He was in the United Kingdom for 183 days in a U.K. tax year: For this test, a day in the U.K. is a day in which the individual is present in the U.K. at midnight;[171] or

   ii) He has a home, which is available to him in the U.K. for at least 91 days and was present in that home for at least 30 days during the tax year. Also, that throughout the 91- day period he had no home abroad, even if he has spent fewer than 30 days in that home in the tax year under consideration;[172]or

   iii) He spent 'sufficient hours' working in the U.K. for over a 365-day period[173] (all or part of which must fall within the tax year under consideration) and he had significant breaks[174] from the UK work.

The above tests are applicable in order of priority. Thus, the 1st automatic UK test takes precedence over all other tests, and once it is satisfied, an individual becomes a UK resident. If the 1st automatic UK test is not satisfied, then the three automatic tests are considered, before considering the 2nd and 3rd automatic UK test. If any of the automatic overseas tests is satisfied, then the individual is not a UK resident.[175]

3) Where neither automatic overseas nor automatic UK tests are satisfied (that is where there is a middle ground) then a 'sufficient ties test' is

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171 Paragraph 7, Schedule 45 of the UK Finance Act 2013
172 Ibid para 8
173 Ibid para 9
174 Absence of significant break means at least 75% of the 365-day period must be days on which the individual works for more than three hours in the UK
175 Gelardi, AMG 'The new United Kingdom statutory residence rules (2014) May-June Int'l Tax J. 40; see also HMRC Guidance Note: Statutory residence test (2013.

applicable. Under this test factors such as the level of individual connection with the UK is considered. This includes:

i) Family tie: This is a situation where the spouse or civil partner of an individual (provided they are not separated) or his minor children are residing in the UK.[176]

ii) Accommodation tie: Where there is accommodation available for the of the individual in the UK for at least 91 days, and he uses it for at least one night or sixteen nights (if the accommodation belongs to a relative) during the tax year.[177]

iii) Employment tie: a substantive job in the UK during the fiscal year, at which an individual spends at least 40 working days (comprising more than three hours' work a day).[178]

iv) The 90 –day tie: UK presence in the previous year if an individual spends 90 days or more in the United Kingdom in either or both of the previous two tax years.[179]

v) Country tie: Where an individual spends more time in the UK than in other countries.[180]

The sufficient ties test considers the number of days an individual spend in the UK as well as the extent of the individual connection with the UK. It considers the two concurrently in determining the residence status of an individual whose circumstances does not fall with the 'automatic over sea test' or 'automatic UK test'. Moreover, in considering the above factors, different tests apply in the case of an 'arriver'[181] and the case of 'leaver'.[182] For the former only the first four of the above ties are a relevant while for the latter case, all the five ties are

[176] Paragraph 32, Schedule 45 of the UK Finance Act 2013
[177] Ibid paragraph 34
[178] Ibid paragraph 35
[179] Ibid paragraph 37
[180] Ibid paragraph 38
[181] That is an individual who is non-UK resident in all of the previous three years. See Ibid paragraph 18
[182] An individual who was a UK resident in one or more of the previous three years. Ibid paragraph 19

relevant. Thus, an individual needs to combine the number of days he spends in the UK and a small number of ties. The statutory test makes harder for an individual who is already a UK resident to become a non-resident than an individual arrives the UK for the first time. That is, the more the number of days spent in the UK the smaller number of factors required to tie an individual with the UK.

It is submitted that the UK statutory resident test did not achieve the desired certainty in determining the tax residence of an individual. It was excessively complex to the extent that an individual required more expert legal assistance that he required under the old regime. For instance, section 218 of the UK Finance Act 2013 sets out the framework for the statutory residence test. The detail of the test is contained in the Schedule 45 of the Act. The Schedule is divided into five parts with about 159 paragraphs running to 66 pages of the Act. Apart from the cumbersome provisions contained in Schedule 45, the HMRC also issued a Guidance Note (RDR3) which sought to interpret the provisions of the Finance Act 2013 regarding the statutory residence test. Therefore, both individual and their tax advisers are expected to read the schedule 45 in conjunction with the HMRC guidance note. Certainty is fundamental to the rule of law; it suggests that the law should be clear, easily accessible, comprehensive and stable.[183]Is it possible to achieve certainty in a complex form?

The statutory residence test places a greater burden on individuals who are internationally mobile than those who live and earn their income in the UK.

[183] Pagone, GT ‘Tax uncertainty’ (2009) 33 MU L. Rev. 887; Raz J ‘The rule of law and its virtue (1977) 93 L. Q. Rev. 195 at 198

Under this regime, an individual is required to keep extensive records of his movement and working time in the UK.[184]

5.2.3.1.2 The United States

The US regime imposes a worldwide income tax on all US citizens and resident aliens. From 1983 to date, a US resident for tax purposes has been statutorily defined as an individual who is admitted into the US as a permanent resident (Green Card holder). Individuals who do not hold a 'Green Card' are also taxable based on a calculation of the number of days of their physical presence in the US. Therefore, there are two basic tests; the 'Green Card test' and the 'substantial presence test'. The immigration laws govern the resident status of a Green Card holder. Under the substantial presence test, an individual is deemed to be a resident of the US if he spends 31 days during the calendar year in the US. The total he spent in the US during the current calendar year and the two preceding years must be at least 183 days.

In computing the number of days spent in the US, the days in the current year is multiplied by one. The days in the first preceding year is multiply by one-third and the days in the second preceding year is multiplied by one-sixth. For instance, an individual spent 130 days in the year 2014, 120 days in 2013 and 90 days in 2012.[185] Applying the above formula, the computation of the days will be as follows:

2014 (current year)	130 x 1 = 130
2013 (1^{st} preceding year)	120 x 1/3 = 30
2012 (2^{nd} preceding year)	90 x 1/6 =15

[184] Paragraph 7 HMRC Guidance note: statutory residence test 2013 (The RDR3) which provides for list of what an individual is expected to keep record of, including evidence of days of work in the UK and overseas, evidence of where the individual's personal life is attached , evidence of home in the UK or overseas.

[185]

The total days spent in the US by that individual will be 130 +30+15 = 185 days and 185 days, thus exceeding the threshold stipulated by the law that is 183 days. Therefore, he becomes a US resident –alien for the year 2014. However, in terms of the above formula, an individual can avoid the substantial presence test by limiting his presence in the US to 121 days or less in each calendar year. For instance, using the scenario cited above:

2014 (current year)	121x1 = 121
2013 (1st preceding year)	121x1/3 = 40.33
2012 (2nd preceding year)	121x1/6 = 20.17

In this scenario, the total of days spent in the US by that individual will be 121 +40.33+20.17 = 181.49 (181 days) which is below the threshold stipulated by the law that is 183 days. Therefore, he is not a US resident –alien for the year 2014 in that he spent more days in the US than the first case, but he is not a resident for tax purposes.

However, there are certain exceptions attached to the 'substantial presence test'. The regime provided that an individual regularly commuting to the US for employment and returning to his place of residence either in Canada or Mexico was exempted. So too an individual who is in transit in the US and is physically present in the US less than 24 hours will not be treated as present on that particular day of transit. The exemption applies to an individual who happens to be in the US but cannot leave due to a medical condition. Students, teacher-trainer, professional athletics are also exempted from the substantial presence test.[186]

[186] For more discussion on these exceptions see Hoose, MS 'Trading one danger for another: crating US tax residency while fleeing violence at home' (2012) 12 (10) Fla. Tax Rev. 827 (making case for extending the exception to cover individuals who fled their home countries as a result of violence there.) see also Rosenberg, M 'Expanding the exceptions to the US income tax resident alien definition' (2008) 9 Corp. Bus. Tax Monthly 9 (He advocated for new exception to cover individuals with medical condition)

An individual who spent less than 183 days in the current year may not be treated as a US resident for that year[187] if he establishes a 'tax home' and 'closer connection' in another country. Even though the statute defined 'tax home' as an individual's main location or main place of employment,[188] it did not define what amounts to the main location or main place of employment. Thus, only the facts and circumstances of the case can determine whether the location or the place of employment is the main one for the individual. Furthermore, there is no definition of the 'closer connection', and its determination is based on the fact and circumstances of the case. It could be argued that the substantial presence test claims to be an objective test, but on closer scrutiny it seems to be a mixture of objective and subjective tests.[189]

5.2.3.1.3 Canada

In Canada, an individual is deemed resident throughout a tax year if he sojourned in Canada for a total period or periods of at least 183 days.[190] There is no provision as to what constitutes a 'day'[191], but the regime provides for a time frame for counting the period.[192] The period could be either consecutively or intermittently because the Act mentions 'a period' or 'periods'. However, the Act did not define 'sojourn'. Therefore, reference must be made to judicial

[187] Section 7701(b)(3)(B) of the IRC 1986
[188] Sections 162(a)(2) and 911(d)(3) of I.R.C. 1986
[189] Also
[190] Section 250 (1) (b) of the Canadian Income Tax Act 1985
[191] Whether a 24-hour period or any part thereof.
[192] However, section 114 of the Canadian Income Tax Act 1985 provided for the taxation of a part-time resident. Under this provision an individual who resides in Canada for a period of 183 or less but leaves Canada during a tax year is to be treated as a resident up to the time he leaves and thereafter, he will have treated as a non-resident. Thus, he liable for the period he was a resident pro rata. But the deemed resident is taxable on his worldwide income for the whole year. This rule treats similarly situated individual differently, because section 250 (1) (b) deemed certain class of individual who reside abroad (such military personnel and Canadian diplomats) as residents and made them liable to the whole year tax. But part-time resident is liable to part-year tax.

interpretation. In Thomson v, MNR[193]the appellant contended that he merely sojourned in Canada for a period less than 183 days in the tax year at issue, but was not an ordinary resident. In defining sojourn Estey, J stated that "one sojourns at a place where he unusually, casually or intermittently visit or stay." It has been argued that sojourn means a temporary stay in Canada.[194]

5.2.3.1.4 Australia

Under the Australian tax regime, an individual becomes a resident for income tax purposes is if he is "physically present in Australia continuously or intermittently for more than half of the year of income."[195] Dirkis[196] views this test as a 183-day test. However, half of a year cannot be automatically translated to 183 – days as it could be extended in the case of a leap year. Also, the time frame for calculating half of the year is the Australian Financial Year, which runs from 1st July to 30th June.[197] Thus, many uncertainties surround the Australian physical presence test. The duration of physical presence that could trigger the application of the test is not certain. Therefore, the time frame for the calculation is not certain. What is certain under the Australian regime is that the period of stay in Australia need not be consecutive, because, the Act provides that the stay could be continuously or intermittently.

An individual who satisfies the deemed resident provision may not be treated as a resident if he can prove that he has a usual place of abode outside Australia

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[193] (1946) SCR 209. See also R & L Food Distribution Ltd. V. MNR (1977) CTC 2579 at 2581 (It held that shareholders' stay overnight in Canada for only six to seven times a year did amount to Sojourning in Canada)
[194] McGregor, G 'Deemed resident' (1974) 22 Canadian tax Journal 381 at 386
[195] See Section 995-1 of the Australian Income Tax Assessment Act 1997 and section 6 (1) (ii) of the Australian Income Tax Assessment Act 1936.
[196] Dirkis, M 'Australia' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication. 197
[197] Section 4- 10 (2), 9-5 (2) and 995.1 of the Australian Income Tax Assessment Act 1997

and he has no intention to establish residence in Australia. The Act does not define the expression 'usual place of abode' or what amounts to 'intention to reside'. Therefore, these tests depend on the individual facts and circumstances. Furthermore, in defining the place of abode for the purpose of this test, the Australian Act uses the word 'usual' instead of 'permanent' as used in the domicile test. Another dimension of the complexity surrounding the determination of 'permanent place of abode' is that there is no guidance on what makes 'permanent' different from 'usual' in qualifying 'place of abode'. The Australian physical presence requirement shares the same trend with that of the US, where the expressions 'tax home' and 'closer connections' are left for a fact-intensive inquiry. Thus, the US and Australian regimes are a mixture of both physical presence tests and fact and circumstance tests. If the rationale for adopting the physical presence test is to remedy the complexity involved in the facts and circumstances tests, then it has not been achieved.

The New Zealand regime provides that an individual is a resident if "he is present in New Zealand for more than 183 days in total in a twelve-months period commencing from the first day of the 183 days."[198] The individual residence status terminates if he spent more than 325 days over a twelve months period outside New Zealand.[199] Moreover, from the first day of the 325 days he remains a non-resident until he acquires that status again.[200] Therefore, the New Zealand regime defines both resident and non-resident based on the number of days present in or absent from New Zealand, that is 183 – days and 325 – days respectively.

[198] Section YD 1 (3) and (4) of the New Zealand Income Tax Act 2007
[199] Ibid (5)
[200] Ibid (6)

5.2.4 Summary

The above analysis reveals a divergent approach adopted by the states in the determination of individual residence for tax purposes. The definition of individual residence takes the following forms:

(1) The automatic physical presence: in this test the residence status of an individual is triggered automatically by a fixed duration of physical presence in a particular state. The duration is usually 183 days in the year.[201] Most arguments cited in support of this test are based on the need to tax individuals who might be physically present in a state for an extended period, but who did not satisfy any of the factors set out by the courts for the determination of their residence status. However, this method is also used by states to deem a certain class of individuals as residents even though some members of that class are not residing within the state. This type of provision questions the impact of the physical presence test in determining individual residence.[202] The question is – can a state design the deeming provisions arbitrarily? The answer is no. The general notion of residence requires states to reflect the real connecting factor in their deemed residence provisions. In the light of globalisation, the states can only satisfy the above requirement if they co-operate with each other in designing the rules.

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[201] But there is a divergence of approach by the states regarding what constitute a 'day' does it mean a full period of 24 hours spent in the state? Or does it refer to a 'partial day'? That is whether the date of arrival or departure is included; the number of days that can trigger the application of the test. Most of the states use 183 day, others 91; the time-frame within which the days are counted. That is what constitutes a 'year' for the purposes of the test. Does this mean a calendar year? Tax year? Or a period of 365 days? Whether the number of days must be consecutive or it could be interrupted and if so, what are the qualities of the interrupting events.

[202] Kirch, MS 'The role physical presence in the taxation of cross-border personal service (2010) 51 B.C.L Rev. 993 (He challenged the relevance of physical presence test on the activities of cross-border service provider. He argued that the physical location of the service provider should not be the focus. But rather the places of the service impact)

(2) **The subjective physical presence** (residence simpliciter): By this method, an individual's residence is defined subjectively. Other factors are employed to augment the short physical presence of an individual within a state.

(3) **The ordinary residence:** In determining residence simpliciter, the courts focus on the tax year at issue, whereas in deciding ordinary residence, the court examines the individual's activities over a period. The court examines whether there is some degree of permanence in the individual's residence, that is to say, that it is more than casual residence.

(4) **The Domicile**: The residence of individual for tax purposes is also defined as the individual's fixed and permanent home, which he permanently intends to remain in or return.

States define the concepts of residence, ordinary residence and domicile differently. Thus, there is a divergence among the states even when two or more states formulate their respective individual residence test in identical terms. The tax policy issue also adds to this divergence. In designing the definitional rule, states differ on whether to rely on the individual's personal or economic interest in the state in adopting one rule or the other. Most common law jurisdictions lean towards the personal interest of the individuals in the state. Civil law states, on the other hand, give preference to the economic interests of the individuals. Apart from choosing one concept of residence or the other, states within the same legal family may adopt different tests in determining the selected concepts. Whenever the tests are based on specific externally observable actions, they are objective standards, and when the tests centre on the individual's state of mind, they are subjective standards. For the purposes of this research, these tests are categorised into statutory and facts-and-circumstances tests. The above analysis reveals that the appropriateness of adopting a particular conception of residence against another or even a particular test against another in a globalised economy requires cooperation between the states in designing their residence rules. A state should not restrict itself to their particular economic and social values in defining the tax residence.

5.3 Concept of Corporate Residence

Both statutes and common law recognise corporate bodies, [203] as an artificial person, separate and distinct from its shareholders.[204] Therefore, incorporation clothes the corporation with the power to engage in all commercial activities (as prescribed in its constitution) in the same way as an individual and it is also subject to taxation. The concept of corporate residence is used in determining the sufficiency of the personal and economic ties between the corporate body and the taxing authority as justification for imposing income tax on a residence basis. For the individual, this can be easily analysed and appreciated. However, in the case of a corporation, the issue is complicated because corporations have no physical existence – they are everywhere and nowhere.[205] They have no physical identity not do they reside anywhere. They have no home or place of abode that serve as the factors indicating the residence of an individual. The corporation is made up of shareholders, directors, managers, employees and have assets that might be spread around the globe.

The peculiar nature of corporations calls into question the rationale for taxing the income of corporations on a residence basis because it will be difficult to ascribe resident status to a corporation. Even if it is ascertained successfully through any connecting factor, it will be difficult to choose between competing

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[203] Cousin, R 'Corporate residence and international taxation' (2002) IBFD Publication

[204] Solomon v. Solomon (1897) AC 22 (HL)

[205] Avi-Yonah, RS 'Corporation, society and the state – a defense of the corporate tax' (2004) 90 Va. L. Rev. 1194 – it is everywhere because almost all economic, political and social activities are being carried out through corporate institutions, for example bank, school, hospital and even the state itself. The corporation is nowhere because its existence as an entity is very controversial and many theories have been formulated in order to analyse its existence or otherwise.

connecting factors. Income earned by a corporation and distributed to the shareholders as dividends is subject to tax both at the corporate and shareholder level. Thus, if the income earned by the corporation is retained and reinvested in the corporation, the law taxes the corporation only as the shareholders are liable to tax only when they receive a dividend.

5.3.1 Why Tax on Corporations?

In analysing the rationale for corporate income taxation, the central question is – who bears the burden of corporate tax, the corporation or the shareholder?[206] The debate on the propriety of corporate taxation revolves around theories of the corporation.[207] Avi-Yonah[208] argues that the real entity nature of the corporation permits it to acquire power and the original rationale for adopting

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[206] Weisbach, DA 'The irreducible complexity of firm-level income taxes: theory and doctrine in the corporate tax (2007) 60 Tax L. Rev. 215

[207] Because the corporations are legal rather than natural persons that is why corporate law plays a greater role in the determination of corporate location. The relevant theories are:

a) Artificial theory: this theory posit corporation as an artificial person who owed its existence to the positive law of the state rather than to the private initiatives of the individuals who formed it. Therefore, the corporations are legal fiction, invisible and intangible.
b) Aggregate theory posit that in a real sense, corporations do not exist but rather they only serve as meeting point for various relationships between the shareholders, directors, employees and the customer/clients. This theory champions the shareholder supremacy in a corporation.
c) Real theory recognised corporation as real entity with all the powers of natural person which vested in the corporate management. Its existence is separate from the shareholders and the state. Therefore, even though the corporations exist by operation of the law, the corporate management and its powers over shareholders and employee are real. It upholds the supremacy of directors. This theory posits corporate tax as a means of regulating the shareholders and management of a corporation.

See Kane, MA and Rock, EB 'Corporate Taxation and International Charter Competition' (2008)106 Mich. L. Rev. 1229 at 1235 Ho, VH 'Theories of corporate groups: corporate identity reconceived' (2012) 42 Seton Hall L. Rev. 879; Avi-Yonah, RS 'Citizen united and the original form' (2010) 9 Wis. L. Rev. 999; Millon, D 'Theories of the corporation' (1990) Duke L. Rev. 201; Braton, WW ' The new economic theory of the firm: critical perspective from history' (1989) 41 Stan. L. Rev 1471; Butler, HN 'The contractual theory of the corporation (1989) 11 Geo. Mason L. Rev. 99; Rudnick, RS 'Who Should Pay the Corporate Tax in a Flat Tax World?' (1989) 39 Case W. Res. L. Rev. 965; Arlen, J and Weiss, DM ' A Political Theory of Corporate Taxation' (1995)105 Yale L.J. 325, 327

[208] Avi-Yonah, RS 'Corporation, society and the state: a defence of the corporate tax' (2004) 90 Va. L. Rev. 1194 (Which is vested with the corporate management and exercisable over both the shareholders and employees of the corporation. But he noted that the complications and transactional cost of corporate tax can drive potential investors away from transacting through a corporation.) See also Doron M 'Manager, shareholder and the corporation double tax' (2009) 95 Virg. L. Rev. 517 at 524; Bainbridge, SM 'Director primacy: the means and end of corporate governance' (2002) UCLA Research paper No. 02-06

corporate income tax in the USA was to regulate managerial powers of the corporations. He maintains that that rationale remains valid in so far as corporations are viewed as a real entity. [209] Although a corporation could be termed as a real entity, the argument of Avi-Yonah on the rationale for imposing the corporate tax is not appealing. There are other legal regimes (particularly in corporate law) that directly regulate the so-called powers of corporate managers better than taxation. Therefore, the regulation of corporate management cannot be the justification for imposing a corporate tax. Furthermore, the degree of separation between owners and managers of a corporation and whether or not corporate management possesses a certain power is determined by the corporate law of the respective states.

From the perspective of the aggregate theory, each shareholder is an owner of the undivided interest in the corporate assets and liabilities. Therefore, corporate tax is an indirect way of taxing the shareholder. This theory conceives corporate tax as a means of preventing shareholders from earning income through the corporation and sheltering such income from being taxed.[210] Hence, corporate tax is no more than a withholding mechanism imposed on the corporate earned income of the shareholders.[211] Brauner[212] argues that there is no rationale for

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[209] This argument cannot stand the test of aggregate or artificial theories of corporation that is why many commentators criticized this line of reasoning – Shaviro DN 'Decoding the US corporate tax (2009) The Urban Institute Press, Washington 23 "even the most persuasive of the recent corporate tax proponents Avi-Yonah admits that prior attempt to defend the existence of corporate tax are unconvincing."; see also Bird, RM 'Why tax corporation' (2002) 56 Bull. For Int'l Fiscal Documentation 194

[210] Bird (2002)

[211] But the problem with this mechanism is that, once a corporation engages into a buss activity other class of persons (apart from the shareholders) become interested in the economic well-being of the corporation. These are the employee (whose wages may be affected by the corporate tax) and the ultimate consumer of the business activity (who will pay more as a result of the corporate tax). So what is the justification for making this class of people to suffer for the purposes of withholding the shareholders' corporate income? But it should be noted that even under withholding system the determination of residence of the collector of tax is very important, because for a state to impose withholding obligation on a person, it must have tax enforcement jurisdiction over that person. See Hellerstain (supra)

[212] Brauner, Y 'The non-sense tax: a reply to new corporate income tax advocacy' (2008) Mich. St. L. Rev. 591. But contrast this with Bank, SA 'Is double taxation a scape-goat foe declining dividend?

imposing income tax at the corporate level. By way of historical, normative and tax policy analysis he concludes that corporate income tax is not desirable, that there is no need to debate its desirability and that it should be abolished. He[213] also advocates replacing corporate tax with an integrated system by way of a withholding system or credit imputation.[214]

The artificial theory views corporate tax as payment for the benefits provided by the state to corporations, such as the right to operate in corporate form. Thus, there is justification for the state to tax such income. That argument is not convincing because, by the nature of the corporation in the current economic setting, it is hard to quantify any benefit derived by a company that would warrant the imposition of the corporate tax. Some commentators[215] have argued that the state provides the enabling environment for the corporation to earn income. However, the state accords the same kind of benefit to some corporate bodies that are not subject to tax. For instance, S corporations and partnerships

Evidence from history' (2003) 56 Tax L. Rev. (He argued that both corporate tax and integration is not earning retention problem. The legislature must take both tax and non-tax motivating factors into consideration to come up with a definite solution.)

[213] Brauner, Y 'Should corporation be taxpayer?' in Infanti C (ed) 'Controversies in tax law: a matter of perspective' (2015) Ashgate, Farnham 178. See also Weisbach (2007);

[214] That is integrating the both corporate and individual income tax into a single system. Under this system, both the corporation and the shareholder pay part of the corporate income tax, but the shareholder is granted a credit to offset the tax already paid by the corporation. Contrast another method of dividend deduction whereby a corporation can deduct the dividend it pays to its shareholders that will then renders it taxable income to zero. For detailed discussion on this systems see: Graetz MJ and. Warren AC 'Unlocking business tax reform' (2014) Tax Notes 707 See also Graetz MJ and Warren, AC 'Integration of Corporate and Individual Income Taxes: An Introduction' (1999) *Tax Notes*, Sept. 27, 1767Graetz MJ and. Warren AC, 'Income Tax Discrimination and the Political and Economic Integration of Europe,' (2006). 115 Yale L. J. 1186; Amiram D et al., ''Tax Avoidance at Public Corporations Driven by Shareholder Demand: Evidence From Changes in Shareholder Dividend Tax Policy' (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2111467; Ikin C and Tran, A 'Corporate Tax Strategy in the Australian Dividend Imputation System,' (2013) 28 Australia Tax Forum 523; Vann, RJ 'Corporate Tax Reform in Australia: Lucky Escape for Lucky Country?' (2013) 1 Brit. Tax Rev. 59-75. But it should be noted that even under withholding system the determination of residence of the collector is very important. Because for a state to impose withholding obligation on a person, it must have tax enforcement jurisdiction over that person. See Hellerstain (supra)

[215] Great, MJ and O'Hear MM 'The "original intent" of the US International taxation' (1990) 46 Duke L.J. 1021 at 1036

in the United States, enjoy most of the so-called benefits equally with other corporations, but they are not a taxable subject.

From a tax policy perspective, corporate income tax satisfies the fairness criterion. It serves as a mechanism for checking a potential imbalance that may occur when a taxpayer earns income through a corporation and allows the corporation to retain such income. Another taxpayer in a similar position to the first-mentioned taxpayer (who earns income from a source other than a corporation) pays tax on his income. This scenario indicates that the corporate tax also satisfies the efficiency criterion because other taxpayers may consider tax in deciding whether or not to invest in a corporation. As a corollary, corporate tax is the most convenient method of taxing income from corporate earnings. As Avi-Yonah[216] puts it; there are fewer corporations than shareholders. Therefore, collection of income tax from corporations is more administratively convenient. Therefore, with the current global economic integration, the most convenient way to tax shareholders (especially shareholders of publicly traded corporations) on corporate income is by taxing that income at the corporate level.

Even commentators who question the rationale for corporate tax do not totally reject the general idea of taxing the corporation. They advocate for corporate income integration, which is an alternative corporate tax system. However, many states that adopt the integration system have reverted to the classical corporate tax system as a result of globalisation, where markets become integrated and cross-border activities increase. On this note, Brauner[217] cited the lack of global co-operation in designing tax.

[216] Avi-Yonah (2004)
[217] Brauner, Y 'Integration in an integrating world' (2005) NYU J.L. Buss. 51

It is submitted that the main difference between corporate and individual income tax stems from the nature of the personality of the individual and the corporation.[218] The idea of ascertaining the tax residence status of corporations hinge son the proposition that a corporation is a taxable subject separate from its shareholders.[219] Apart from the divergent views on the propriety of corporate tax the next line of divergence is on how to tax the corporation. This leads to the second question, namely, how residence status should be ascribed to the corporation.[220] The main purpose of the concept of corporate residence is to determine the corporations that are taxable on their worldwide income.[221] The complexity of corporate residence involves the interface between the legal status of the corporations and how they behave.

5.3.2 How to Determine Corporate Residence

In general, jurisdictional discourse, connecting factors are required to link a corporation with a particular state. These connecting factors are context specific.[222] For instance, in private international law, the common issue for determination is the proper law applicable in a particular transaction. However, in the tax law context, it is the scope of jurisdiction of the taxing state that is in issue. States prescribe differently the extent of their tax jurisdiction under their

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[218] Brauner (2015)

[219] It has been argued that corporate taxes are eventually borne by real people not by imaginary people. See Omri, M 'meaningful corporate tax residence' (2013) Tax Analysis (Special Report). See also Auerbach, AJ 'Who Bears the Corporate Tax Burden: A Review of What We Know' (2006).20 Tax Pol'y and Econ. 1.

[220] This question is relevant even under the integrated system, because there is always a need to ascertain the scope of the taxing authority over the corporation in issue.

[221] Anold, B.J 'A tax policy perspective on corporate residence' (2003) 51(4) Canadian Tax J. 1559 at 1561.

[222] That is to say the factors that link corporations to a state under general or private international law are different from those applicable for the determination of corporate residence for income tax purposes. See Behrens, P 'General principle on residence of companies: a comparative analysis of connecting factors used for the determination of the proper law of companies in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 27 (There is diversity in the definition and practical use of connecting factor of companies under the private international law and tax law…a proper interpretation of connecting factors can only be achieved by contextual legal analysis on case-by-case basis).

respective domestic laws. The determination of the residence status of a corporation is easy and straightforward if the corporation in issue is incorporated in and governed purely by the corporate law of a particular state. That is to say, if the corporation carries on business (and makes all its corporate decisions) exclusively within that state and all its shareholders; directors and managers reside in that state. However, complexity in ascertaining the residence of a corporation arises where it is incorporated in one state but[223] carries out its business activities in another state. Alternatively, where the shareholders, directors or and managers reside in more than one state.

The idea of applying connecting factors is to determine whether a particular corporation is domestic or foreign[224] for income tax purposes. Most states use the concept of corporate residence. Omri[225] argues that the importance of the concept of corporate residence in determining corporate residence is not restricted to the residence-based system, but extends to a territorial system. The states adopts either objective and subjective tests or a combination of the two[226] in determining corporate residency.

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[223] Due to the economic advancement coupled with current globalisation

[224] The domestic corporations are being taxed by some state (like USA) on their worldwide income while other states like UK and Canada exempt passive income of the corporation. The foreign corporations, on the other hand, are taxed on their income which is sourced from the taxing state. See Cousin R. 'Corporate residence and international taxation' (2009)

[225] Omri, MY 'The function of corporate tax-residence in territorial system' (2014) 18 (1) Chapman L. Rev. 157 at 161 (in deciding the source of income from interest or dividend, the residence of income earner is very relevant.) see also Omri MY 'Jurisdiction to tax corporation' (2013) B.C. L. Rev.

[226] Ault, HJ and Arnold, BJ 'Comparative Income Taxation: A Structural Analysis' (2010) (3rd ed) at 434 (The former is use to establish a personal jurisdictional connection for a corporation. The latter is more of economic and commercial connection of the corporation with the state. For instance, USA and Japan adopted a purely legal test while until 1988 UK adopted purely legal test but later combined the two tests); see also Mitchell A. Kane, MA and Rock, EB 'Corporate Taxation and International Charter Competition' (2008) 106 Mich. L. Rev. 1229 at 1235; Cousin, R (2002); Brauner, Y 'United States' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 855, 865; Broe, LD 'Corporate Tax Residence in Civil Law Jurisdiction' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 95 at 96

5.3.2.1 Objective Statutory Test

Corporations acquire legal personality upon registration, and the place of incorporation is determined by the registered office of the corporation as defined in its memorandum and article of association. Thus, the law ascribes the resident status of a corporation, inter alia, through the instrumentality of the place of incorporation test. By way of analogy, the law assigns the same resident status to the individuals by using a similar method, which is based on the physical presence of the individual in the state. However, a corporation does not have physical attributes and, therefore, it cannot be physically present in any state even for a day.[227] However, the determination of corporate residence by way of an objective test is purely a question of law.

5.3.2.1.1 Place of Incorporation

What is required under this test is to ascertain that the corporation in issue falls within the statutory definition of a corporate resident. It is premised on the provisions of the laws of the state. Thus, once a corporation has satisfied the legal requirement and obtained a Certificate of Incorporation, it automatically becomes a resident in the state of its incorporation. Most states complement this test with a subjective test. However, some developed states like the US adopt it as the sole test for determining corporate residence. The policy issue in this test is that, in adopting the place of incorporation as a test for corporate residence, the state disregards the notion of equity in taxation. States do not base tax policy on the economic connection of the corporation with the state. Thus, once a corporation is registered in a state, it becomes liable to tax even if it does not conduct any business within the state.

[227] This is the main area of concern in corporate taxation that generate controversy on constitutes corporate residence

5.3.2.1.2 Registered office (The Legal Seat)

Apart from the incorporation, some states[228] impose a tax on corporations that locate their registered office in the state. The corporation need not be incorporated in that state. The registered office of a corporation is usually determined by its initial subscribers or shareholders. As with the place of incorporation test, this test is governed by corporate law, which does not require the corporation to conduct any business at the registered office. As the time of incorporation, the shareholders may not be certain whether or not their chosen location of the registered office could expose the corporation to taxation.

5.3.2.2 Facts and Circumstances (Subjective) Test

The subjective test comprises 'central management and control' (CMC) and 'place of effective management' (POEM). The test is based on where the 'real business of the corporation is carried on'.[229] Behrens[230] argues that these tests have something in common. They all determine the factual connection between the corporation and the taxing state by considering the relevant management decisions of the corporation, [231] the person who takes the decision and the place where he made the decision. The nature of a corporation and the type of its business determine the form and frequency of its strategic decisions. Some corporations require frequent decision-making while other corporations require a long-term strategic decision. On the other hand, the day-to-day management

[228] Like Italy, Portugal, Belgium and Spain. See Gall, JPL 'Is it possible to avoid conflicts of companies' tax residences? in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 889 at 891

[229] De Beers' case at 458 ("The real business is carried on where the central management and control actually abides.")

[230] Behrens, P 'General Principles of residence of companies' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 95 at 96

[231] Which Broe, LD '(2009) argued that it could be either 1) strategic decision – the fundamental policy affecting the key elements of the corporation's business; 2) day-to-day decision – the decision which implements the key strategic decision or 3) Shop-floor decision – that is the immediate supervision of the day-to-day operation of the corporation.

decisions are subordinate decisions of the corporation that implements the outcome of the strategic decisions.

The central question is – which of the corporate decision takes priority in determining whether or not a corporation took a management decision in a particular state. Broe[232] opines that the strategic decision takes precedence. However, in assigning priority to the various decisions of a corporation reference must be made to the nature of the corporation at issue. For example, in corporations that are composed of a parent and subsidiary most of the decisions are taken at the parent corporate level, whereas the implementation of such decision is carried out at subsidiary corporate level. In this situation, the strategic decision is that of the parent corporation while the day-to-day management decision is the one taken at the subsidiary level. What is relevant here is the management decision that generated the corporate income, and this is a pure question of fact.[233] Broe emphasises the corporate structure of a large corporation, whereby the strategic decisions are taken by the board of directors, while the managing director and his team carry out the day-to-day decisions.

The articles of association of the company and the corporate law of the state where the corporation was registered determine what constitutes strategic, day-to-day or shop-floor decisions of the corporation, who takes the decision and where it is taken The corporate law and tax regimes of states deal with these vital questions differently. There may be a divergence on the relevant decision that can pin down a corporation to a particular state. The determination of CMC and POEM is a fact-intensive inquiry by the courts that centres on an analysis

[232] Ibid

[233] For instance, Article 4(3) of the OECD Model Tax Convention on income and on capital (2005) attempted to set out criterion of determining the Place of effective management such as ‘place where key management and commercial decisions that are necessary for the conduct of the corporate business’ ‘place where the most senior persons or group of person make their decision. But in 2008 it abandoned those criteria and leave the issue of place of effective management to be determined by fact and circumstances.

of the above vital questions. Even though both CMC and POEM share a common goal of determining the real seat of a corporation, there is a need to highlight their silent features.

5.3.2.2.1 Central Management and Control

It is significant to differentiate the role of the courts in the UK in developing the CMC test and that of other common law jurisdictions. Thus, the UK courts formulated the concept of CMC by drawing an inference from other non-tax judicial precedents.[234] Before 1988,[235] there was no any statutory definition of corporate residence in the UK. However, in other common law jurisdictions, the application of the CMC is based on statutory provisions.[236] Therefore, the role of courts in other common law jurisdictions like Australia is purely that of applying the principles of statutory interpretation[237] to come up with a meaning based on the fact of the case at hand. The judges in De Beer and other cases have formulated a legal rule. In the same way, Lord Atkin in the case of Donoghue v. Stevenson[238] formulated the neighbourhood principle of establishing the duty of care in the tortious act of negligence. It may be argued that the CMC test provided by a statute is no longer a subjective test because a statute provides for the test, not a judicial formulation. It should be noted that such a CMC test is a question of law, but its application is purely a question of

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[234] Even Lord Loreburn formulation of CMC in *De Beers Consolidated Mines v Howe* [1905] 5 TC 198drawn inferences from the notion of the County Court jurisdiction (that empowered the court to decide on matters where the defendant dwells (later resides) and carry on business within the area of its jurisdiction) see for example, Attorney General v. Alexander (1874) LR 10 Exch 20. And the judicial trend in determining the residence of railway companies, where the cases held that railway companies carried on businesses in their respective head office not the multiple railway stations (that spread all over the country) where the actual business took place. See for example Brown v. London and North Western Railway Co.; Adam v. Great Western Railway Co.

[235] UK Corporate Income Tax Act of 1988

[236] For instance, section 6(1) (b) of the Australian Income Tax Assessment Act of 1936 provided for three different tests for corporate residence including the CMC.

[237]The plain the wordings of a statute must be given their full meaning and effect and the judicial pronouncement should not override the actual word of a statute.

[238] (1932) AC 562 (HL)

fact. According to Cousin,[239] corporate residence is found not where the CMC should be in terms of its constitution, but where it abides. That is where the de factor CMC took place.

The notion of CMC in determining corporate residence has its origin in the twin decisions in Calcutta Jute Mills Co Ltd v Nicholson[240]and Cesena Sulphur Co Ltd v Nicholson.[241] In these cases, the court defined corporate residence by way of analogy with the residence of an individual, that is “where he sleeps and lives”. Thus, the corporate residence is “where it carried on its real trade and business”.[242] Lord Loreburn followed the same line of reasoning in De Beers Consolidated Mines Ltd. v. Howe.[243] In De Beer’s case, the appellant was incorporated in South Africa, and its registered office was also located in Kimberley, South Africa. The general meetings of the company had always been held in South Africa. A few directors of the company also resided in South Africa with board meetings held in both South Africa and London. In this case, the court determined whether the appellant was a resident of the United Kingdom for tax purposes. The appellant contended that the company resides where it is registered, and nowhere else. The court held that the appellant was a UK resident for tax purposes. The case enunciated the leading principles for establishing corporate residence. The principles are summarised as follows:

a) The residence of a corporation for tax purposes is where the corporation carries out its real business;
b) The corporation carried on its real business where the central management and control abides.

[239] Cousin (2002) at 42
[240] (1876) 1 TC 83 at 107.
[241] (1876) 1 TC 88
[242] But the main question was where the real business of the corporation carried on? The court held the place to be the London offices of the Appellants.
[243] (1906) AC 455.

c) The determination of the 'central management and control' is a question of fact. Thus, the court should not base its decision on the provisions of the article or the constitution of the corporation, but should examine the course of business or trade.

d) In determining the CMC the court should consider factors like: the location of the principal business office, the place of the directors' meetings, the residence of a majority of the directors, the place of incorporation and registered office, and the location of the policy and decision-making process of the entire corporate activity in determining residence include.

The above principles have been followed and expanded by subsequent decisions of the English Courts. For instance, the cases of Swedish Central Railway Co Ltd v Thompson and Egyptian Delta Land and Investment Co Ltd v Todd addressed the issue of whether the word 'central' in the CMC test suggest that the strategic decision must be made by more than one body of the corporation?[244] In Swedish Railway's case, [245] the court enunciated the proposition that the CMC of a corporation may take place in more than one jurisdiction. Once a corporation has two CMCs, it follows that it has two residences.

Therefore, the court held that the management decision taken in the UK was sufficient to make the appellant a UK resident for tax purposes. Jones[246] argues that a corporation may reside in more than one place, but it may not have two

[244] Before 1988 the UK determined corporate residence solely on the principles in De Beers' case. The place of incorporation was not a test then. Therefore, before these cases, a UK incorporated can move all its directors to the location where the corporation operates its main business. In that situation the court found it very difficult to determine the residence of the corporation based on the DeBeers' principle of CMC. Therefore, the court addressed the possibility of dual corporate residence.

[245] (1925) 1 AC 495 at 501

[246] Jones, JFA 'Corporate residence in Common law: The origins and current issues' in Miasto, G (ed) Residence of corporations under tax treaty and EC law' (2009) IBFD Publication at 121

residences for tax purposes. He also stated that a corporation's CMC might be exercised in either 'one centre', 'two equal centres' or 'major and minor centre'. Linking this argument with the Swedish Railway's case, it could be seen that the court had considered both the Swedish and the UK Board as an equal centre in the exercise of the Appellant's CMC. The Appellant was found to be a UK resident, due to the sufficiency of the UK CMC.

The decision in Swedish Railways was distinguished in Egyptian Delta. In that case, the articles of association provided and maintained a register of members, a local secretary and an office in England, whereas the active secretary and the directors were residing in Egypt. The court held that the Appellant's CMC was in Egypt. Thus, it was an Egyptian resident for tax purposes. The court emphasised the real business location of the Appellant instead of what was contained in the articles of association. Therefore, the issue of having CMC in more than one place can only be tenable where the argument does not hinge on statutory requirements.

The Egyptian Delta case raised another vital issue regarding the determination of the CMC, namely, the dichotomy between de jure and de facto management exercise of the CMC. In Unit Construction Co. Ltd v. Bullock[247] the Kenyan directors of a subsidiary of UK company had never functioned as a board of directors. Despite the fact that the articles of association gave them managerial powers and the court did not consider any meetings held in the United Kingdom as valid. The Court found that in determining the CMC, the court ought to consider facts beyond the contents of the articles or any other regulation. Thus, based on the facts, the court could conclude that the board of directors had ceded their powers to another person or that the other persons have usurped such powers. Thus, where the court found that the board has ceded its powers or

[247] (1960) AC 351 (HL)

someday has usurped it, the company is a UK resident if such person exercised the usurped power in the UK. The question is what amounts to the usurpation of the board's power?

In Wood v. Holden,[248] the court addressed this question by distinguishing the role of an outsider who advises and influences the decision taken by the board and that of an outsider who dictates the decision taken by the board. In this case, it was argued that the appellant was managed and controlled by a sole director pursuant to the provisions of its articles of association. However, the HMRC argued that a UK-based adviser exercised and influenced the decision of the appellant and that the Netherland-based sole director performed only an additional role in the managing and controlling the appellant. The court held that despite the fact that the UK-based adviser influenced the decision of the Netherland sole director, it could not be inferred that he actually dictated the decision taken by the director. Therefore, the appellant was not a UK resident. This decision distinguished between exercising the CMC of a corporation and advising the directors of the corporation on what decision to be taken. On the basis of this decision, the Revenue Authority must satisfy the court that any advice given by an outsider did not merely influence but dictated the decision of the board.

The decision in Laerstate BV v. HMRC[249] further illustrated the issue of usurpation of the board's power of CMC. In this case, the appellant, a Dutch company with two directors, Trapman a UK non-resident and Bock a UK citizen as well as the principal shareholder of the company. Bock as the sole shareholder of the company had admitted that there were no board meetings let alone taken any decision there. The court held that Bock had continued to exert

[248] (2006) EWCA 26 see also *News Datacom Ltd and another v Atkinson* (2006) STC 732;
[249] (2009) UKFTT 209 (TC)

influence over the company after his resignation as a director and that he exercised the de facto control of the company in the UK. Therefore, the appellant was found to be a resident of the United Kingdom.

The UK case law on the CMC that is premised on the principles established in De Beers has influenced other common law jurisdictions such as Canada and Australia. Like the UK, the Canadian statute does not mention the CMC test for corporate residence. Thus, reference is always made to De Beers principles.[250] However, the earlier Canadian decisions have based the CMC test on 'de jure management and control' In British Columbia Electric Railway v. The King[251], the articles of association of the appellant, authorised it to hold all general meetings in Canada, and that all the directors must be Canadian residents. The Privy Council held the CMC of the company to be in Canada in line with the provisions of the articles.[252]

However, in subsequent cases, the Canadian courts have followed the trend of the UK courts in giving more emphasis to the 'de facto exercise of CMC'. In Capitol Life Insurance Co. V. The Queen[253], the company executed a power of attorney in favour of its agent (who resided in Canada) to take control of its business. The court held that the agent was not exercising any control over the company's affairs. Thus, the CMC of the company remained in the US. This decision adopted the principle in the UK case of Unit Construction Co. Ltd v. Bullock. In Fundy Settlement v. Canada,[254] the Canadian Supreme Court

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[250] For discussion on the Canadian Corporate residence see Cousin, R 'Corporate residence and international taxation' (2002) IBFD Publications, Amsterdam, Wilkie, S 'Locating Corporate business income: Reconsidering the tenets of international tax jurisdiction' (2003) 51 Canadian Tax Journal; Pyrez, OA 'The basis of Canadian Corporate taxation: residence' (1973) 21 Canadian Tax Journal.

[251] (1946) AC 527 at 538 (PC)

[252] The same line of reasoning was followed in Zehder & Co. v. MNR, (1970) CTC 85. See also the case of Bedford Overseas Freighters Ltd. v. MNR, (1970) CTC 69

[253] (1984) CTC 141

[254] (2012) SCC 14

extended the De Beers principle to the determination of the residence of trusts. The court held that the trust was a resident of Canada for tax purposes because it was the beneficiaries who exercised the CMC of the trusts, and they exercised it while residing in Canada. The court did not say that the residence of a trust can never be the residence of the trustees if the trustees (not the beneficiaries) exercised the CMC. The Trustees in this relied on the earlier decision[255] where the court held that the residence of a trust for tax purposes was where the majority of the trustees reside.

To sum up: the Canadian courts adopt most of the principles established by the UK courts on the CMC up to the case of Wood v. Holden. Ordinarily, the factors considered by the court ought to be similar to those of the UK; Brook[256] argues that the Canadian Courts tend to follow the decisions of the UK courts. However, a close examination of the trend of the Canadian decisions reveals that the courts consider the residency of the directors, the location of the registered office and meetings of the directors as the factors that determine the central management and control of the corporation. These factors are not conclusive because they are the minimum statutory requirements for the existence of the corporation. The trend of the UK courts is to emphasise the 'real business' location of the corporation rather that statutory requirements. The Canadian Courts, on the other hand, consider formal requirements as corroborative factors for determining the 'real business' location of the corporation. These inconsistencies usually result from the application of a facts and circumstances test.

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[255] Thibodean Family v. The Queen, 78 DTC 6376

[256] Brook, K 'Canada' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication. At 407. The same view shared by other commentators; Krishna, V 'The fundamentals of Canadian income tax law' (2006) (9th ed) Thompson Carswell, Toronto at 113; Kroft, E 'Jurisdiction to tax: an update' (1993) Corporate Management Conference, Toronto at 1:25

In defining corporate residence for tax purpose, Australia combines the CMC with carrying on business.[257] Thus, a corporation is a resident if it is either incorporated in Australia or "carries on business" and has its "central management and control" in Australia. The relevance of the "carrying on business" element in the Australian CMC test generates controversies. It is debatable whether the two elements of the test are independent of each other. Some judicial decisions[258] and commentators[259] have viewed the element as redundant and as dependent on the satisfaction of the second element, namely, 'management and control'. Dirkis[260] holds a contrary opinion. He points out that the Tax Rulings[261] of the Australian Tax Office consider the two elements of the test to be independent of each other. Thus, there is a conflict between the above mentioned view and Tax Rulings. Legislative intervention is necessary. However, Dirkis did not consider the legal position of the ATO Tax Ruling vis-à-vis the judicial pronouncements on the issue. He cited the efforts of the Commissioner in designing the Tax Rulings to distinguish the facts of those cases, but a question arises as to whether he has the power to do so. The level

[257] Section 6 (1) (b) of the Australian Income Tax Assessment Act of 1930

[258] In Malayan Shipping Co v Federal Commissioner of Taxation (1946) 3 AITR 258 at 261; Williams J stated "The purpose of requiring that, in addition to carrying on business in Australia, the central management and control of the business .must be in Australia is to make it clear that the mere trading in Australia by a Company not incorporated in Australia will not of itself be sufficient to cause the company to become a resident of Australia. But if the business of the company carried on in Australia consists of or includes its central management and control, then the company is carrying on business in Australia and its central management and control is in Australia." See also North Australian Pastoral Co Ltd v Federal Commissioner of Taxation (1946) 3 AITR 314, 319 Esquire Nominees Ltd v Federal Commissioner of Taxation (1973) 4 AITR 75; Waterloo Pastoral Co Ltd v Federal Commissioner of Taxation [1946] 72 CLR 262

[259] Sadiq, K 'Jurisdiction to tax and the case for threshold reform' (2004) Paper presented at the 16th Australasian Tax Teachers Association Conference, Adelaide, 30 January 2004 9; Kohl, U 'The Horror-Scope for the Taxation Office: The Internet and its Impact on "Residence"' (1998) 21 UNSW L. J. 436, n 45; Magney, T 'Australia-Singapore Taxation Aspects of Carrying on Business in Singapore – Part II' (1975) 4 Aust. Tax Rev. 67at 69; Vann R and Parsons, R 'The foreign tax credit and reform of international taxation' (1986) 3 Aust. Tax Forum 131 at 148.

[260] Dirks, M 'Still a problem child: central management and control after RITA' (2005) 15 Revenue L. J. 126

[261] Australian Tax Office Taxation Ruling TR 2004/15: Income Tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control.

of inconsistencies inherent in the application of the CMC by the states is striking.

On the second segment of the Australian CMC test the Australian courts followed the trends of the United Kingdom and Canada, namely, the principles in De Beers. In Koitaki Rubber Estates Ltd. v. FCT,[262] the Court applied the rule in De Beers and held that the appellant was an Australian resident for tax purposes since the CMC of the company was exercised in Australia. The court considered the fact that the directors and the majority of the shareholders resided in Sydney. The appellant's rubber plantations and the production operations in Papua New Guinea were merely auxiliary. The appellant was under the supervision, direction, and control of the Sydney office. This decision shows that the court gave greater emphasis to the place where management and control of the company took place rather than where the physical operations of the company's business were carried out. The decision of the court could have been different if the focal point was the day-to-day management decision rather than the strategic decisions.[263]

In the recent case of Hua Wang Berhad v. Commissioner of Taxation,[264] the court followed the UK court's decision in Wood v. Holden. It distinguished the influence of an adviser of the board and the actual decision of the board. The Australian tax regime clearly separated the board's control and the shareholder's control over a corporation. Apart from the CMC test that has regard to the board, the regime adopted 'the voting power test' that focuses on the power of the shareholder at the General Meetings of the corporation.

[262] (1941) HCA 13

[263]The Koitaki's case applied the principles in De Beers, Egyptian Delta and the Swidish Railway cases. Also the subsequent case of North Australian Pastoral Co Ltd v FCT (1946) 3 AITR 258, Esquire Nominees Ltd v FCT (1973) 4 ATR 75 followed Koitaki case.

[264] (2014) FCA 1392

However, this latter test is less significant to this research because it is an anti-avoidance mechanism.[265]

All the cases cited centred on the principles in De Beers. Therefore, in the determination of the CMC, the focus is on those who actually took the decisions of the corporation rather than those who had the right to take the decision. Under the corporate law of various states, the strategic decisions of a corporation lie with the board of directors. However, in reality, the strategic decisions may not be taken by the board. Given the fact that the De Beers principles are determined based on the facts and circumstances of each case, it is difficult to apply the CMC test accurately. For instance, the appellant in De Beers had active businesses in South Africa and also had directors there. However, the court focused on the activities of the board rather than the actual business of the appellant. This is one of the weaknesses in the De Beers decision Furthermore, under the De Beers principles, it may not be difficult to have board meetings in various locations, have boards meet otherwise than in person or have boards comprised of individuals residing in different locations. The difficulty lies in the scope and number of such meetings that would be sufficient to establish the CMC.

5.3.2.2.2 Place of effective management

The place of effective management (POEM)[266] traces its origin from the notion of central management and control (CMC).[267] It is a tie breaker rule for

[265] Kohl, U 'The horror-scope for the taxation office: the internet and its impact on 'Residence' (1998) 21 University of New South Wales Law Journal 436 at 449.

[266] Chapter seven of this thesis captured detailed discussion of the South African notion of the POEM encapsulated in the Oceanic Trust case.

[267] Cerrioni, L 'The place of effective management as a connecting factor for companies' tax residence within the EU vs. the freedom of establishment: The need for a rethinking?' (2012) 13(9) German L. J. 1095

allocating taxing jurisdiction between the states who are parties to a Double Tax Agreement (DTA).[268] It is also used as a connecting factor in imposing income tax on the corporation under the domestic laws of most civil law jurisdictions. Thus, the POEM serves as either a tie-breaker rule in the DTA or a connecting factor for domestic tax jurisdiction.

Due to the dual roles plays by the POEM even states that adopt the CMC test find it useful in the interpretation of DTA provisions. Therefore, once a corporation is proved to have its CMC outside the state asserting tax jurisdiction, the existence of any DTA between the asserting state and the CMC state must be enquired into. If there is a DTA, then the POEM will be used to resolve the conflict rather than the CMC. Conversely, where the CMC was found to be in the asserting state, the corporation can escape liability if it can prove that its POEM was held in another state that has an existing DTA with the asserting state.

Despite the vital role played by the POEM on the allocation and determination of the taxing right between the states, there is no unanimity as to its meaning. This research focuses on the POEM as a connecting factor. In the absence of a universal definition, an analysis of the concept of POEM centres on two broad views. The first group views the POEM to mean the place where the strategic management decisions of the corporation are taken which is usually where the board of directors' meetings are held. The second group argues that the POEM refers to the place where the day-to-day management decision is reached by the managing director and his management team.

[268] That is a situation where a corporation falls within the definition of residence under the domestic laws of the contracting parties. See Article 4(3) of the OECD Model Tax Convention on Income and on Capital

To reconcile these divergent views recourse should be had to the similar concepts used by various states. As stated above, the POEM as a connecting factor stems from the notion of a CMC. Thus, the concept of CMC agrees with the view of the first group.[269] Civil law jurisdictions adopted the different concept of the POEM that varies between the first and the second view. For instance, the German tax regime has adopted 'place of management' which has been defined as the centre of the chief business management of the corporation.[270] Therefore, the German POEM is the centre of the strategic decisions of the corporation.

The Belgian tax regime adopts the 'registered office', 'principal establishment' and the 'seat of management or administration'.[271] The last two are conflicting variations of the POEM. Bammens[272] argues that the principal establishment is the nerve centre of the corporation, and the location of the registered office determines the principal establishment. It is the place where the shareholders or board of directors meets. The seat of management or administration, on the other hand, refers to the location of the day-to-day management and administration of the corporation. The registered office is a test of its own as well as the determinant of the principal establishment. There is no clear guidance on which of two tests takes precedence. Furthermore, the regime separates the place of strategic decisions from that of the management and administration. Superficially, the dichotomy reconciled the two conflicting views on POEM. However, it is not clear whether the 'principal establishment' and the seat of management or administration are to be satisfied concurrently or disjunctively.

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[269] The concept of CMC has been fully analysed in the immediate preceding heading.

[270] Section 10 of the German General Tax Code See also English, J 'Germany' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication. 455

[271] Article 2(5) (b) of the Belgium Income Tax Code 1992

[272] Bammens, N 'Belgium' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication. 375 at 382

Austria has adopted the POEM and the legal seat as the test for determining corporate residence.[273] According to Simader,[274] the POEM is situated where the actual not statutory (legal) seat of the corporation is located. He argues that the real seat refers to the centre of business direction. Thus, the most important decision is that day-to-day management was exercised by the managing director who usually operates from the actual seat. However, this view is not appealing because assuming that the legal seat is where the corporation reaches its strategic decisions, it is not clear whether or not the POEM and the legal seat tests are to run concurrently. Therefore, Simader did not shed light on the dichotomy between the strategic and day-to-day decisions. It is still debatable whether the decision to be taken at the actual seat must be on strategic or day-to-day management.

Some jurisdictions clearly define the POEM within the context of their domestic laws. For instance, in Switzerland, the POEM is the place where important decisions on the affairs of the corporation are taken.[275] The Dutch regime, on the other hand, gives a blanket provision for the determination of corporate residence based on facts and circumstances.[276] It does not mention the POEM, but the Dutch Supreme Court in BNB 1993/1932[277] endorsed the Dutch notion of POEM to be based on the strategic decisions taken by the board of director.

Given the above, the factors considered in determining both the POEM (as a connecting factor), and the CMC are substantially the same. They are all premised on the issue of the real business of the corporation. The main reason for viewing POEM different from the CMC is the failure to appreciate the dual

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[273] Section 1 (2) of the Austrian CorporateTax Act 2009
[274] Simader,K 'Austria' in Miasto, G (ed) Residence of Individual under tax treaty and EC law' (2009) IBFD Publication.339 at 350
[275] Article 50 of the Federal Income Tax Act 1990
[276] Article 4 (1) of the General State Taxes Act 1962
[277] No. 27 293

role being played by the POEM (as tie-breaker rule and a connecting factor). As a tie-breaker rule, the POEM only applies to the parties to a DTA. The parties to a DTA are at liberty to define the scope of the POEM or to simply adopt the OECD model. However, when the POEM is used as a connecting factor, it is purely determined pursuant to the domestic laws. The dual roles of the POEM lead to confusion in the determination of corporate residence. The CMC is a more viable connecting factor for corporate residence. The viability of the CMC is evident in the current move by the US to introduce the CMC test alongside its 'place of incorporation.[278]

5.3.3 How to choose between competing connecting factors

There are divergences of opinion as to which of the tests[279] is suitable for the state to adopt in determining the corporate tax residence. The divergence centres on two traditional normative criteria used in evaluating the corporate residence tests; one supports the objective tests while the other supports the subjective test.[280] Those advocating the adoption of the objective test base their arguments

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[278] Avi-Yonah, R S. 'Beyond Territoriality and Deferral: The Promise of "Managed and Controlled' (2011) 63 (9) Tax Notes Int'l. 667 at 668 (He argued for the amendment of section 7701 of the US Inland Revenue Code, to cover corporation that are managed and controlled in the US. He specifically makes a case for the UK model of the CMC. He also argued that there is a distinction between CMC and POEM) See also New York State Bar Association Tax Section, Report on the Management and Control Provision of the International Tax Competitiveness Act of 2011, dated 7th January 2011. See also Holmes, RY 'Deconstructing the rules of corporate tax' (2010) 25 Akron Tax J. 1 at 21 (Making case for a shift from the objective to subjective tests in determining the US corporate residence)

[279] The statutory (objective) test, (the place of incorporation) or the subjective tests (the center of effective management and control) or the combination of the two tests, one supplementing the other.

[280]Ault and Arnold, (2010) at 434 (There are two basic approaches are used in establishing corporate residence: one is to focus on some formal legal connection to the jurisdiction the other is based on economic and commercial connection.) Couzin, R (2009) at 22 (who discussed the distinction between the 'place of incorporation test' and the 'place of permanent establishment test'); Brauner, Y United States, in Maisto, G (ed) Residence of Companies Under Tax Treaties and EC Law (2009) 855 at 865 (contrasting between the 'place of incorporation test' in the United States and other fact and circumstances tests used by other countries); Broe, LD (2009) at 96 (differentiating between "formal and factual tests" used in civil law countries); Martin Norr, M (1961) at 437 (contrasting "fiscal domicile" with "legal domicile"); David R. Tillinghast, DR 'A Matter of Definition: 'Foreign' and 'Domestic' Taxpayers' (1984) 2 Int'l Tax and Bus. Law. 239 at 266

on efficiency as a normative value.[281] They argue that the objective test makes the taxpayer indifferent regarding the place of incorporation.[282] The proponents of the subjective test ground their arguments on the need to have a connection between the state that wants to impose a tax and the corporation at issue, resulting from the benefit it derives from the state's machinery.[283] Some commentators[284] view these two arguments as unconvincing to justify both the objective and subjective tests for corporate residence. They argue that the concept is meaningless because corporations are merely imaginary, and residence in the real sense, easy to manipulate by the taxpayers and that the corporate residence tests fails normative evaluation.

Omri,[285] on the other hand, rejects this view and argues that the corporate tax residence test should be designed to support the policy purposes of corporate taxation. Thus, each of the corporate residence tests should be linked with a

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[281] Kane, MA and Rock, EB 'Corporate Taxation and International Charter Competition' (2008)106 Mich. L. Rev. 1229 at 1235; Shaviro, DN 'The David R. Tillinghast Lecture: The Rising Tax-Electivity of U.S. Corporate Residence' (2011) 64 Tax L. Rev. 377at 413;

[282] For instance, a corporation may be registered in state A but it carries out its business in state B which determines the residence of corporations exclusively by way of objective test. In this scenario, the corporation at issue is a foreign corporation for tax purpose in state B, notwithstanding the fact that it operates that state, because it was not incorporated there. But it could resident of state A if it also adopts objective test, even though it is not operating in state A. Thus, once a corporation is registered in a particular state and that state adopts objective test, the location of the corporate business is immaterial in determining the residence status of the corporation. Therefore, objective test is efficient in this regard.

[283] Pistone, P 'EC law and tax residence of companies' in Miasto, G Behrens (2009) Broe (2009) Couzin (2008)

[284] Avi-Yonah, RS 'Tax Competition and the Trend Toward Territoriality' (2012), Univ. of Mich. Public Law Research Paper No. 297(3) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2191251; Kleinbard, ED 'The Lessons of Stateless Income' (2011) 65 Tax L. Rev. 99 at 159; Graetz, MJ 'The David R. Tillinghast Lecture —Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies,' (2001); 54 Tax L. Rev. 261 at 320; Kirsch, MS 'Taxing Citizens in a Global Economy' (2007) 82 N.Y.U. L. Rev. 443, 465-467; see also Nikolakakis, A 'The unbearable lightness of being incorporated: The diminishing relevance of corporate residence' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 903; Bouthillier, J 'Residence-Based Taxation and FAPI: A World of Fictions' (2005) 53(1) Canadian Tax J. 179 at a180 ("The concept of residence, however, is elusive and may not be adapted to modern economic realities.")

[285] Omri, YM 'Jurisdiction to tax corporation'

particular corporate theory.[286] He argues that “there is no perfect residence test, but there are perfect residence tests” because the corporate residence test is country specific. Therefore, the call to have a ‘best residence test’ should be abandoned. With the current global economic integration in mind, I take a different line of reasoning from Omri, particularly on the last point. He premises his argument on the US system with total disregard of the impact of globalisation that has caused the tax sovereignty of the state to be questioned. Omri’s argument that the states should face a different direction in designing their corporate residence is a misconception.

Omri puts this argument in response to the challenge by other commentators on the meaningfulness of corporate residence tests. The missing point is that, assuming the normative justification for the residence test cannot be distilled for the reasons cited by those commentators the policy rationale for corporate taxation is diverse as argued by Omri. In summary they all head in the same direction. That is to tax the income earned by the shareholder through their ownership interest in the corporations indirectly. Therefore, the divergence of the corporate theories is more of form rather substance. [287] And any test formulated to determine the residence of a corporation for income tax purposes

[286] For instance, the notion that corporate tax is imposed to regulate corporate management is more in tandem with the USA regime, where limited liability corporations with only one member are exempted from corporate tax unless they choose to be treated as corporation. That is why some argued that corporations are taxed in the United States for the very purpose of taxing the corporation’s equity holders and to regulate the corporate managers. See Bank, SA ‘Entity Theory as Myth in the US Corporate Excise Tax of 1909’ in Tiley, J (ed) ‘Studies in the History of Tax Law’ (2007) 393 at 394; Bank, SA Entity Theory as Myth in the Origins of the Corporate Income Tax’ (2001) 43 Wm. & Mary L. Rev. 447, 452 Bank, SA ‘The Dividend Divide in Anglo-American Corporate Taxation’ (2004) 30 J. Corp. L. 1, 15–18.

[287] By closer look at these approach, through the lens of globalisations, the traditional approach is more appealing, because it creates a universal evaluative criterion that address the silent issues involves in the residence test that are country specific. For instance, ‘place of incorporation has been justified because it is efficient and easy to administer. The only challenged raised against this efficiency is that, since corporate tax is not efficient itself, how can a rule of determining residence be efficient. See Omri (2013). On the issue that the objective test is easy to manipulate, the current trend of enacting CFC regimes could greatly prevent allay that the fear of manipulation.

goes to the substance. Hence, there is no need to have different tests for corporate residence by each state.

Furthermore, both Omri and those he challenges view the competing connecting factors from an objective and subjective tests dichotomy. They fail to realise that there are competing models, especially in the subjective test. For instance, most civil law countries use the 'place of effective management' (POEM) as the subjective test, whereas, most of the common law states use 'central management and control'(CMC).[288] Even within these classes, there is a divergence of the judicial approach to the interpretation and formulation of the guiding principle or factors to be considered in defining either POEM or CMC.[289]

As the divergence increases, economic integration also expands. The economic integration is a reality that cannot be avoided.[290] There is a need to stick to the insistence on having the 'best test' for ascertaining corporate residence. This could be achieved if there is consensus about the rationale for imposing the corporate tax at the corporate level. Given the reality of globalisation, the imposition of corporate tax is inevitable because even some states that abandoned the corporate tax have been forced to revert to it.[291] Thus, the assertion that corporate tax is an inefficient method of revenue collection, let

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[288] Ault and Arnold, (2010) at 434,Broe (2009)

[289] For instance, the USA exclusively adopted objective test, while from 1988 UK adopted both objective and subjective test (CMC model). Within the subjective test category, the UK and other common law countries use CMC model whereas most of the civil law jurisdiction as well as the OECD Model convention apply POEM. Also within the CMC jurisdiction, the courts arrived at different decision as to what constitute 'central management and control' means. In De Beer Consolidated Mines Ltd. V. Howe (1906) AC 455 – CMC means where the directors exercise their power, while in Australian case of Northern Australian Pastoral Co, ltd v. FCT (1946) 71 CLR 623 – CMC is located where actual business operation carried on.

[290] Bird, R 'Taxing electronic commerce: A revolution in the making' (2003) available at www.cdhowe.org/pdf/commentary_187.pdf (The implication of globalisation has thrown the application of tax law into disarray. What constitute state and its tax jurisdiction is not based on geography).

[291] Brauner (2005)

alone any test to determine the residence of the corporation[292] cannot be valid. Therefore, both the objective and subjective tests represent two different types of locating rules (legal v. factual) that are worth keeping separate.[293]

Finally, the dilemma of choosing between objective and subjective or even the combination of the two centres on the fact that, the objective test is simple and straightforward, but leaves room for easy manipulation.[294] The subjective test, on the other hand, is complex in nature, but is difficult to manipulate. However, the dilemma of choosing the subjective test is the fact that two or more states may adopt either CMC or POEM tests. Also, even within the CMC and POEM, States may apply different approaches in determining them. In choosing the combination of substantive or objective criteria the two, the hierarchy of the criteria is not usually clear.

5.4 Conclusion

In the absence of a single residence test that could be applied globally, the inconsistency and conflict inherent in the definition of residence would continue to rise. Besides, states approach the determination of the residence of the person (both natural juristic) for income tax purposes differently. This chapter has examined the trends in the existing laws (both statutory and judicial) of the selected common law and civil law jurisdictions. These states set out various tests in determining the tax residence. Whenever the tests are exclusively

[292] Nikolakakis, A 'The unbearable lightness of being incorporated: The diminishing relevance of corporate residence' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 903; Bouthillier, J 'Residence-Based Taxation and FAPI: A World of Fictions' (2005) 53(1) Canadian Tax J. 179 at a180 ("The concept of residence, however, is elusive and may not be adapted to modern economic realities.")

[293] Kane and Rock (2008)

[294] A resident of a state which only applies an objective test for the determination of corporate residence may move to another state and incorporate a company thereby running from being taxed in his state of residence. Therefore, to adapt to the current wind of globalization the subjective test is preferable.

founded on externally observable actions, they are objective standards, and when the tests centred on the taxpayer's state of mind, they are subjective standards.[295] For this research, these tests are categorised into statutory and facts-and-circumstances tests.

The diversity and inconsistencies in defining both the individual and corporate tax residence stem from the notion of tax sovereignty. The states protect their taxing power. Thus, they define tax residence differently. Conflicts of jurisdiction arise where a taxpayer falls within the definition of resident provided by two states. The states resolve the conflicts through a Double Tax Agreement (DTA). The reality of globalisation renders the DTA less important because a taxpayer could be trapped in a triangular situation by falling within the definition of another state, which is not a party to the DTA. A taxpayer may be exposed to uncertainty about his tax status, where the tie-breaker provision of the DTA could not resolve the jurisdictional conflict between the two states.[296]

As a result of the growing weakness, there has been a call for a multilateral tax treaty to address the definition of residence and other relevant issues.[297] The proponents of the multilateral treaty did not take into cognisance that the tax sovereignty of the state comprises both substantive and enforcement jurisdiction over the taxpayer. Therefore, it is possible for the states to surrender

[295] McGacrry, SJ ‘State of mind stand in taxation’ (1988) 7 Am. J. Tax Pol’y 249

[296] Most of the DTA provides that where the tie-breaker rule fails, the parties shall resolve the conflict by mutual agreement. Before such agreement is reach, the person remains in uncertain situation. Failure to reach the mutual agreement reached by the parties exposes the person to become dual resident for tax purposes.

[297] From the empirical research conducted there are more than 2600 DTA around the globe. See Braun, J and Zagler, M ‘An economic perspective on double tax treaties with(in) developing countries’ (2014) 6 (1) World Tax Journal 1. See also Cockfield, AJ ‘International Tax Competition: The Last Battleground of Globalization’(2011) 63 (12) Tax Notes International 867 (argued that while trade and investments becomes international, taxation remains national as the states are unwilling to surrender their tax sovereignty to multilateral tax treaty.)

enforcement jurisdiction as a result of a multilateral treaty. However, it could be difficult for the states to surrender their substantive tax jurisdiction because it goes to their sovereignty. Thus, the multilateral treaty is not feasible. The crux of this research is that the states need to co-operate with each other in defining tax residence. The co-operation could be achieved through comparative analysis of the states' domestic regime on the definition of residence. The next chapter addresses all the above-mentioned concerns, particularly the nature and scope of the co-operation mechanism explored by this thesis.

CHAPTER SIX

A COMPARATIVE ANALYSIS OF THE NIGERIAN AND SOUTH AFRICAN FISCAL REGIMES ON AN INDIVIDUAL'S TAX RESIDENCE

6.0 Introduction

The residence-based system suggests that states should impose a tax on both the domestic and foreign earned income of their residents. The residence status of a person is crucial in determining his tax liability because the ascertainment of tax liability is a necessary condition for a person to become subject to tax. Thus, liability to tax is different from being subject to tax. Under a residence base regime, a person becomes 'liable to tax' and 'subject to tax'[1] once he falls within the definition of resident provided by the regime. He remains liable to tax even if, for some reasons, the regime exempts him from paying tax, or it grants him certain tax relief thereby making the person not subject to tax. Thus, all persons subject to tax are liable to tax, but not all persons liable to tax are subject to tax. Therefore, the concept of residence could be used to determine whether or not a person is liable or subject to tax. The crux of this thesis is the notion of residence as a determinant of establishing 'liability to tax' not 'subject to tax'. The preceding chapter discussed the diversity of the definitional rule of tax residence for both individuals and corporations. The chapter highlighted the States' efforts to resolve the conflict inherent in the determination of fiscal residence.

In addressing the conflicts, states adopt both unilateral and bilateral mechanisms, that is to say, double taxation relief provisions in their domestic laws and a bilateral Double Taxation Agreement with each other.[2] The comparison is centred on the function of the concept of residence as a means of establishing jurisdictional nexus not for determining the eligibility to tax exemption or relief. Thus, this chapter and the next chapter do not only describe the relationship between Nigeria and South African residence-based regimes; it makes an in-depth analysis of the definitional rule of individual residence in Nigeria and South Africa. The comparative analysis explores the possibility of

[1] Wheeler, J 'Persons qualifying for treaty benefits' in Trepelkov, A et al (ed) 'United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries' (2013) UN Publication, New York 60 at 63.

[2] The reference made to the bilateral or multilateral tax treaty regime is only limited to the definitional rule of 'resident' for the purposes of the treaty not the detailed content of the treaty

achieving co-operation among the states outside the realm of the tax treaty (bilateral or multilateral).

6.1 Residence-Based Taxation of Individuals and other Entities in Nigeria

Payment of tax is a duty imposed by the Nigerian Constitution:

> "it shall be the duty of every citizen to declare his income honestly to appropriate and lawful agencies and pay his tax promptly."[3]

Even though the section seems to impose the tax payment obligation on the 'citizen', the obligation is extended to all persons living in or having an economic connection with Nigeria. The protection against compulsory acquisition of movable and immovable properties of persons is a fundamental right recognised in chapter four of the Nigerian Constitution. The protection mentioned above is not restricted to Nigerian citizens.[4] However, "nothing in subsection (1) of this section shall be construed as affecting any general law for the imposition or enforcement of any tax, rate or duty."[5] Therefore, the imposition and collection of the tax in Nigeria shall be made pursuant to a statutory provision. Moreover, once a statute imposes a tax, the right to property is suspended to the extent of the provision of that statute.

The taxation of individuals is governed by the Personal Income Tax Act (from now on referred to as 'PITA')[6] and individual includes a corporation sole and a body of individuals.[7] In addition to individuals, section 1 of the Act imposes a tax on the income of a partnership or trustee,[8] estate, and on communities and families.[9] In other words, any entity that does not fall under the definition of a

[3] Section 24 (f) of the Constitution of the Federal Republic of Nigeria 1999
[4] Ibid Section 44 (1)
[5] Ibid section 44 (2) (a)
[6] Cap P8 Laws of the Federation of Nigeria 2004 (as amended by PITA 2011).
[7] Section 108 of the PITA
[8] Not incorporated trustees, because an Incorporated Trustees is registered under Part C of the Companies and Allied Matters Act C20 Laws of the Federation of Nigeria 2004
[9] section 1 of the PITA

company[10] is a taxable person under the Act.[11] The taxpayers are liable to pay tax on their global income[12] to the relevant tax authority of the state of their residence[13] as at the 1st day of the year of assessment.[14] The significance of section 3(1) PITA is that all the income is taxable whether sourced inside or outside Nigeria. The section reads:

> "Subject to the provisions of this Act, the tax shall be payable for each year of assessment on the aggregate amounts each of which is the income of every taxable person, for the year, from a source inside or outside Nigeria…"

Hence, it established a worldwide income tax system.

In any federal state, there is the notion of fiscal federalism that envisages the decentralisation of the taxing power between the states of the federation and the central government. The Nigerian constitution devolved the taxing power between the states and the federation government.[15] However, it gives the federal government the exclusive substantive tax jurisdiction for both the individual and corporate income tax, while the federal and state governments shared the enforcement tax jurisdiction for individual[16] income tax.[17] The PITA recognises the shared enforcement jurisdiction and that is why it makes separate

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[10] Under section 105 of the Companies Income Tax Act 2007 - "Company" means any company or corporation (other than a corporation sole) established by or under any law in force in Nigeria or elsewhere"

[11] Saulawa JCA in Lagos State Internal Revenue Board v. Motorola Nigeria Ltd and another (2012) LPELR-14712 (CA)

[12] Section 3 of the PITA

[13] Section 2 PITA

[14] By section 108 of the PITA the year of assessment commences from the 1st January each year.

[15] Emiko, G.I. 'An Analysis of Federal/State Taxing Powers' in Ajemo, M.A. (ed) Tax Law and Tax Administration in Nigeria (1991) NIALS Publication, Lagos, 12 at 45

[16] And other entities

[17] This constitutional arrangement traced its origin from section 10 (1) of the Nigerian (Constitution) Order-in-Council Act 1960 "The Parliament of the Federation of Nigeria may make laws for the peace, order and good government of any Region of the Federation with respect to taxes on income and profits, not being taxes on the income or profits accruing in, or derived from, that Region, of Africans resident in that Region and African communities in that Region." And section 70 of the 1960 Constitution. Prior to the 1960 constitutional arrangement, each region (North, West and East) imposed and enforced the collection of the income tax of all persons with their territory.

provision for the determination of residence both of states and at the federal level.

6.1.1 Residence of Individual within the states of the federation of Nigeria

The PITA set out the criteria for the determination of the residence of all taxable persons. It provides that, for any year of assessment, income tax shall be assessed and collected only by the state in which the individual (other than itinerant worker) resides in that particular year.[18] Thus, the taxable persons are liable to tax in the state of Nigeria where they are residing from the first day of January (i.e. for 12 months) in the year of assessment.[19] In the case of an individual, he becomes liable if he has a 'place of residence' or 'principal place of residence' in the state. Therefore, all individuals and other taxable persons under PITA[20] who reside within the territory of a state of the federation are liable to pay their income tax to the state they reside.[21] This heading determines the residence of the individual other than those mentioned under section 2 (1) (b) of the PITA.[22] Therefore, any mention of individual refers to that class of individuals. An objective test principally determines the individual tax residence. The PITA provides for two statutory tests for the determination of the tax residence of individuals that falls under this heading. That is 'place of

[18] Section 2 (1) (a) and (2) PITA

[19] In Shittu V. Nigeria Agricultural & Cooperative Bank Ltd[19] the court elaborated the provisions of section 2 PITA in the following words: "Section 2 (2) of the Personal Income Tax Decree No. 104 of 1993, empowers the State Government to impose Personal Income Tax for every year of assessment on the Personal Income of individuals who are resident for the year in the State under the provisions of the First Schedule to the Decree".

[20] Like trust, estates, communities and families with the exception of the members of the armed forces, the police and the itinerant workers.

[21] Section 2 (2) of the PITA (as amended)

[22] Section 2 (1) "(*b*) the following other persons, that is— (i) persons employed in the Nigerian Army, the Nigerian Navy, the Nigerian Air Force, the Nigerian Police Force other than in a civilian capacity; (ii) officers of the Nigerian Foreign Service; (iii) every resident of the Federal Capital Territory, Abuja; and (iv) a person resident outside Nigeria who derives income or profit from Nigeria."

residence' as connecting factor and 'principal place of residence as a tiebreaker test for resolving the interstate jurisdictional conflict.

6.1.1.1 Place of Residence

The location of residence of individual for tax purposes has been defined[23] as a place available for the domestic use of the individual in Nigeria on a relevant day.[24] It does not include a hotel, guest-house or any other lodge temporarily stayed by the individual unless he has no any permanent place available for him on that day.[25] In determining the residence of individuals under this test, the PITA provides that if the individual:

> "holds a foreign employment on the 1st day of January in a year of assessment, or who first becomes liable to income tax in Nigeria for that year by reason of his entering that employment during that year, *shall be deemed to be resident for that year in the territory in which the principal office of his employer is situated on that day or on the day his foreign employment commences, as the case may be.*"[26] (emphasis added)

However, where an employee does not have a place of residence in Nigeria as at the relevant day the rule applies to the foreign employees as well.[27] For an individual under Nigerian employment, the PITA provides a different criterion for determining his residence. That is if he

> "holds a Nigerian employment on the 1st day of January in a year of assessment, or who first becomes liable to income tax in Nigeria for that year by reason of his entering that employment during that year, *shall be deemed to be resident for that year in the territory in which he has a place or principal place of residence on that day or, as the case may be,*

[23] Paragraph 1 of the first schedule to the PITA
[24] 1st January each year
[25] Paragraph 1 of the first schedule to the PITA
[26] Ibid Paragraph 2
[27] Ibid Paragraph 4

on the day on which he enters upon the full duties of that employment in Nigeria"[28] (emphasis added)

When an individual retires from his job the criteria for ascertaining his tax residence changes from the one applicable to him during the employment. The Act provides that:

> "(1) An individual whose only source of earned income arising in Nigeria on the 1st day of January in a year of assessment was a pension, and who had a place or principal place of residence on that day shall be deemed to be resident for that year in the territory in which that place or principal place of residence was situated on that day. (2) An individual whose only source of earned income arising in Nigeria on the 1st day of January in a year of assessment was a pension, and who had no place of residence on that day, shall be deemed to be resident for that year— (*a*) if the pension is a Nigerian pension wholly payable by the Government of one territory, not being a Nigerian pension in respect of which the subsection (1) (*b*) of section 2 of this Act applies, in that territory; (*b*) if the pension is not a Nigerian pension, in the territory in which the principal office in Nigeria of the pension fund or another person authorizing payment of the pension is situated. (3) An individual whose only source of earned income arising in Nigeria on the 1st day of January in a year of assessment was a Nigerian pension, and who had no place of residence on that day shall, if the pension is payable to more than one government or if there are two or more pensions arising in different territories to the individual on that day, be subject to subsection (1) (*b*) of section 2 of this Act."[29]

The above provisions hinge on the source of income as the determinant of the individual residence because all the items mentioned relate to the source of the individual's income. One may argue that the provision concentrates on the income derived from employment. However, for the individuals whose income is not derived from employment, the PITA provides:

[28] Ibid paragraph 3
[29] Ibid paragraph 5

> "An individual who has a source of earned income in Nigeria for a year of assessment, other than employment or a pension, shall be deemed to be resident for that year in the territory in which he had a place or principal place of residence on the 1st day of January in that year."[30]

And where

> "An individual who has no source of earned income in Nigeria for a year of assessment, but who has one or more source of unearned income in Nigeria for that year shall be deemed to be resident for that year in the territory in which he has a place or principal place of residence on the 1st day of January of that year"[31]

From the above provisions, it is clear that the individual's tax residence is determined by his 'place of 'residence.' Also, that the source of the individuals' income is the sole determinant factor of the place of residence. Thus, the source of income determines the residence of the individual. In defining the taxable income, the PITA provides that:

> "Subject to the provisions of this Act, tax shall be payable for each year of assessment on the aggregate amounts each of which is the income of every taxable person, for the year, from a source inside or outside Nigeria, including, without restricting the generality of the foregoing—(*a*) gain or profit from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised (b) "any salary, wage, fee, allowance or other gain or profit from employment including compensations, bonuses, premiums, benefits or other prerequisites allowed, given or granted by any person to any temporary or permanent employee.."[32]

The scheme stipulates different criteria for determining residence and each of the criteria hinges on the source of income. Thus, the nature of the income determines the criteria applicable for ascertaining the resident status of individuals. Therefore, the ascertainment of the sources or sources of the above array of incomes is the first inquiry for the determination of the residence of

[30] Ibid paragraph 6
[31] Ibid paragraph 7
[32] Section 3 (1) PITA

individuals. The main problem with this scheme is to determine which of the criteria would be applied to determine an individual's residence where he derived his income from different sources?

6.1.1.2 Principal Place of Residence

Under the Nigerian regime, an individual is required to pay income tax to the state where he resides as at 1st January each year.[33] Nigeria is a federal state with thirty-six states and a Federal Capital Territory (Abuja).[34] In applying the provisions of section 2 (2) of PITA, there is the likelihood of a conflict of jurisdiction between the states because an individual may be resident in two or more states at the same time. To address the potential conflict, the PITA makes the 'principal place of residence' a tiebreaker test applicable in resolving the conflict. Thus, where an individual resides in more than one state, he is liable to pay tax to the state where his 'principal place of residence' is located. In determining the principal place of residence, the Act provides that the source of the individual's income is the sole factor for consideration. That is to say, where the source of the income is a pension in Nigeria, the 'principal place of residence' "is the place or places in which the individual usually resides."[35] The same rule applies to an individual who derived his income from 'unearned income'.[36]However, where the income is an 'earned income'[37] the 'principal place of residence' "is the place nearest to the individual's usual place or places

[33] Section 2 (2) PITA

[34] By section 2 (2) of the Constitution of the Federal Republic of Nigeria, 1999 which states that "Nigeria shall be a Federation consisting of States and a Federal Capital Territory and section 3 (1) provides that "There shall be 36 states in Nigeria, that is to say, Abia, Adamawa, Akwa Ibom, Anambra, Bauchi, Bayelsa, Benue, Borno, Cross River, Delta, Ebonyi, Edo, Ekiti, Enugu, Gombe, Imo, Jigawa, Kaduna, Kano, Katsina, Kebbi, Kogi, Kwara, Lagos, Nasarawa, Niger, Ogun, Ondo, Osun, Oyo, Plateau, Rivers, Sokoto, Taraba, Yobe and Zamfara."

[35] Paragraph 1 (a) of the first schedule of the PITA

[36] Paragraph 1 (c) of the first schedule of the PITA Unearned income refers to income derived from investment such as dividend, royalty from patent or trade mark, rental income

[37] This refers to income derived from trade, business, profession, vacation or employment carried on or exercised by the individual, which include profits, salaries, commission, bonuses and pension.

of work."[38] Where an individual works in a branch office or operational site of a company with at least fifty workers, his 'principal place of residence' "is the location of the branch office or the site."[39]

The PITA stipulates that when dual or multiple residence cases occurs the individual pays tax to the state where he has the principal place of residence. However, it does not provide the criteria for determining the 'principal place of 'residence.' Furthermore, the PITA provides certain exceptions to the above-stated tiebreaker rule. Firstly, members of the Nigerian armed forces and the police, who by the nature of their job, resides in more than one state, are deemed to be residents of the Federal Capital Territory, Abuja.[40] Thus, wherever this class of the individual resides, their tax residence is in Abuja. Secondly, the case of an itinerant worker.[41] The PITA provides that:

> "In the case of an itinerant worker, the tax may be imposed for any year by any State in which the itinerant worker is found during the year."[42]

Both the definition and the method of determining the residence of the itinerant worker raise a concern in terms of apportioning the taxable income to the two or more states in a year of assessment. For instance, an individual may work in two or more states at a different time in a month. The question is – where is he supposed to pay the tax? If he requires a Tax Clearance Certificate, from which state will he obtain the certificate?

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[38] Paragraph 1 (b) of the first schedule of the PITA
[39] Ibid paragraph 1 (d)
[40] Section 2 (1) (b) and (2) of the PITA
[41] Who is defined by Section 108 of the PITA (as amended) 2011 as "'Itinerant worker' includes an individual irrespective of his status who works at any time in any state during a year of assessment (other than as a member of the armed forces) for wages, salaries or livelihood by working in more than one state and work for a minimum of twenty (20) days in at least three (3) months of every assessment year." See also section 28 for the mode of assessing the income of an itinerant worker "The assessable income for any year of assessment of an itinerant worker shall be determined either under the provisions of sections 23, 24, 25, 26 and 27 of this Act or be the income of the year ending on the thirty-first day of December within the year of assessment.
[42] Section 2 (3) of the PITA

The key terms used under this heading are the ‘place of residence’ and the ‘principal place of residence’. As stated above, the PITA defines these two expressions, but the definitions are too vague. The Act defines individuals ‘place of residence’ as:

> “A place available for his domestic use in Nigeria on a relevant day, and does not include any hotel, rest-house or another place at which he is temporarily lodging unless no permanent place is available for his use on that day.”[43]

This definition suggests that the available place for the individual on that day must be a permanent one because it clearly excludes any form of temporary place. In United Bank for Africa Plc. V. Odimayo the Court defined residence within the context of PITA as:

> “One is said to reside if he lives, dwells, lodges or abides at a designated place. The residence is accordingly about personal presence at some place of abode with the purpose to remain for some undetermined period. One can be said to reside in a place without necessarily staying permanently thereat. Residence conveys the fact of abode and the intention of remaining. It means more than the physical presence”.[44]

Therefore, the ‘place of residence’ means a permanent residence. What does ‘permanent residence’ mean? The answer to this question needs to be inferred from the definition of ‘permanent place of abode.' Justice Fisher succinctly explained the nature of ‘permanent place of abode’ as follows:

> “…the word “permanent” is used to qualify the expression ‘place of abode’ i.e. the physical surroundings in which the person lives, and to describe that place… *the proper construction of place upon the phrase ‘permanent place of abode’ is that it is the taxpayer's fixed and habitual place of abode*.. Material factors for consideration will be the continuity or otherwise of the taxpayer's presence, the duration of his presence and

[43] Paragraph 1 of the first schedule to the PITA
[44] (2005) 2 NWLR (Pt 909) 21 at 38 E-F

> the durability of his association with the particular place."[45]<u>(emphasis added)</u>

The 'permanent residence' suits the above description of the permanent place of abode because the only difference between the two expressions is the 'place of abode' and the 'residence'. Lord Viscount Cave LC in Levene's case[46] defined residence as the place of abode. Based on this pronouncement, residence, and place of abode mean one and the same thing. It follows that permanent residence and permanent place of abode are the same. That is a residence with some degree of permanence. Conversely, in defining the 'principal place of residence,' the PITA uses the word 'usual' in all the three circumstances to qualify the word 'residence'. That is the individual's usual residence. Therefore, the central question is – what is the distinction between 'permanent residence and usual residence'? Ordinarily, they all suggest that the residence should be a continuous one.

However, there could be a conflict between the definition of 'place of residence' and 'principal place of residence'. The PITA defines 'place of residence' as an available place for the individual's domestic use that is not a hotel or guest-house. On the other hand, in defining 'principal place of residence', the PITA does not exclude a hotel and guest house.[47] In all the circumstances that could lead to the application of 'principal place of residence', the PITA defines the principal place of residence as "the place where the individual usually resides*."*[48] Arguably, the usual place of residence could be a hotel or guest house that has been excluded in defining 'place of residence'. Similarly, in respect of an individual who works at a branch office or operational site of a

[45] Applegate v. FCT (1979) 79 ATC 4307 at 4317 See also FCT v. Jenkins (1982) 82 ATC 4098 the same line of reasoning was followed in the case of Mayhew v. FCT (2013) AATA 130. However, in Iyengar v, Commissioner of taxation (2011) AATA 856

[46] Levene v. IRC (1928) AC 217

[47] As it did while defining 'place of residence'

[48] Paragraph 1 (a) and (b) of the first schedule to the PITA

company, the principal place of residence is *the location of the branch office or site*.[49] The conflict may arise where the corporation operates its branch activities from a hotel or guest house and individual works in that branch. Going by the definition of ‘place of residence’ the hotel and guest house cannot be the individual’s place of residence whereas the ‘principal place of residence’ is defined to be the location of the branch office. The conflict mentioned above creates a complex situation for individuals, tax experts as well as the tax administrators in ascertaining the ‘place of residence.' Moreover, if he has more than one place of residence the difficulty lies in determining his ‘principal place of residence.'

Ideally, the ‘place of residence’ and ‘principal place of residence’ are supposed to be objective tests. The international trend in designing the objective test for the determination of an individual is the number of days spent in the state at issue. However, the Nigerian regime, under this heading, does not specify the period of presence in the ‘place of residence’ or ‘principal place of residence’ that qualifies an individual to be a resident. It only determines the commencement period of the residence status that is “on the 1st day of January in a year of assessment.” The key word in the commencement date is “on” meaning that once an individual happens to be in a state on the 1st January, he automatically becomes a resident of that state. Thus, an individual can become a resident of a state, even if he spent only one day. For instance, if he arrives at the state on 31st December, then become resident on the following day (1st January). Given the permanent nature of ‘place of residence’ and ‘principal place of residence’ mentioned above, an individual can acquire permanent residence status in just one day. Conversely, an individual can spend over 365 days in a state without establishing permanent residence status.

[49] paragraph 1 (d) of the PITA (as amended)

6.1.2 Residence of Entities other than corporations

The Nigerian regime classifies entities such as trusts, estates, communities and families as taxable persons under the PITA. The income of these entities is assessed through direct assessment.[50] Like the individual, PITA provides that these entities are liable to pay tax to the state where they are located. It provides for the determination of the tax residence of each of the entities. However, as discussed below, the PITA does not provide for a situation where any one of these entities happens to be located in more than one state in Nigeria. That is the type of tiebreaker rule provided in the case of an individual.

6.1.2.1 Partnership

Although the PITA recognises the notion of partnership income, it treats the partners individually. It provides that:

> "The gains or profits from a partnership of a partner therein shall be the sum of— (*a*) any remuneration, interest on capital, or the cost of passages to or from Nigeria wholly or mainly undertaken for the purpose of leave or recreation, which is charged in the partnership accounts in respect of that partner; and (*b*) his share of the income of the partnership, computed in accordance with the provisions of this Act…"[51]

The Act requires a partnership to be registered with the relevant tax authority of the state where the partnership is situated.[52] Thus, the tax residence of each of the partners is the state where the partnership is registered.[53]

[50] Section 41 (1) PITA
[51] Section 8 (1) of the PITA
[52] Section 8 (8) of the PITA
[53] Ibid section 8 (7)

6.1.2.2 Corporation sole or body of individuals

The residence of a corporation sole[54]or body of individuals[55] is the state[56] where its principal office is located as at the 1st January of the year of assessment. If it has no any office in any territory in Nigeria, then the residence is the state where the income is wholly or partly derived for that year.[57]

6.1.2.3 Trustees and Executors of Estate

The usual mode of creating a trust is where a settlor transfers his property to a trustee for the benefit of the beneficiary. On the other hand, an estate refers to the assets and liabilities left behind by a deceased person at his death. The Nigerian law recognises both the trust and the estate as entities capable of engaging in income-earning activities. It follows, therefore, that the income generated by these entities is taxable. However, in respect of a trust, the income tax liability depends on who earns the income as between the trustee and the beneficiary. Thus, whoever earns the income is liable to pay the tax. In the same vein, the tax liability on the income earned by an estate depends on whether the income is earned by the heirs or by the estate before devolution. When the estate earns an income before devolution, the estate pays the tax on the income earned.

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[54] Historically corporation sole is a legal entity created to allow holders of religious offices to pass title and lands from one office holder to another in perpetuity without having to pay taxes. It is managed by a single director who is the sole incorporator or the successor of the incorporator of the corporation. But in the context of the PITA, the sole corporation is considered as a 'sole proprietorship". That is where an individual solely establishes an unincorporated business enterprise.

[55] One may argue that and other legal entities are associations of persons which may also be considered as body of individuals. Hence, the body of individuals is akin to a company. However, the term body of individuals should not be confused with the term association of person. Only individuals could be members of the former and it is usually established not necessarily for income-earning activities. In the case of the latter, both individuals and other legal personalities could form the association of person and it is usually established for income-earning purposes. For income tax purposes it is the income of the association of person that is taxable not that of the members. In the case of body of individuals, the taxable income is that of each of the members. see Lee, S 'A Body of Individuals: The Paradox of Community in Contemporary Fiction' (2009) Columbus: The Ohio State University Press, Ohio

[56] The state in this context includes the Federal Capital Territory, Abuja.

[57] Paragraph 9 of the 1st schedule of PITA

However, after distribution, each of the heirs pays the tax from his share and the rule of determining individual's residence apply.[58] The PITA makes the following provision for the determination of the tax residence of a trust or estate:

> "In the case of income arising to a trustee of any settlements or trusts, or estates or to an executor of any estate of a deceased person, tax may only be imposed by the territory of which the tax authority is the relevant tax authority in relation to such settlement, trust or estate and to the extent provided in the Second Schedule to this Act."[59]

Nigeria has a different regime for the taxation of trust because it classifies trusts within the realm of personal income tax. The regime avoided the complexities involved in determining the residence of a trust under the South African[60] and other regimes. Until recently when the Canadian Supreme Court in Fundy Settlement v. Canada[61] gave guidance on the issue of trust residence, the Canadian regime was surrounded by uncertainty about the residence of a trust for tax purposes.

6.1.2.4 Families

Under the Nigerian customary laws, there is no notion of individual ownership of landed property. Thus, the land is considered as the property of the whole

[58] See section 27 of the PITA "Notwithstanding the foregoing provisions of this Part of this Act, the assess-able income of a trustee, or of an executor of the estate of a deceased individual, or of a beneficiary of a trust or estate for any year of assessment shall be the income of that person as determined under the provisions of the Second Schedule to this Act of the year preceding that year." See also section 16 PITA

[59] Section 3 (6) PITA

[60] Under the South African regime, Trust is equated with corporations. Thus, the rule for the determination of corporate residence also applies to Trust. See DU Plessis, I 'The Residence of a Trust for South African Income Tax Purposes' (2009) 21 SA Merc L.J. 322–343. However, the Nigerian regime does not concern itself with the Trust. Instead it only makes the Trustee(s) liable to tax on the income accruable to them.

[61] (2012) SCC 14 the Canadian Supreme Court has extended the De Beers principle to the determination of residence of trusts as well. The court held that the trust was residents of Canada for tax purposes because it is the beneficiaries who exercised the CMC of the trusts. And they exercised it while residing in Canada. The court did not say that the residence of a trust can never be the residence of the trustees if the trustees (not the beneficiaries) exercised the CMC. The Trustees in this relied on the earlier decision in Thibodean Family v. The Queen, 78 DTC 6376 where the court held that the residence of a trust for tax purposes was where the majority of the trustees reside.

family that comprises both the dead, living and unborn members of the family. The family property or any form of interest is managed and control by the head of the family who serves as the representative of the family in any transaction that affects the interest of the whole family. Most of the Nigerian customary laws recognise the power of the head of the family to engage in income-earning activities with the family property and income so derived is devolved to the whole members of the family. As a result of this, the PITA classified the family income so generated as taxable under its provisions. Therefore, in determining the residence of the family for the purposes income tax, the Act provides that:

> "In the case of income of a family recognised under any law or custom in Nigeria as families income, in which the several interests of individual members of the family are indeterminate or uncertain, tax may be imposed only by the territory in which the member of that family who customarily receives that income in the first instance in Nigeria usually resides."[62]

The above provision makes the place where the original ancestor of the family resided. How can we determine the member who was first entitled to the family income? What about the ancestors who died even before the creation of Nigeria let alone its division into states? The complexity of this provision could be cured if law concentrated on the individual members only and tax them by the aggregate of their income whether or not it was derived from family income.

6.1.2.5 Communities

The Federal Republic of Nigeria consists of more than two hundred and fifty-six different tribes.[63] Among these groups, there are nomadic pastoral communities[64] that move around the territory of Nigeria without any settled

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[62] Section 3 (5) PITA

[63] Oni, BA 'Discriminatory property inheritance rights under the Yoruba and Igbo Customary Law in Nigeria: The need for reforms' (2014) 19 (2) IOSR-JHSS 30 at 30

[64] There are about 6.5 million nomadic pastoralists in Nigeria. See SITUATION REPORT ON NOMADIC EDUCATION – The Department of Programme Development and Extension, National Commission for Nomadic Education, Kaduna, Nigeria found at

location. The PITA imposes tax on the collective income of this type of communities in the following terms:

> "In the case of a village or other indigenous communities, tax may be imposed for any year only by the law of the territory in which that community is to be found, and the tax may be charged on— (*a*) the estimated total income of all its members; (*b*) the estimated total income of those of its members whose income it is impracticable in the opinion of the relevant tax authority to assess individually; or (*c*) the amount of any communal income which, in the opinion of the relevant tax authority in relation to such community, it is impracticable to apportion with certainty between its members."[65]

In the light of the above provision, the tax residence of the nomadic pastoral communities is any state in Nigeria where they are found in the year of assessment. The problem with this provision is that by the nature of the nomadic communities, there is no specific time of the year where these communities could be found in a particular place. Therefore, they do not fall within any year of assessment unless a separate year of assessment will be provided for them.

6.1.3 Residence of an Individual in Nigeria

Due to the global economic integration, individuals residing in one state may engage in cross-border labour, business, and trade that inevitably bring him into contact with other states. Similarly, most of the Foreign Direct Investment regime allows foreign investors to incorporate companies.[66] It follows, therefore

http://www1.chr.up.ac.za/chr_old/indigenous/documents/Nigeria/Report/Situation%20Report%20on%20Nomadic%20Education For discussion on the nature and activities of these communities see VerEecke, C 'Nigeria's experiment with a national programme for nomadic education' Paper presented at the Association for African Studies meetings, Chicago, October 1988 Dyson-Hudson, R and Dyson-Hudson, N 'Nomadic Pastoralism' (1980) 9 Annual Review of Anthropology 15 at 16

[65] Section 3 (4) PITA

[66] For instance, in Nigeria, by section 17 of the Nigerian Investment and Promotion Council Act 2004 "foreign companies are allowed to invest and participate in the operation of any enterprise in Nigeria, except those in the negative list." and sections 20 and 54 of the Companies and Allied Matters Act Cap C20 LFN 2004 "for any foreign company that intends to carry on business in Nigeria to first be incorporated under the Nigerian law before it commences the business" The

that the income earned by the expatriate is liable to tax in the state where the income earner resides. The determination of the tax residence of this class of individuals varies from one state to another. While some states determine the individual residence based on physical presence, others use a combination of the physical presence and other connecting factors such as ordinary residence. The Nigerian Constitution empowers the federal government of Nigeria to exercise both substantive and enforcement tax jurisdiction over all individuals residing in the Federal Capital Territory, Abuja and over all members of the armed forces, the police, officers of the Nigerian embassies/high commissions and the expatriates.[67] The regime adopts a different formula for the determination of these classes of taxpayers.

6.1.3.1 Physical Presence Test

The Nigerian regime focuses more on expatriates working in Nigeria than on those who engage in business or trade. That is why both the physical presence and ordinary residence tests applicable in Nigeria hinge on the issue of employment rather than business or trade. Therefore, the tax residence of expatriate or foreigners is determined by the making reference to their employment. That is to say, an individual is deemed resident in Nigeria if he exercises duties of employment in Nigeria. Thus, an expatriate under foreign employment become a Nigerian resident if he carries out the duties of his job in Nigeria for 183 days or more[68] in a 12-month calendar year. The PITA provides:

> " The gain or profit from an employment shall be deemed to be derived from Nigeria if— (*a*) the duties of the employment are wholly or partly performed in Nigeria, unless— (i) the duties are performed on behalf of an employer who is in a country other than Nigeria and the remuneration of the employee is not borne by a fixed base of the employer in Nigeria; and (ii) the employee is not in Nigeria for a period or periods amounting

companies incorporated by the foreign investors engage the services of expatriate to carry out essential services to the companies.

[67] Section 2 (1) (b) of the PITA 2004 (as amended)

[68] including temporary periods of absence

> to an aggregate of 183 days (inclusive annual leave or temporary period of absence) or more in any twelve month period commencing in a calendar year and ending either within that same year or the following year; (iii) the remuneration of the employee is liable to tax in that other country under the provisions of the avoidance of double taxation treaty with that other country "[69]

The application of the 183-day rule is very confusing and complicated. The above section has a deeming provision in respect of income from employment that took place in Nigeria where the employee did not stay in Nigeria for 183 days or more in any twelve month period. It does not make the 183 – day rule a connecting factor for establishing tax residence; rather it only determines the source of income of an expatriate. Most Nigerian commentators[70] and the Tax Authorities lean toward the notion that once an individual spends 183-days in Nigeria, he becomes a Nigerian resident. The commentators may arguably be persuaded by the phrase "(inclusive annual leave or temporary period of absence)" in section 10 (1) quoted above. Superficially, the section suggests that once an expatriate spends 183 – days in Nigeria, he becomes a Nigerian resident. Hence, it constitutes a connecting factor by the length of physical presence. However, the operative phrase in that section "The gain or profit from employment shall be deemed to be derived from Nigeria if …" suggests the contrary. It specifically deals with the issue of deemed sourced not residence.[71]

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[69] Section 10 (1) of the PITA

[70] Fowler, T 'Highlighting the Issues, problems and challenges relating to the taxation of foreign individuals' Paper presented at the 5th Business Law Conference of the Nigerian Bar Association Section On Business Law 7th April, 2010 in Lagos Nigeria at 3 Arogundale, JA 'Nigerian income tax and its international dimension' (2005) (1st ed) Spectrum Books Limited, Ibadan at 23 Elegido, JM 'Liability of Non-Residents to Nigerian Tax' (1987) 15 Int'l Bus. Law at 411; Abdulrazaq, MT 'Nigerian Revenue Law' (2005) Malthouse Press Limited, Lagos at 21

[71] Section 3 of PITA defined taxable income as "(1) Subject to the provisions of this Act, tax shall be payable for each year of assessment on the aggregate amounts each of which is the income of every taxable person, for the year, from a source inside or outside Nigeria, including, without restricting the generality of the foregoing— (*a*) gain or profit from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised; (*b*) any salary, wage, fee, allowance or other gain or profit from employment including compensations, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to an employee …" This definition makes a clear distinction between income derived from trade or business and the income derived from employment. Moreover, the notion of 183 – day rule

Be that as it may, the so-called 183 – day rule under the Nigerian regime is totally lopsided. It is only restricted to an individual who derives his income from employment. Therefore, it is entirely at variance with international trends on the physical presence test as discussed in chapter four, above. Even the US regime that is the closest to that of Nigeria provides for a 'substantial presence test'.[72] Under this test, an individual could become a US resident by spending a specific number of days irrespective of the source of his income. Another dimension of the weakness of the Nigerian regime is that it sought to treat expatriate differently, but it does not make any separate provision for the administration of tax of the expatriate. Thus, the regime makes them subject to the relevant tax authority of the state they reside in the year of assessment. Moreover, the local tiebreaker provision is not elaborate enough to deal with the case of expatriates. Therefore, the Nigeria operates a flawed regime on the physical presence test, and the complexities and inconsistencies of the regime could create a double residence situation that cannot be resolved by any DTA.

6.1.3.2 Ordinary Resident

Under the Nigerian regime, the expression 'ordinary resident' appears in the provisions dealing with the issues of exempted incomes and that of allowable deductions. Thus, the PITA exempts certain income of some particular individuals who are not ordinary residents of Nigeria.[73] It also allows an

in Nigeria hinged on the individual who earns his income from employment. What about the individual who happens to be in Nigeria and earn his income through trade or business other than employment?

[72] For discussion on substantial presence test see chapter four of this thesis

[73] Section 19 (1) of the PITA provides that "There shall be exempt from the tax all that income specified in the Third Schedule to this Act" Paragraph 1 of the third schedule to the PITA provides that "The incomes set out in this Schedule are exempted from taxation." The exempted income includes; "The emoluments payable from United Kingdom funds to members of visiting or other forces and to persons in the permanent service of the United Kingdom Government in Nigeria in respect of their offices under the United Kingdom Government and the emoluments payable to members of any

individual who ordinarily resides in Nigeria or who at any time during the year of assessment becomes ordinarily resident in Nigeria to deduct certain expenditure[74] that is not available to a non-ordinary resident.[75] Therefore, the ordinary resident status of an individual is crucial in determining the level of his tax liability. However, what could be distilled from the notion of 'ordinary residence' provided in the PITA is that the concept of ordinary residence is not considered as a connecting factor for establishing tax liability. Rather, it is used as a factor for totally exempting a taxable income or reducing its quantum. Thus, the Nigerian notion of ordinary residence hinges on the income instead of the income earner. In other words, the question as to whether or not an individual is an ordinary resident is premised on the issues of income exemption and allowable deduction. This makes Nigeria regime more complex and contradictory.

Be that as it may, the PITA or any subsidiary legislation does not define the concept of 'ordinary residence'. Also, there is no guidance from the Nigerian courts on the correct interpretation of the concept.[76] In a search for the

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civilian component, and the income of any authorised service organisations, accompanying the visiting forces: *Provided that this exemption shall not apply to any individual who is a citizen of Nigeria or who ordinarily resides in Nigeria*." Also "All consular fees received on behalf of a foreign State, or by a consular officer or employee of the State of his own account, and all income of such officer or employee, other than income in respect of any trade, business, profession or vocation carried on by an officer or employee or in respect of any other employment exercised by him with Nigeria: *Provided that this exemption shall not apply where the employee is engaged on domestic duties or where the officer or employee ordinarily resides in Nigeria and is not also a national of the foreign State."* See paragraphs 4 and 5 of the third schedule to the PITA.

[74] Such as insurance, Alimony paid, maintenance of an unmarried child, maintenance of a close incapacitated relative, payment made for assistance in respect a disabled individual.

[75] Section 33 (3) of the PITA (as amended) provides that "In the case of an individual who ordinarily resides in Nigeria, or who at any time during the year of assessment— (*a*) becomes ordinarily resident in Nigeria in connection with any trade, business, profession or vocation carried on by him; or (*b*) exercises any employment, the whole gains or profits of which are deemed under the provisions of section 12 of this Act to be derived from Nigeria, there shall also be allowed the deduction specified in subsection (4) of this section.

[76] The Federal Inland Revenue Service, Information Circular No: 9302 of 22 March, 1993 attempted to provide explanation on the concept. Paragraph 2.1 of the Circular provides that: An individual is regarded as resident in Nigeria throughout an assessment year if he:

(i) is domiciled in Nigeria;
(ii) sojourns in Nigeria for a period or periods in all amounting to 183 days or

definition of the expression 'ordinary resident', the Nigerian courts are required to rely on decisions of the UK courts[77] and by extension, those of other common law jurisdictions.[78] With the introduction of the Statutory Residence Test as the sole test for the determination of individual residence in the UK decisions on 'ordinary residence' are now abandoned. The UK Finance Act 2013 expressly abolished the concept of 'ordinary residence' as a connecting factor. Now, what would be the stand of the Nigerian Courts when confronted with the issue of ordinary residence?

Given the different notion of 'ordinary residence' discussed in chapter four, the question is – is there any distinction between the ordinary resident of Nigeria and the resident of one of the states in Nigeria? To sum it up, the complexities and inconsistencies that characterise the Nigerian regime on the physical presence test extend to the issue of 'ordinary residence'. The only difference between the physical presence and ordinary residence tests is that the former test deals with individuals who earned their income from employment whereas the latter covers all types of incomes.

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more in a 12-month period; or

(iii) serves as a diplomat or diplomatic agent of Nigeria in a country other than Nigeria

Paragraph 2.3.1 of the Circular provides that "A non-resident individual is a person who is not domiciled in Nigeria or who stays in Nigeria for less than 183 days but derives income or profits from Nigeria. A non- resident individual becomes liable to tax from the day he commences to carry on a trade, business, vocation, or profession in Nigeria" However, one of the cardinal feature of tax is that only a legislation can define the persons who liable to tax not a mere Circular. Moreover, the Circular introduced the issue of 'domicile' which the PITA did not provide.

[77]. Under the Nigerian legal system, all courts are enjoined to follow the line of reasoning of the UK's court and the UK decisions are recognized as part of the persuasive judicial precedence. See Section 10 of the High Court Law of Lagos State which is pari material with all other states High Court laws provides: "The High Court shall in addition to any other jurisdiction conferred by the Constitution of the Federation or by thus or other enactment possess and exercise, within the limits mentioned in, and subject to the provisions of, the Constitution of the Federation and this enactment, all the jurisdiction, powers and authority which are vested in or capable of being exercised by the High Court of Justice of England."

[78] Like Canada and Australia

6.1.4 Critique of the Nigerian Regime on Individual Residence

The Nigerian residence-based regime violates horizontal equity principles because it treats similarly situated residents unequally. It also violates vertical equity by giving more emphasis to the lower income-earners and leaves the higher income earner. In the former case, the regime concentrates on the Pay-As-You-Earn (PAYE) system[79]that is designed to deal with the income earn from the formal employment. Thus, the regime has limited application to the informal jobs, trade or business that constitute the largest part of the Nigerian economy.[80] Take for instance, the case of two Nigerian residents. The first resident earns his income through a formal employment with a registered and known employer while the other resident is self-employed or engaged in an independent trade or business. The employer of the first resident is under obligation to deduct the taxable income from the salary or wages payable to the resident.[81] Thus, there is no room for him to either evade or avoid the income tax. The second resident, on the other hand, is must pay the tax through the method of direct assessment. As a result of inadequate information and records on the activities of the self-employed resident, it would be easy for the second resident to avoid or even evade the tax.

Furthermore, the Nigerian regime is not economically efficient because it segregates residents who derive their income from employment through the

[79] Made pursuant to section 81 of the PITA and the Operation of PAY-AS-YOU-EARN (PAYE) regulations (S.L. 18 of 2002)

[80] Akhidime, EA and Rachel, AE ‘Nigerian Personal Income Tax (amendment) Act 2011: Implication for tax administration and enforcement’ (2013) 2 (4) AFRREV IJAH 217 at 222; Adebisi, JF and Gbegi, DO ‘Effect of Tax Avoidance and Tax Evasion on Personal Income Tax Administration in Nigeria’ (2013) 1 (3) American Journal of Humanities and Social Sciences 125 at 134 “The major problem lies in the collection of the taxes especially from the self-employed such as the businessmen, contractors, professional practitioners like lawyers, doctors, accountants, architects and traders in shops among others.” According to Ayua “This class of individual blatantly refuses to pay tax by reporting losses every year.” See Ayua, LA. ‘The Nigerian Tax Law’ (1999) Spectrum Law, Publishing, Ibadan. “This class of individual blatantly refuses to pay tax by reporting losses every year.”

[81] Section 82 and 84 of PITA

PAYE system. The only enforcement mechanism that could be argued to be similar to PAYE is the withholding tax regime but the provisions only deal with the formal form of businesses or trades.[82] Other residents who earn their income from informal self-employed businesses enjoy the deficiency of the tax enforcement mechanism. This lopsided regime could distort the decisions of residents on whether to be in the formal or informal sector of the Nigerian economy. Thus, residents will be more inclined to be in the informal self-employed which some commentators[83] argue to be the largest sector of the Nigerian economy. Statistics show that as at 2014 the revenue generated from PAYE is far higher than that collected through direct assessment for the informal sector of the economy.[84] For instance, in 2014 Lagos State generated the sum of N163, 001,789,450.77 from the personal income tax. Out of this amount only N9, 392, 939,866.44 was generated from the direct assessment of the informal sector, whereas the remaining N153, 608, 849,584.33 was generated from the PAYE system.[85]

On administrative efficiency, the Nigerian residence-based regime for individuals is characterized by both administrative and enforcement concerns. The Nigerian Constitution shared the enforcement tax jurisdiction of the individual income tax between the federal and states governments.[86] Under the

[82] By sections 73 (1) "Income tax assessable on a person whether or not an assessment has been made, shall, if the relevant tax authority so directs, be recoverable from any payment made by any person to that person." The other sections deal with specific aspect of the income; sections 69 (rent), 70 (interest), 71 (dividend), 72 (directors fees)

[83] Akhidime, EA and Rachel, AE 'Nigerian Personal Income Tax (amendment) Act 2011: Implication for tax administration and enforcement' (2013) 2 (4) AFRREV IJAH 217 at 222; Ayua, LA. 'The Nigerian Tax Law' (1999) Spectrum Law, Publishing, Ibadan.

[84] See Internally Generated Revenue at State Level (2014), published by Nigerian National Bureau of Statistic found at www.nigerianstat.gov.ng last visited on 27/07/2015

[85] Source: Lagos State of Nigeria, Board of Internal Revenue Service found at www.lirs.gov.ng last visited on 27/07/2015

[86] Section 4 (2) of the 1999 Constitution provides that "The National Assembly shall have power to make laws for the peace, order and good government of the Federation or any part thereof with respect to any matter included in the Exclusive Legislative List set out in Part I of the Second Schedule to this Constitution" Item 59 of part of the second schedule provides that. **"**Taxation of incomes, profits and capital gains, except as otherwise prescribed by this Constitution." That means the exclusive

provision of the Constitution, the PITA provides that an individual is liable to pay tax to the state he resides in as at the 1st January.[87] For the purpose of enforcing this residence-based provision, PITA adopts Pay-As-You-Earn (PAYE) system.[88] The system imposes an obligation on all employers of labour to deduct taxable income from the emoluments of their employees, and they must remit the deducted income to the relevant tax authority.[89] By the provisions of section 2 (2) PITA, the relevant tax authority is supposed to be the tax authority of the state where the employee resides.[90]

However, an individual may live in state A and work in state B and the income deducted from his salary goes to the state where his employer is situated not the state where he resides. The problem is created by the provision of the PITA where it states that:

> "Income tax chargeable on an employee by an assessment whether or not the assessment has been made, shall, if the relevant tax authority so directs, be recoverable from any emolument paid, or from any payment made on account of the emolument, by the employer to the employee. (2) A direction under subsection (1) of this section shall be in writing addressed to an employer or be published in the State *Gazette*, and shall specify the emolument of an employee or class of employees to which it

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substantive tax jurisdiction to impose income tax on both individuals and corporations lie with National Assembly (The second arm of the federal government). In addition to the above exclusive jurisdiction, the National Assembly is also empowered to share the enforcement jurisdiction on individual income tax with the states. Section 4 (4) of the 1999 Constitution provides: " In addition and without prejudice to the powers conferred by subsection (2) of this section, the National Assembly shall have power to make laws with respect to the following matters, that is to say:- (a) any matter in the Concurrent Legislative List set out in the first column of Part II of the Second Schedule to this Constitution to the extent prescribed in the second column opposite thereto;" Item 7 of part two of the second schedule to the Constitution provides; **"**In the exercise of its powers to impose any tax or duty on - (a) capital gains, incomes or profits or persons other than companies … the National Assembly may, subject to such conditions as it may prescribe, provide that the collection of any such tax or duty or the administration of the law imposing it shall be carried out by the Government of a State or other authority of a State." See also Emiko, G.I. 'An Analysis of Federal/State Taxing Powers' in Ajemo, M.A. (ed) Tax Law and Tax Administration in Nigeria (1991) NIALS Publication, Lagos, 12 at 4.

[87] Section 2 (2) PITA

[88] See Section 81 of the PITA and the Operation of PAY AS YOU EARN (PAYE) regulations (S.L. 18 of 2002.) see also Akhaah JCA in Lagos State Internal Revenue Board v. Motorola Nigeria Ltd and another (2012) LPELR-14712 (CA).

[89] Section 82 PITA

[90] See also section 108 of the PITA for the definition of 'relevant tax authority'.

> refers and the amount or amounts of income tax to be deducted, whether by reference to tax tables issued by the relevant tax authority or otherwise."[91]

Therefore, the above provision creates a relationship between an employer and the tax authority of the state where it is located not the state where the employee resides. The PITA clearly establishes the territorial limit of the relevant tax authority that:

> "The State Board shall be responsible for— (*a*) ensuring the effectiveness and optimum collection of all taxes and penalties due to the Government under the relevant laws; (*b*) doing all such things as may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed by the Commissioner; (*d*) generally controlling the management of the State Service on matters of policy, subject to the provisions of the law setting up the State Service;"[92]

Thus, the relevant tax authority of the state where the employee resides is not empowered to direct the employer, who is located in another state, to remit the deducted tax. Furthermore, for individuals in the informal sector of the Nigerian economy, the PITA directs such class of taxpayers to file their annual return to the relevant tax authority in the state where they reside:

> "For each year of assessment, a taxable person shall, without notice or demand therefor, file a return of income in the prescribed form and containing the prescribed information with the tax authority of the State in which the taxable person is deemed to be a resident…"[93]

In the light of the above provisions, there is a serious competition between states and federal and states, inter se on who is their resident for the purposes of individual income tax. It is a general trend in all the federal states that the geographical maps of the sub-national states share a gaunt boundary delineation. Due to the proximity of the sub-national states, the individuals

[91] Section 81 (1) and (2) PITA
[92] Section 88 (1) PITA
[93] Section 41 (1) PITA

residing in one state may be working in another. They usually work in the daytime and return to their respective state of a residence after closing hours in another state.[94] The issue of inter-state conflicts on individual residence has drawn the attention of many commentators.[95]

The Nigerian inter-state conflict on individual tax residence brings another dimension to the discourse. The Nigerian Constitution granted only enforcement tax jurisdiction[96] in respect of individual income tax to the states. Thus, the State Governments only enforce the individual income tax imposed by the Federal Government.[97] The Federal Republic of Nigeria consists of thirty-six states and the Federal Capital Territory, Abuja. There are conflicts of enforcement jurisdiction between some of the economic centre states[98] that share gaunt borderline with the states[99] with less economic activities.

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[94] For instance, the USA individual residence regime recognized this fact, because by section 7701 (b) (7) (B) of the US Internal Revenue Code 1986, an individual regularly commuting to the US for employment and return to his place of residence either in Canada or Mexico is exempted.

[95] Swain, JA[95] examined the US approach in addressing cross-border transaction both international and state levels, focusing on issues of residency, enforcement, and jurisdiction and sourcing in the light of US citizen-based income tax system; Lemos, MH 'State enforcement of federal law' (2011) 86 (3) NYU L. Rev. on the other hand analysed the interface of law enforcement between state and federal government. That is the situation where a state seeks to enforce a federal law. Zelinsky, EA 'Apportioning the state personal income taxes to eliminate the double taxation of dual residents: Thought provoked by the proposed Minnesota Snowbird tax' (2014) 15 (7) Fla. Tax rev. 533 (He challenged the traditional inter-state jurisdictional conflicts whereby if an individual is deemed resident in to two states, the states are entitled to tax the whole income of the individual. He argued that the emphasis should be placed on the physical presence of the individual in each of the states. Therefore, the taxing right on an individual income should be share between the states in pro rata of the days spent by the individual in each of the state. The problem with this view is that if the individual spent a half day in the two states and each of the state considers half day as full day, then the individual may end up paying the double of what he ought to have paid under the traditional rule. See also zelinsky EA 'Rethinking tax nexus and apportionment: voice, exit and the dormant clause (2008) 28 Va. Tax Rev. 1; Hashmi A 'Is Home Really Where the Heart Is?: State Taxation of Domiciliaries, Statutory Residents, and Non-residents in the District of Columbia' (2012) 65 Tax Lawyer 797; Feld, LP and Kirchgassener, G 'Income tax competition at the State and Local Government level in Switzerland' (2000) CESiFo working Paper series. 238

[96] Whereas substantive tax jurisdiction on individual as well as both the substantive and enforcement tax jurisdiction are given to the Federal Government.

[97] Achara, RA 'Can Nigerian local government council autonomously impose rates? (2003) 47 J. Afr. L. 221 Okorodudu, MT 'Nigeria: Analysis of federal and state taxing powers' (1985) 11 Int'l Tax J.

[98] Such as Lagos, Kano, Rivers, Abia, Oyo, Ananbra States and the Federal Capital Territory, Abuja.

[99] Like Ogun, Osun, Jigawa, Niger, Nassarawa and Delta States.

In consideration of the high living expenses in the former states, individuals may decide to reside in the latter states but work in the former states. Therefore, they earn their income in one state and reside in another. Moreover, the enforcement mechanism for collecting the taxable income of the individual is the PAYE system. As discussed above, the obligation to deduct the individual's income tax from the salary is imposed by the states where the employer is located not where the employee resides. This arrangement is a challenge for the Nigerian individual residence regime as to whether it is truly residence-based. As a result of the complex situation highlighted above, it is the source-states that collect the income tax, not the residence state.

As a corollary, there is the issue of remittance of the income tax deducted to the beneficial state. Notwithstanding the fact that the PITA imposes a remittance obligation on the employer who deducts the taxable income of its employee to the state that imposes the deducting obligation, the employers often fail to discharge the obligation.[100] The failure to comply may be a result of the employees' discretion to indicate his state of residence in the record of his employment that may mislead the employer. It may be due to the employer's deliberate failure to remit the deducted taxable income, and this is very common for government departments and agencies.[101] To sum up, some vital unresolved questions expose the complexity and inconsistency of the Nigerian regime:

[100] The Nigerian Court of Appeal in the case of Seven-Up Bottling Co. Plc V. Lagos State Board of Internal Revenue (2000) 3 NWLR (pt. 650) 565 held that failure to remit the tax deducted from salaries or emoluments of employees was a debt to the State Board of Internal Revenue that imposes the deduction and remittance obligation on the employer and it is enforceable and recoverable in the Court of law. However, under the PAYE system the revenue authority has no right to issue Notice to the employer, because it is the employee that is the taxpayer. See Elf Oil Nigeria Ltd v. Oyo State Board of Internal Revenue (2002) LPELR-12260 (CA).

[101] According to a report in 2009, the Nigerian Government departments and agencies as well as the National Assembly failed to remit the total of N72 Billion of the individu al income tax deducted from their employee. See Yusuf, I A 'Why Nigerian tax system is weak' The Nation Newspaper dated 5th June, 2011. In some situations, the employers use to resist the deduction and remittance

- If an individual resides in state A and has been paying his income tax to state B, can he unilaterally switch the payment of tax to the proper state (state A) under the PAYE system?
- Does the PAYE system require each state to have a database of its residents and their respective employers in the other states?
- How could a company remit the deducted taxable income in a situation where it is located in state A, but some of its employees reside in state A, and some other staff reside in state B?

PITA established the Joint Tax Board with the function of resolving most of the questions raised above.[102] The JTB was created by Section 85 of PITA It consists of the Chairman Federal Inland Revenue Service (FIRS) who acts as its Chairman and one member from each State experienced in income tax matters nominated by Commissioner for Finance in that State. The Public Service Commission is empowered to appoint an officer experienced in income tax matters as the Secretary of JTB. The duties of JTB are to arbitrate disputes between FIRS and State Board of Internal Revenue (SBIR) and between SBIR of each State and another state, and to promote uniformity in the application of the law. However, the board lacks any form of enforcement mechanism. It only plays the role of an advisory body. Therefore, it is incapable of resolving the potential jurisdictional conflicts.

obligation impose on them, which was one of the issue raised in Ukpong & anor. v. Commissioner for finance and economic development & anor (2006) 19 NWLR (pt. 1013) 187.

[102] See section 86 (1), (2) and (9) of the PITA.

6.2 Residence-Based Taxation of Individuals in South African

South Africa adopted a source-based regime[103] as at the inception of its income tax system in 1914.[104] The regime was in operation up to the end of the year of assessment 2001 when the Republic of South Africa switched from a source-based system to a residence-based system. The switch was gradual, starting with the expansion of the deemed source rule to cover the investment income of all South African residents.[105] Thus, this transitional regime introduced a partial residence-based system and for its application, resident has been defined as:

> For the purposes of this section … 'resident' means any natural person who is ordinarily resident in the Republic and any person other than a

[103] Under the source-based income tax system the state imposes tax on the basis of the nexus between the state and the taxable income. See Olivier, L 'Residence based taxation' (2001) J. S. Afr. L. 20 at 21. See also Boltar, J 'Law of taxation' (2000) Ann. Surv. S. African L. 813 at 813 - 814That is to say, once a person (resident or non-resident) derived income from a state, such income becomes taxable by the state at the same rate and the same rate of deduction is allowed to the income earners. Thus, residence status of the income earner is immaterial. See Williams, RC 'Income Tax in South Africa: Law and Practice' (2006) LexisNexis, Durban at 31. It is worth noting that the determination of the residence status of a taxpayer was relevant under the South African source-based regime by virtue of the deemed-source provisions in the Income Tax Act. For instance, sections 9 (2) and 9 (3) of the Income Tax Act deemed certain class of income accrued to an individual who is a South African ordinary resident or a corporation that is a domestic company. Similarly, section 10 of the Income Tax Act exempted certain income but the exemption is not applicable to the income accrued to an individual who is ordinary resident in South Africa or a domestic company. However, the word 'resident' was defined under the regime.

[104] Williams argued that except for secondary tax on companies, the South African source-based regime was non-residents-friendly. See Williams (2006) at 32

[105] Section 9C (2) of the Income Tax Act No. 28 of 1997provides that "Subject to the provisions of section 9D(4), any investment income received by or accrued to any— (a) resident; and (b) person (other than a resident) arising from the activities carried on by him through a permanent establishment situated in the Republic, from any country other than the Republic during any year of assessment, shall, for the purposes of the definition of 'gross income' in section 1, be deemed to have been received by or accrued to such resident or person from a source within the Republic during such year of assessment." Section 9C (4) provides that "Where any investment income is received or accrued in accordance with this section in the course of the carrying on of any trade outside the Republic, such trade shall for the purposes of sections 11, 20 and 28 be deemed to have been carried on in the Republic." Section 9 D deals with the taxation of the investment income of 'Controlled Foreign Companies' while section 9E deals with foreign earned dividend. This regime was introduced based on the recommendation of the Commission of Enquiry into Certain Aspects of the Tax Structure of South Africa, *GG* 15924, Regulation Gazette 5378 of 1994 (Known as Katz Commission). In its Fifth Interim Report of the Katz Commission captioned 'Basing the South African Income Tax System on the Source or Residence Principles – Options and Recommendations, the Commission recommended for the retention of the source-based for the active income and the extension of the deemed-source rule which implies the adoption of the residence-based for the passive income. See Katz Commission 5th Interim Report at paras. 9.1, 9.2. and 9.4

> natural person who has its place of effective management in the Republic;" [106]

In switching to a fully-fledged residence-based regime, two major amendments were made to the interpretation section of the South African Income Tax Act. That is the provision that imposes the tax liability and the one defining the class of person on whom the tax liability is imposed. The former refers to the redefinition of the term 'gross income' which the amended legislation defines as:

> "'gross income', in relation to any year or period of assessment, means- (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic, during such year or period of assessment ..."[107]

Before the amendment, the word 'person' was mentioned in the definition of 'gross income' that envisaged that the residence status of the taxpayer was not relevant to the determination of tax liability. That is to say, a person whether or not a resident of South Africa, was liable to tax on the income he earned within the Republic of South Africa. At its infancy stage, the South African residence-based regime exempted certain foreign income earned by the residents.[108] This notion of residence-based system "has been described as a 'residence-minus' system."[109] However, in 2003, the residence-minus regime was modified,[110]

[106] Section 9C (1) of the Income Tax Act No. 28 of 1997

[107] Section 1 of the Income Tax Act No. 58 of 1962 (as amended by section 2 of the Revenue Laws Amendment Act 59 of 2000). Before the amendment, the word 'person' was mentioned in the definition of gross income which envisaged that the residence status of the taxpayer was not relevant in the determination of tax liability. That is to say a person whether or not a resident of South Africa is liable to tax from the income he earned within the Republic of South Africa.

[108] Section 12 of the Revenue Law Amendment Act No 59 of 2000 as amended by section 24 of the Second Revenue Law Amendment Act No. 60 of 2001 and further amended by section 16 of the Revenue Law Amendment Act No. 74 of 2002. The essence of this provisions was to except the certain class of income if the income earner was a South African resident.

[109] Williams, RC (2006) at 32

[110] By way of reducing list of exempted foreign income to those mentioned in section 10 (1) (o) of the Income Tax Act (dealing with the issue of remuneration for foreign employment). More particularly,

which brought the South African regime more into line with the international trends. Unlike the former tax regime where the term 'resident' had not been defined, the definition of a 'resident' is crucial under the residence-based system. Thus, the new regime clearly defines the term in the following words:

> "'resident' means any- *(a)* natural person who is - (i) ordinarily resident in the Republic; or (ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic- *(aa)* for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and *(bb)* for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment, in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that- (A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a 'port of entry' as contemplated in section 9 (1) of the Immigration Act, 2002 (Act 13 of 2002), or at any other place as may be permitted by the Director-General of the Department of Home Affairs or by the Minister of Home Affairs in terms of that Act; and (B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; … but does not include— (A) any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the Governments of the Republic and that other country for the avoidance of double taxation; …Provided that where any person that is a resident ceases to be

section 24 (1) of the Revenue Law Amendment Act No. 45 of 2003 which states that from 1st June 2004 the whole provisions of section 9F has been abrogated. "The amendments contained in the Act widened South Africa's tax base by shifting the tax system from a "source plus" system to a "residence-minus" tax system. Under the former "source plus" system, South Africa taxed items arising only from South African sources plus a limited category of foreign source items. Under the current "residence-minus" system, South Africa imposes taxes on a worldwide basis less a limited category of foreign source items." See National Treasury's detailed explanation to Section 9D of the Income Tax Act (2002) at iii available at http://www.treasury.gov.za/divisions/tfsie/tax/legislation/Detailed%20Explanation%20to%20Section%209D%20of%20the%20Income%20Tax%20Act.pdf

> a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident…"[111]

It will be recalled that both individuals and entities (other than companies) are being treated under the one regime in Nigeria. The South African system, on the other hand, terms the individual a 'natural person'. It separates the determination of the tax residence of individuals from that applicable to non-natural persons such as companies and other entities. Thus, an analysis of the South Africa residence-based regime in this chapter centres on natural persons. The above provisions encompass two basic tests for the determination of the tax residence of individuals; 'ordinary residence' and 'physical presence'.

6.2.1 Ordinary Residence

The two tests were designed in hierarchical order. The starting point for the determination of the residence status of an individual under the South African tax regime is to inquire whether or not the individual involved is an ordinary resident of South Africa. Once the ordinary resident status is established, there is the need to apply the 'physical presence' tests. [112] The vital question is how to establish the 'ordinary resident' of an individual under the South African regime. The concept of ordinary residence has not been statutorily defined. Thus, reliance must be placed on the judicial connotations of the term. The cases

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[111] Section 1 of the Income Tax Act No. 58 of 1962 (as variously amended by Section 2 *(h)* of Act 59 of 2000 Revenue Laws Amendment Act 59 of 2000; Section 6 (1) *(p)* of the Revenue Laws Amendment Act No.74 of 2002; Section 33 (1) of the Exchange Control Amnesty and Amendment of Taxation Laws Act No. 12 of 2003 and Section 12 (1) (i), (j), *(k)* of the Revenue Laws Amendment Act No. 45 of 2003; section 3 (1) (j) of the Revenue Laws Second Amendment Act No. 32 of 2005 up to section 2 (1) (w) and (x) of the Taxation Laws Amendment Act No. 22 of 2012) see also Koker, A and Williams, RC 'Silke on South African Income Tax' (2010) LexisNexis; Koker, A et al 'Silke Tax Yearbook 2012 – 2013' (2013) LexisNexis, Durban at D37 – D39

[112] Williams, RC (2006) at 33

of Cohen v. CIR[113] and CIR v. Kuttel[114] are the two leading decisions in South African analysed the concept.

In Cohen's case, the appellant lived in South Africa but left for the US together with his family in 1940. Although his visa indicated that he was to stay in the US for less than one year, he remained there up to June 1942. In the interval, neither the appellant nor any member of his family had returned to South Africa. While he was away, the appellant earned income that supposed to be exempted if the income earner was not a South African 'ordinary resident.' The appellant sought to benefit from the exemption on the ground that he was neither an 'ordinary resident' nor carried out any business in South Africa at the time he earned the income. The Revenue Commissioner rejected the appellant's claim and assessed him accordingly. He appealed against the decision and the court addressed the question whether or not the appellant was an ordinary resident of South Africa. From the beginning, the court explicitly stated its intention to rely on English decisions where is it stated that

> "…no case in our Courts has dealt with the argument now before us. Reference was, however, made to certain cases decided in Great Britain; but in none of them has it been decided that residence, or ordinary residence, in a country requires the physical presence of the taxpayer in that country during the year of assessment."

Thus, the court adopted the notion of ordinary residence formulated by the English courts.[115] However, in delivering the judgment, Schreiner JA stated that:

> " If, though a man may be "resident" in more than one country at a time, he can only be "ordinarily resident" in one, it would be natural to

[113] 13 SATC 362
[114] 54 SATC 298
[115] Levene v Inland Revenue Commissioners (1928) All ER 746 (HL); Inland Revenue Commissioners v Lysaght (1928) AC 234; Reid v Inland Revenue (1926) SLT 365; Turnbull v Solicitor of Inland Revenue (1904) 42 S.L.R. 15

> interpret "ordinarily" by reference to the country of his most fixed or settled residence. This might not be his country of domicile, for it might not be his domicile of origin and he might not have formed the fixed and settled intention, which "excludes all contemplation of any event on the occurrence of which the residence would cease", which is necessary to bring into existence a domicile of choice Johnson v Johnson, (1931, A.D. 391). *But his ordinarily residence would be the country to which he would naturally and as a matter of course return from his wanderings*; as contrasted with other lands it might be called his usual or principal residence and would be described more aptly than other countries as his real home. If this suggested meaning were given to "ordinarily" it would not, I think, be logically permissible to hold that a person could be "ordinarily resident" in more than one country at the same time"[116] (emphasis added)

One of the concern in the above formulation is how to reconcile the distinction between 'domicile' and 'ordinary residence' formulated by the Court in Cohen's case. The court defined ordinary residence as the place where an individual would return from his wandering as a matter of course. This suggests that there must be an intention on the part of the individual to go back to that particular place from his wandering as a matter of course. To return to a place, of course, suggests a degree of permanence.[117] Thus, both the two basic elements of domicile (intention and permanence) have featured in Schreiner JA's definition of ordinary residence. This is contrary to the UK notion of ordinary resident as enunciated in the UK cases of Levene and Lysaght where ordinary residence was defined as:

> "residence in a place with some degree of continuity and apart from accidental or temporary absences."

Justice Schreiner stated that in the South African context an individual could not be an ordinary resident of more than one place. Domicile means an

[116] 13 SATC 362 at 364;

[117] Compare this with the view of Bristowe J, in the earlier South African decision Robinson v. Commissioner of Taxes (1917) 32 SATC 41 that "Residence means a man's home or one of his homes for the time being." And for a person to be resident in South Africa his presence need not to be permanent.

individual's fixed and permanent place of abode in which he intends to remain indefinitely, or if he leaves, he maintains an intention to return. As a rule, no individual can live without a domicile, and he cannot have two domiciles at the same time.[118] However, the notion of ordinary residence connotes residence in a place with some degree of continuity and apart from accidental or temporary absences. It is not so with usual or occasional or temporary residence.[119]

Therefore, the key elements of domicile are the intention of the individual to live in a particular place indefinitely coupled with the permanent intention to return to that place even if he left it. This element of domicile has featured in the South African notion of ordinary residence contained in the statement of Schreiner JA in 13 SATC 362 at 364 that "…However, his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings .." It is submitted, therefore, that the South African notion of ordinary residence is akin to the concept of domicile.

In Kuttel's case, the respondent had left South Africa for the US in 1983. As at the time of his departure the respondent retained his house and director's position in a South African company. While staying in the US, the respondent had visited South Africa and stayed at his house for almost ten times. He even attended board of directors' meeting on two occasions. The Commissioner assessed him for tax on the income he earned while he was away. The respondent claimed that his income falls within the definition of section 10 (1) (h) of the Income Tax Act. Thus, the income was exempted under the Act. The Commissioner rejected this assertion. The court of first instance held that the respondent was an ordinary resident of the US not of South Africa as holding a

[118] Mark v. Mark (2006) 1 AC 98; IRC v. Bullock (1976) 1 WLR 1178 at 1184. For discussion on the significance of the parent domicile to the determination of an individual domicile see Lollman, J 'The significance of parental domicile under the citizenship clause' (2015) 101 Va. L. Rev. 455

[119] Levene v. IRC at 225

director's position could not make an individual to be an ordinary resident. Therefore, his income was exempted. The Commissioner appealed against this decision. The Court held that:

> "Words 'ordinarily resident' narrower than just 'resident' – Unnecessary in this case to decide whether a person may not be held to be ordinarily resident in more than one country at the same time – Natural and ordinary meaning of the words 'ordinarily resident' to be applied to provisions under consideration – applying this meaning to the words in question, there could be no doubt that at the relevant times the taxpayer was not ordinarily resident in the Republic the fact that the taxpayer had kept his home in Cape Town was in no way inconsistent with his usual or principal residence or home having been in the United States – Held accordingly that Commissioner for Inland Revenue had incorrectly assessed the taxpayer to tax in the Republic in respect of interest and dividend income in the relevant years of assessment."[120]

From the above quotation, it is clear that the court followed the line of reasoning of the court in Cohen's case which by extension fell in line with the decisions of the UK Courts.[121] In essence, the central theme of the above cases is that an individual has his ordinary residence in the place where he has his 'usual' or 'principal residence'. Thus, the physical presence of the individual in South Africa is not a determinant of whether or not he is an ordinary resident.

In the light of the above, it could be argued that the concept of 'ordinary resident' is not new to the South African tax system because it featured in the former source-based regime. Thus, the concept is not unique to the residence-based regime.[122] The question is, whether or not the above South African cases dealt with the concept of ordinary residence as a connecting factor or as a relief or exemption mechanism? It should be noted that the notion of ordinary residence under the source-based system should not be construed to have the same effect

[120] 54 SATC 298 at 299
[121] More particularly the case of Shah v Barnet London Borough Council (1983) 1 All ER 226(HL)
[122] Danziger, E 'International income tax: The South African perspective' (1991) Butterworts, Durban at 33 - 46

on the residence-based system. In the former source-based regime, the concept of ordinary residence was a mere determinant for deciding the eligibility of an individual to certain reliefs or exemption. Whereas, under the residence-based system, it is used as a connecting factor. Therefore, there is a need to distinguish the concept of 'ordinary residence' as a jurisdictional nexus and as a ground for relief or exemption to appreciate the South African notion of ordinary residence.

In the former perspective, the concept serves as a link between the potential taxpayer and the state. It must be established first, before the issue as to whether or not the taxpayer is entitled to any relief or exemption. Thus, in the absence of any jurisdictional link, the person is not liable to pay tax in the first place let alone seeking for any relief or exemption. Furthermore, the jurisdictional nexus is applied to determine the extent of the state tax jurisdiction that could be both substantive and enforcement jurisdiction.[123] In the latter perspective, the concept deals with the issue of entitlement to relief and exemption available to an individual upon whom the state has already asserted its tax jurisdiction. All the earlier South African cases on ordinary residence were premised on the latter perspective, and they all predate the adoption of the residence-based system. Therefore, it is doubtful whether such decisions analysed the concept of ordinary residence in the context of establishing a jurisdictional link.

Most commentators[124] on the South African notion of ordinary residence rightly made reference to the leading Canadian authority of Thompson v. MNR[125]. It is

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[123] Hellerstein, W 'Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective' (2003) Geo. L. Rev. 1 at 3 see also Swain, JA 'Misalignment of Substantive and Enforcement Tax Jurisdiction in a Mobile Economy: Causes and Strategies for Realignment' (2010) 63 (x) National Tax Journal, Fox Special Issue at 112 "When a state asserts substantive jurisdiction over the subject matter of a tax, the state generally should also have enforcement jurisdiction over a person who can remit the tax."

[124] Notably, Williams, RC (2006) at 35; Olivier, L 'Residence based taxation' (2001) J. S. Afr. L. 20 at 25; Olivier, L and Honiball, M 'International tax: A South African perspective' (2008) (4th ed), Siber Ink, Cape Town at 61

[125] (1946) SCC

a good approach because Thomson's case directly dealt with the concept of an ordinary resident as a jurisdictional link. Thompson's case is the leading case where the ordinary residence as a jurisdictional link was directly at issue.[126] Stressing the assertion that the South African cases did not deal with the concept of ordinary residence as a jurisdiction link, there is the need to distinguish Thomson's case and Cohen and Kuttel. In Thomson's case, the central issue is whether or not the appellant was a Canadian ordinary resident and liable to Canadian income tax.

The determination of the individual's residence goes to the root of exercising tax jurisdiction by the Canadian authority. Because failure to establish the ordinary residence status, Thompson would not be liable to tax on any part of his income. In both Cohen and Kuttel, on the other hand, the central issue was whether a certain class of income that supposed to be taxable was exempted. Thus, the vital question was not premised on the assertion of tax jurisdiction over both Mr Cohen and Mr Kuttel. Rather it was the taxability of a certain class of their income that was linked to their ordinary residence status. This suggests that other part of their income remained taxable, and that was the position in the Thompson's case.

It is submitted that as at August 2015 there is not any South African that clearly dealt with the question of ordinary residence as a jurisdictional link, not as a ground for enjoying relief or exemption of certain income from tax. Therefore, if the definition of legal concept should always be contextual, the South African court defined the concept of ordinary residence out of context. The only available guidance is the Interpretation Notes issued by the South African Revenue Service on how to determine the ordinary residence. Given the non-

[126] Even the UK case of Shah v. Barnet London Borough Council and others (1983) 1 All ER 226 (HL) 234 did not considered the 'ordinary residence' as jurisdictional link but rather as a ground of enjoying certain educational benefit.

binding nature, the Interpretation Notes will not be discussed in this thesis. It should be noted that, even the UK that set the pace of the analysis of ordinary residence has abandoned the concept of ordinary residence as a connecting factor for individual residence. Furthermore, the Canadian Courts are wary of applying the UK decisions on the meaning of ordinary residence. Because the UK decisions focused on the cessation rather than the establishment of ordinary residence. While stating the difference between the Canadian and the UK approach to questions of 'resident' and 'ordinary resident' Bowman, J. in Kadrie v. Canada,[127] stated that:

> "It is, I believe, apparent from the decision of Schujahn v. M.N.R. 62 DTC 1225 and the Thomson case that one should treat with some caution the decisions under the United Kingdom taxing statutes."

Therefore, the most relevant leading authority for ordinary residence is Thompson's case.

Despite the above concerns raised about the notion of ordinary residence under the South Africa regime, it is far better than the confused and incoherent notion under the Nigerian regime. Under the Nigerian regime, both tax practitioners and academics have deliberately avoided discussion of the concept of ordinary residence. To date no Nigerian case has even made reference to the concept from both perspectives. Finally, it is submitted that inconsistency characterises the definition of ordinary residence. The question as to whether an individual could be an ordinary resident in more than one state depends on the notion of ordinary residence adopted by the two states at issue. Thus, it is possible for an individual to fall within the definition of ordinary residence of two or more states.

[127] (2001) T.C.J. No 601 (Q.L.)

6.2.2 Physical presence

Given the fact-intensive nature of ordinary residence, it is possible for an individual to reside in South Africa for a very long period without assuming an ordinary resident status. Perhaps he maintained an intention to return to the country whence he comes. An objective test was introduced to bring this class of individual into the tax net. The test ascertains the residence status of an individual based on the number of days he spends in the Republic. It dictates that an individual is resident or non-resident in particular circumstances for the purposes of specific tax provisions, irrespective of the actual residence status of that individual.[128] It does not decide the question of the factual situation surrounding the residence. The test is designed to provide the absolute certainty that may not be found under the ordinary residence test. An individual falls within the ambit of this test if the aggregate number of days he physically spent in the Republic exceeds:

a) 91 days in the present year of assessment;[129] and
b) 91 days in the previous five years of assessment before the current year; and
c) 915 days in those previous five years of assessment

Thus, an individual becomes a South African resident immediately he satisfies all the above conditions. That is to say, for an individual to fall within the ambit of this test, he must be present in South Africa for a certain number of days for at least six consecutive years. Thus, an individual is deemed to be a resident

[128] Kamal, S 'Individual tax residence' (2011) Sweet & Maxwell, London at 125 - 126

[129] Section 7 (1) (G) of the Taxation Laws Amendment Act No. 17 of 2009 provided that ''year of assessment' means any year or other period in respect of which any tax or duty leviable under this Act is chargeable, and any reference in this Act to any year of assessment ending the last or the twenty-eighth or the twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company or a portfolio of a collective investment scheme in securities be construed as a reference to any financial year of that company or portfolio ending during the calendar year in question."

from the first day of the sixth year of in which he has had a physical presence in South Africa for the required number of days. Superficially, it could be argued that the test is straight forward and easy to analyse since the physical presence of the individual is measured by the number of days he spends in South Africa.[130] However, in the light of the quoted provisions of section 1 of the Income Tax Act 1962 (as severally amended) there are many issues surrounding the physical presence test that needs to be addressed.

Under this test, a 'day' includes a part of a day it does not mean a full period of 24 hours spent in South Africa. Thus, since part of day counts, it follows that the dates of arrival in or departure from South Africa are included. Because, an individual may arrive or depart South Africa in the noon or immediately before midnight. However, the day spent in transit without formal entry into South Africa is not considered in computing the number of days spent. The inclusion of the part of a day makes the South African regime better than that of the UK.[131] Also, in terms of making reference to the previous periods of physical presence in computing the number of days, the conditions lay down by the South African regime is more generous than that of the US.[132] Furthermore, South Africa and New Zealand are the only jurisdictions that provide for the cessation of physical residence status based on the number of days of absence amongst all the jurisdictions that adopted the physical presence test.[133]

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[130] Unlike the South African Provision, the Nigerian physical presence test is only applicable to the individual who earns his income from employment. Notwithstanding the fact that section 3 of the PITA distinguished income from employment with that of trade or business. Thus, those who earn income from trade or business are not subject to the 183 – day rule.

[131] For instance, in Wilkie v IRC (1952) 1 All ER 92.The court held that the 183-day rule is not satisfied even if the individual spent 182 days and 20 hours in an income year of 366 days in the UK. Therefore, he is not a UK resident

[132] Under the US substantial presence test, an individual is deemed to be a resident of the US if he spends 31 days during the calendar year. And the total of the days he spent in the US during the current calendar year and the two preceding years must be at least 183 days.

[133] Section YD 1 (3) – (6) of New Zealand Income Tax Act 2007 provide that (3) "A person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in total in a 12-month period. (4) If subsection (3) applies, the person is treated as resident from the first of the 183 days until the person is treated under subsection (5) as ceasing to be a New Zealand resident. (5) A person treated as a New Zealand resident only under subsection (3) stops being a New Zealand

However, the main problem with the South African physical presence test is that it is dependent on the ordinary residence test. Thus, it is not an independent test. Despite the fact that the provision of section 1 envisages the issue of cessation of the resident status acquired under the physical presence test, where it stated that:

> "…Provided that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident…"

However, as at October 2015, no South African decision provides guidance as to what constitutes the cessation of ordinary residence.[134] The determination of when ordinary residence status begins and terminates has serious implications in the application of the physical presence test that is only applicable to the non-ordinary resident.[135] Failure to provide clear guidance on the establishment and termination of the ordinary residence status could hinder the application of this test or create a double non-taxation scenario.

For instance, the case of an individual who left South Africa during the 2013 year of assessment and severed all his connection with the Republic. On the

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resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period. (6) The person is treated as not resident from the first of the 325 days until they are treated again as resident under this section."

134 Some commentators make case for making reference to the cases of *Davies and another v HMRC and Gaines-Cooper v HMRC* (2011) UKSC 47 where the UK Supreme Court held that for an individual to lose his UK ordinary resident status he must established a distinct break from his UK mode of life. The same decision was followed in the subsequent case of *Lynette Dawn Yates v HMRC* (2012) UKFTT 568 (TTC) where the court expanciate on what amount to distinct break. See Walt, J 'Ordinary resident – a taxing question' (2012) found at http://www.thesait.org.za/news/109452/Ordinarily-resident---a-taxing-question.htm last assessed on 17/08/2015. Moreover, the leading South African cases of Cohen and Kuttel clearly stated that physical presence is not a decisive factor for establishing ordinary residence. Hence the need for separate test that specifically deals with the issue of physical presence.

135 Section 1 provides that "…not at any time during the relevant year of assessment ordinarily resident in the Republic…"

basis of the above decisions[136] on ordinary residence that person ceased to be an ordinary resident of South Africa. However, he return to South Africa during the 2014 tax year and spent over 91 days in the country. By section 1 of the Income Tax Act 1962 (as amended), the determination of his ordinary resident status is the first criterion for applying the physical presence test.

The question is – did he regain the ordinary resident status by his return? Whereby the computation of the number of days could commence from the date he returns. There is no answer to this question in the South African context. Because there is no decision dealing with the issue of the cessation of ordinary resident status let alone a decision that deals with the question of regaining a lost ordinary residence status. Therefore, there is no certainty of his ordinary residence status and the same section 1 provides that the physical presence test is only applicable where the individual is not ordinary resident in the current year of assessment. Thus, the condition for the application of the physical presence test is not satisfied. Given this quagmire, how can this individual be taxed after his return in the 2014 year of assessment?

It could be argued that the individual may fall into the net of the physical presence test since he spent more than 91 days in the 2014 year of assessment. Also, since he was an ordinary resident of South Africa up to 2013, there is the possibility of satisfying the second and third legs of the test.[137] However, the condition precedent for the application of the test is that the individual must not be an ordinary resident during the year of assessment. Thus, the issue of the

[136] *Lysaght v. IRC (1928) at 535; Reed v Clark (1985) 58 TC 528, 556Tuczka v. HMRC (2011) 113 UKUT 1 at 9 (TCC); Darrell Healey v HMRC (2014) UKFTT 889* (UK) *Beament v. MNR,[136] The Queen v, Reader 75 DTC 5160 at 5163, Kadrie v. The Queen (2001) T.C.J. No 601 (Q.L.*) (Canada) *Applegate v. FCT (1979) 79 ATC 4307 at 4317* (Australia)

[137] That he spent 91 days in 2009, 2010, 2011, 2012 and 2013 and the number of days may exceed 915 days

ordinary residence status of the individual must be settle before moving to the remaining part of the test.

Therefore, for the smooth application of the physical presence test, there is a need for the South African courts to explore clear rules for the acquisition and termination of ordinary residence status. The reliance on the UK decisions is not a viable option because the concept of ordinary residence is no longer relevant to the UK regime that implicitly abrogated the principles established in those cases relied upon in South Africa. It appears that the commentators on the South African regime have rightly considered Thompson' case as the leading guide for the determination of ordinary residence. Therefore, there is a need to consider another Canadian case of Kadrie v. Canada, where Bowman, J. categorised the Canadian cases involving the questions of resident or ordinary resident into three;

> "(a) Cases where a person who has theretofore been ordinarily resident in Canada leaves, takes up residence elsewhere and alleges that he or she has so severed the relationship with Canada that he or she is no longer resident here;
> (b) Cases where a person, ordinarily resident in another country, acquires a residence and other ties in Canada. There the question is whether that person has become "ordinary resident" in Canada;
> (c) Cases where a Canadian resident leaves Canada and severs his or her connection with this country so that he or she is not a Canadian resident, and then require ties here. The question here is whether that person has resumed residence here." [138]

By following the above categorization, the obstacles being faced by the South Africa physical presence test could be removed. However, the problem of the Nigerian physical test is very complex and totally at variance with the international norm, and it needs a total overhaul.

[138] (2001) T.C.J. No 601 (Q.L.)

6.3 Individual Residence under Nigeria – South Africa Double Taxation Treaty 2000

A DTA is a means of achieving cooperation between states to prevent double taxation. The states who are parties to a DTA use it as a mechanism for the exchange of information regarding the activities of the potential taxpayer.[139] They also utilise the DTA to achieve coherence in defining their respective taxable subjects. The latter purpose is a focal point while referring to the DTA or Multilateral Tax Treaties in this thesis. Under the DTA regime, for a person to benefit from the provision in a DTA, he must a be a resident of one or both the contracting parties. [140] That is the main reason for making reference to the definitional rules contained in the DTAs. Thus, it is necessary for a state that is a party to the DTA to determine the residence status of the potential taxpayer under the domestic laws. The need to satisfy this core requirement of the DTA means that the states must understand the intricacies in the definitional rule of residence under their respective domestic laws.

As indicated above, although both Nigeria and South Africa adopted a residence-based system, the residency regime of the two states face in different directions. The two states are Africa's largest economies. Therefore, it is inevitable for individuals of these states to cross the border of either state for the purposes of trade, business or employment. Hence, it is possible for the individuals to fall within the definition of residents of the two states. The states have entered into Double Taxation Agreements to tackle double taxation. The

[139] See Bagaria, S 'The nature and purposes of double taxation agreements and the issues which the interpretation of such agreements may give rise' (2012) found at http://ssrn.com/abstract=2018859 at 6 last visited on 11/08/2015

[140] Arnold, BJ 'An overview of the issues involved in the application of double tax treaties' in Trepelkov, A et al (ed) 'United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries' (2013) UN Publication, New York 1 at 22 -23

Nigeria – South Africa DTA[141] covers both the individual and corporate taxpayers of the two States.[142] Thus, it deals with the issue of dual residency of both individual and corporation. It provides that:

> "For the purposes of this Agreement, the term "resident of a Contracting State" means: (a) in Nigeria, any person who, under the laws of Nigeria, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature … (b) in South Africa, any individual who is ordinarily resident in South Africa and any person other than an individual who has its place of effective management in South Africa."[143]

In resolving the possible conflict in determining the individual residence, the agreement provides for a hierarchy tie-breaker rule of resolving individual dual residence conflict.

> "Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows: (a) he shall be deemed to be a resident only of the State in which *he has a permanent home* available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which *his personal and economic relations are closer centre of vital interests;* (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which *he has an habitual abode*; (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the-State of which *he is a national*; (d) if he is a national of both States or of neither of them, the competent authorities of *the Contracting States shall settle the question by mutual agreement.*"[144] (Emphasis added)

The permanent home; the closeness of personal and economic relations; habitual abode; and nationality are the key tiebreaker rules provided for in the above clause of the DTA. The determination of these terms requires a fact-

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[141] Nigeria – South Africa, Comprehensive Agreement for the avoidance of Double Taxation and Prevention of Fiscal Evasion, dated 29th April, 2000, taking effective on 1st January, 2009.

[142] Article 3 (1) (i) "the term "person" includes an individual, a company and any other body of persons which is treated as an entity under the taxation laws in force in each Contracting State."

[143] Article 4 (1) of the Nigeria – South Africa DTA 2009

[144] Article 4 (2) of the Nigeria – South Africa DTA 2009

intensive inquiry and the agreement fails to define the terms or give guidance on how to ascertain them. For instance, what constitutes a ‘permanent home’ or ‘habitual abode’ in Nigeria may be different in South Africa. Nigeria is a federal state comprising the central government and sub-national states, and there are local dual residence conflicts between the sub-national states.[145] The agreement recognises this fact where states that

> “For the purposes of this Agreement, the term "resident of a Contracting State" means: (c) that State itself and any political subdivision or local authority thereof”.

Therefore, is it a ‘permanent home’ or ‘habitual abode’ in Nigeria or a sub-national state of Nigeria? This makes it difficult to ascertain the ‘permanent home’ or ‘habitual abode’ of an individual in Nigeria with the context of the agreement. However, it may be easily ascertained in South Africa, because South Africa in not a federal state. It may be assumed that the permanent home refers to ‘ordinary residence’ and ‘habitual abode’ refers to ‘domicile.' The analysis in chapter four revealed the different notion of these two expressions, but the DTA does not adopt a particular connotation.

In both Nigeria and South Africa, the closeness of personal and economic relations of an individual vis-à-vis the state is a subjective question that is determinable only by the fact and circumstances of the particular individual involved. Thus, the word ‘close’ envisages an issue of degree. The agreement does not provide for the degree of the closeness required for the tiebreaker rule to apply. Therefore, the application of this tiebreaker requires a judicial determination of the closeness, which is not contemplated by the agreement. Is the ‘personal’ and ‘economic’ relation to be read conjunctively or disjunctively? It may be possible for an individual to have a close personal relationship with a state that is party to the agreement but at the same time have closer economic

[145] See paragraph 1 of the 1st Schedule of the PITA 2004 (as amended)

relation with both parties as well as other non-party states. Economic nexus has been and is still an unsettled issue in a jurisdiction like the USA where it is used as a connecting factor for the states' tax jurisdiction.[146]

The last tie-breaker is the nationality of the individual involved. The notion of nationality is not consonant with the rationale of the residence-based taxation. The policy issue behind the residence-based system is that since an individual benefits from the infrastructure provided by the state where he resides, he is liable to pay tax to that state in consideration of the benefit enjoyed. Thus, a national of one state may live in another state and enjoy the facilities put in place by the state. Therefore, the state of residence is more entitled to tax the individual than his state of nationality. Since nationality cannot be justified as a domestic connecting factor, it cannot be suitable as a tie-breaker rule. For instance, in the context of the Nigeria – South Africa DTA, a British national may reside in Nigeria or South Africa without being a national of either state leading to a triangular situation. This is a situation where a potential taxpayer who falls within definitional rules of a resident of the two states party to the DTA, but he receives the income from sources in a third state.

In the light of the above, it is arguable that the only viable tiebreaker is for the states to agree on the possible solution to the jurisdictional conflict. The question is how long will it take to reach the agreement? What will be the position of the potential taxpayer in the interim? According to Miller,[147] the states take eight to ten years before they reach agreement. Assuming the

[146] Thimmesch, AB 'The Illusory promise of economic nexus' (2012) 13 (4) Fla. Tax Rev. 158; Faber, PL 'Economic Nexus: Right or Wrong' (2009) 87 Tax Mag. 99; Edson, CR 'Quill's constitutional jurisprudence and tax nexus standards in an age of electronic commerce' (1995) 49 Tax Law 893; Fatale, MT 'State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard' (2000) 54 Tax Law 105; Lemmon, ES 'Economic nexus: legislative presumption or legitimate Proposition?' (1999) 14 Akron Tax J. 1; Swain, JA 'State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective' (2003) 45 WM. & Mary L. Rev. 319

[147] Miller, A and Oats, L 'Principles of taxation' (2014), (4th ed) Bloomsbury 143

agreement is reached within two or three years, in the interim, the individual will remain in an uncertain situation about his residence status. The individual's situation would worsen if the states fail to reach agreement. Thus, the individual becomes liable to pay tax to both states on the same income – the double taxation sought to be avoided by the DTA.

Furthermore, the Nigeria-South Africa DTA only captures the substantive tax jurisdiction of the two states. The DTA does not touch the issue of enforcement tax jurisdiction. The enforcement tax jurisdiction of the individual's income tax is a very complicated area under the Nigerian regime. In Nigeria, the states of the federation have no substantive tax jurisdiction over income, but the Constitution clothes them with enforcement jurisdiction.[148] The assertion of enforcement jurisdiction of the states has led to the local dual residence conflict,[149] which has not been addressed by the DTA. Under the Nigerian regime, there is the possibility of having both local and international dual residence conflict. The PITA makes the 'principal place of residence' a tiebreaker for resolving the local dual residence conflict. However, the tiebreaker is very complex because the determination of a 'principal place of residence' is a fact-intensive exercise. Therefore, if a South African citizen falls within of two Nigerian states and the local tiebreaker cannot resolve the conflict, what would be the position of the Nigeria-South Africa DTA?[150]

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[148] See section 4 (3) of the Nigerian Constitution 1999

[149] The mechanism for resolving local dual residence conflict is provided in section 86 of the PITA. Section 86 (1) established body called the Joint Tax Board and section 86 (9) spelt out the function of the board to include "use its best endeavours to promote uniformity both in the application of this Act and in the incidence of tax on individuals throughout Nigeria" Paragraph 10 of the first schedule of the PITA provides for the framework for resolving the local dual residence conflict.

[150] Paragraph 1 of first schedule to the Nigerian Personal Income Tax Act Cap 2004 provided for the tie-breaker rule. But, like any other tie-breaker rule, there is always a confusion where the rule does not work. Section 86 of the same Act established a Joint Tax Board with a view to settle any potential jurisdictional conflicts. However, the Board only serves as advisory body.

The question is whether the DTA resolves all the possible jurisdictional conflicts between the two states? The answer is "no". Given the weakness of the DTA discussed above, especially the non-binding nature of the DTA for a third party, some commentators[151] have advocated a multilateral treaty to address the jurisdictional conflicts. However, the diverse nature of the economic, political and cultural policies has led to the insistence by the state to preserve and retain their tax sovereignty[152] and that result has divergent tax principles and policies. Thus, to achieve cooperation through the DTA, the states must first address the issue of sovereignty.[153] "The state tax sovereignty is not absolute, and complete sovereignty is impossible."[154] Therefore, a comparative analysis is the most viable of achieving co-operation.

6.3.1 Application of DTA under Nigerian and South African Laws

The overlap between a DTA and domestic law makes an analysis of the application DTA crucial. The application of a DTA relates to the enforcement of the DTA provisions.[155] The issue of the domestic application of a DTA is

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[151] Latulippe, L 'The expansion of the bilateral tax treaty network in the 1990s: the OECD's role in international tax Coordination' (2012) 27 Austl. Tax F. 851; Reinhold, RL 'Some things that multilateral tax treaties might usefully do' (2004) 57 (3) The Tax Lawyer 661 at 708 (He argued for multilateral tax treaty to address the issue of multinational service partnership and electronic commerce); Brooks, K 'The Potential of Multilateral Tax Treaties' (2010) *In* Lang, M et al (Ed)Tax Treaties: Building Bridges between Law and Economics' IBFD Publication (He explores the potential of using multilateral tax treaties in achieving coordination of international tax regimes); Thuronyi, V 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 Brook J. Intl L. 1641 Diane M. Ring, DM 'Prospects for A Multilateral Tax Treaty' (2001) 26 (4) Brook J. Intl L. 26 1699 at 1710 (The discussed the method of designing an optimal multilateral tax treaty); Jogarajan, S 'A Multilateral Tax Treaty for ASEAN — Lessons from the Andean, Caribbean, Nordic and South Asian Nations' (2011) 6 Asian Journal of Comparative Law 1 – 23 (making case for the ASEAN countries to enter into a regional multilateral tax treaty)

[152] Rosenbloom, HD 'Sovereignty and the Regulation of International Business in the Tax Area' (1994) 20 Canada-US L. J. 267 at 267; Steines, JP 'Income Tax Implications of Free Trade' (1994) 49 (4) Tax Law Review 675 at 689

[153] Li, J 'Tax Sovereignty and international tax reform: The Author's response' (2004) 52 (1) 141

[154] Charles E. McLure CE 'Globalization, tax rules and national tax sovereignty' (2001) 55 (8) Bull Int'l Fiscal Doc. 328 at 329

[155] Ajomo, MO 'Development in International Relations' in T A Aguda, TA (ed) in 'The Challenge of the Nigerian Nation' (1985) Nigerian Institute of Advanced Legal Studies, Lagos,

centred on the distinction between monist and dualist legal systems.[156] The terms monism and dualism describe different types of domestic legal systems.[157] In dualist states the constitution "accords no special status to treaties; the rights and obligations created by them have no effect in domestic law unless legislation is in force to give effect to them."[158] In contrast, "the essence of the monist approach is that a treaty may, without legislation, become part of domestic law once it has been concluded in accordance with the constitution and has entered into force for the state."[159]

In dualist states, a DTA has legal status in the domestic legal system.[160]Thus, the DTAs require implementing legislation to have the force of law in the domestic legal system. In monist states, DTAs do not require domestic implementation legislation to acquire the status of law in the domestic legal system.[161] However, in some monist states, certain treaties do not require domestic law to operate. In all monist states, some treaties have the force of law within the domestic legal system.

Under the Nigerian regime, a DTA must be passed into law by the National Assembly before it has the force of Law in Nigeria; this rule is codified in Section 12(1) of the Constitution of the Federal Republic of Nigeria as follows:

> "No treaty between the Federation and any other country shall have the force of law except to the extent to which any such treaty has been enacted into law by the National Assembly."

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[156] Sloss, D 'Domestic Application of Treaties (2011), Available at: http://digitalcommons.law.scu.edu/facpubs/635
[157] Aust, A 'Modern Treaty Law and Practice' (2007) CUP, Cambridge at 181–95

[158] Ibid
[159] Ibid
[160] Ian Brownlie, *Principles of Public International Law* (7th edn OUP, Oxford 2008) 31–33.
[161] Ibid

This section makes Nigeria a dualist state.[162] It provides that all treaties must be enacted into law before they can apply in Nigeira. Hence, after such enactment, treaties should occupy the same position with other Nigerian legislation, but subject to the provision of Nigerian Constitution. Thus, the source of law is the law enacted for the implementation of the treaty not the provision of the treaty.[163] The Nigerian Supreme Court reinstated this principle in the case of General Sani Abacha v. Chief Gani Fawehinmi[164] that:

> "Before its enactment into law by the National Assembly, an International treaty has no such force of law as to make its provisions justiciable in our courts…. Where, however, the treaty is enacted into law by the National Assembly, as was the case with the Charter which is incorporated into our municipal law by the 1983 Act, it becomes binding and our courts must give effect to it like all other laws falling within the Judicial powers of the Courts."

This section makes Nigeria a dualist state. It provides that all treaties must be enacted into law before they can apply in Nigeira. Hence, after such enactment, treaties should occupy the same position with other Nigerian legislation, but subject to the provision of the Nigerian Constitution. Thus, the source of law is the law enacted for the implementation of the treaty not the provision of the treaty.[165] For instance, personal income tax is one of the taxes covered by Article 2 (3) of the Nigerian -South Africa DTA. Under the Nigerian tax system, the

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[162] Hollis, DB 'A Comparative approach to treaty law and practice' in Hollis, DB et al (eds), National Treaty Law and Practice (2005) Martinus Nijhoff, Leiden, 32– 45; Ajomo, MO 'Development in International Relations' in T A Aguda, TA (ed) in 'The Challenge of the Nigerian Nation' (1985) Nigerian Institute of Advanced Legal Studies, Lagos,

[163] Oppng, RF 'Re-imagining international law: an examination of recent trends in the reception of international law into National legal systems in Africa' (2007) Fordham Inter'l L.J at 173. See also Murmansk State Steamship Line v. Kano Oil Millers Ltd. (1974)252 S.C at 256; Capital Bancorp v. Shelter Savings and Loans Ltd (2007) All FWLR pt440 p. 684; Ajomo, MO 'Development in International Relations' in T A Aguda, TA (ed) in 'The Challenge of the Nigerian Nation' (1985) Nigerian Institute of Advanced Legal Studies, Lagos,

[164] (2000) 6 NWLR part 660 p/ 228, see also C.S.S.T v. C.O.E., Kogi State (2006) All FWLR Pt 299 at 1549.

[165] Oppng, RF 'Re-imagining international law: an examination of recent trends in the reception of international law into National legal systems in Africa' (2007) Fordham Inter'l L.J at 173. See also Murmansk State Steamship Line v. Kano Oil Millers Ltd. (1974)252 S.C at 256; Capital Bancorp v. Shelter Savings and Loans Ltd (2007) All FWLR pt440 p. 684

states of the federation are empowered to assess, collect and administer personal income.[166] The Nigerian constitution brought the constituent states of the Federal Republic of Nigeria into the process of making a treaty. Section 12 (3) provides that:

> "A bill for an Act of the National Assembly passed pursuant to the provisions of Subsection (2) of this section shall not be presented to the President for assent, and shall not be enacted unless it is ratified by a majority of all the Houses of Assembly in the Federation."

Therefore, the application of a DTA that covers personal income tax requires the involvement of the constituent states of the federation. The rule provided by the Nigerian Personal Income Tax Act for the determination of individual residence within the constituent states of Nigeria must be taken into consideration in applying the DTA provision. It is the responsibility of the states of the federation to determine the residence of individual residing within their territory, not the federal government.[167]

However, the Republic of South Africa is a monist state.[168] Section 231 of the Constitution of the Republic of South Africa 1996 provides that:

> "(1) The negotiating and signing of all international agreements is the responsibility of the national executive.
> (2) An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces unless it is an agreement referred to in subsection (3).
> (3) An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the

[166] Section 2 (1) and (2) of the Personal Income Tax Act 2004. See also Part II of the schedule to the Taxes and Levies (Approved Collection List) Act 2004

[167] Section 2 (1) and (2) of the Personal Income Tax Act 2004. See also Part II of the schedule to the Taxes and Levies (Approved Collection List) Act 2004

[168] Botha, NJ 'National Treaty Law and Practice: South Africa 'in Hollis, DB et al (eds), National Treaty Law and Practice (2005) Martinus Nijhoff, Leiden, 600–02

National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.

(4) Any international agreement becomes law in the Republic when it is enacted into law by national legislation, but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.

(5) The Republic is bound by international agreements which were binding on the Republic when this Constitution took effect."

By section 231 (3) above not all treaties require domestication and the treaties are lower than domestic legislation[169] whereas in Nigeria the Constitution makes no exemptions as regards the domestication of treaties. Thus, DTAs also require domestic legislation to operate. However, there are divergent views in South Africa as to whether DTAs fall within the self-executing treaties mentioned in section 231 (3) above. Section 108 of the South African Income Tax Act 1962 (as amended) provides that:

"(1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.

(2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act."

The above provision makes clear that a DTA requires parliamentary approval before it binds the Republic. Thus, the DTA is not a self-executing treaty. Du Plessis opines that "(a) South Africa's DTAs do not attain a status on the same level as the Constitution; (b) treaty override is possible in terms of the

[169] Section 231 (4) of the South African Constitution 1996

provisions of the Constitution."[170] On the other hand, Hattingh argues that DTAs are self-executing and become law upon the approval of the parliament.[171] Therefore, the legal position of the DTA is South Africa is not settled. The question is how to apply the DTA between Nigeria, a federal and dualist state and South Africa a non-federal and monist state?

6.4 Lessons for the Two Regimes

The crux of the comparison between the Nigerian and South African regimes of individual residence-based taxation centres on the misalignment of the substantive and enforcement income tax jurisdiction under the two regimes. Nigeria is a federal state, but South Africa operates a sui generis system of government that reflects the features of a federal state[172] but in practical terms, it is not a federal republic. Thus, the provinces do not enjoy the autonomy of the sub-national states under a typical federal system. Therefore, South Africa has a single income tax system for both individuals and corporates. That is to say, both the substantive and enforcement income tax jurisdiction lies with the national government. On the other hand, the Nigeria individual income tax regime exclusively allocates the substantive jurisdiction of the federal government and shares the enforcement jurisdiction between the federal and states governments.[173] Given the divergence of the two regimes discussed above, it is possible to view the regimes through the lens of three federal states

[170] Du Plessis, I 'The incorporation of double taxation agreements into South African domestic law' (2015) (18)4 PELJ at 1200

[171] Hattingh, PJ 'Elimination of International Double Taxation' in De Koker, A and Brincker, E (eds) 'Silke on International Tax' (2010) LexisNexis, Durban

[172] See sections 101 (1) of the Republic of South Africa 1996 "The constitution provides for a constitutionally-entrenched distribution of powers between the national and provincial governments, and appoints the constitutional court to enforce the arrangement. The relationship between the spheres of government is determined **by** the principle of co-operative government" See Leonardy, U and Brand, D 'The defect of the constitution: concurrent powers are not co-operative or competitive powers' (2010) J. S. Afr. L. at 657

[173] See sections 2 and 3 of the PITA 2004

that have adopted the residence-based system, namely, the USA, Canada, and Australia.

Under the US federal constitution, both the federal and the state governments are clothed with substantive and enforcement income tax jurisdiction.[174] Thus, the federal and states governments exercise income tax jurisdiction concurrently. In other words, a state may impose and enforce both individual and corporate income taxes within its territorial jurisdiction even if there is overlap with the tax imposed by the federal government. For instance, a resident of New York is concurrently subject to the federal income and that of the New York State. The arrangement has been sanctioned by the US Supreme Court which stated that:

> "The Concurrent federal and state taxation of income, of course, is a well-established norm and, in the absence some explicit directive from Congress, we cannot infer that treatment of income at the federal level mandates identical treatment by the States."[175]

However, the federal government retains the power to control and coordinate the states taxing jurisdiction. It also regulates the international tax regime.[176] In the exercise of their income tax jurisdiction, the states adopt two primary connecting factors, the 'domicile' and the 'physical presence' tests.[177] Thus, the determination of individual tax residence is carried out in vertical form. At the federal level, there are three connecting factors for individual residence; citizenship, Green Card and substantial presence tests, whereas, at the state

[174] Hellerstein, W 'The Original Model: The United States' in G. Bizioli, G and Sacchetto, C (ed) 'Tax Aspects of Fiscal Federalism A Comparative Analysis' (2011) IBFD Publication, Amsterdam 23 at 36 Hellerstein, W 'The U.S. Supreme Court's state tax jurisprudence' in R. S. Avi-Yonah, J. R. Hines and M. Lang (eds.), Comparative fiscal federalism: Comparing the European Court of Justice and the US Supreme Court's tax jurisprudence' (2007) Kluwer Law International 66 at . 68 Super, D "Rethinking Fiscal Federalism" (2005)118 (8) Harvard L. Rev. 2544 at 2652

[175] Mobil Oil Corp. v. Commissioner of Taxes, (1980).445 U.S. 425, 448

[176] Art. I section 8 of the US Constitution, 16th amendment

[177] For detail discussion on the US states income tax jurisdiction see Hashmi, A 'Is Home Really Where the Heart Is? State Taxation of Domiciliaries, Statutory Residents, and Nonresidents in the District of Columbia' (2012) 65 Tax Law. 797

level, there are two basic tests, namely, 'domicile' and 'physical presence'. Superficially, Nigeria seems to be closer to the US regime, but they differ because in Nigeria the federal government exclusively retains the substantive jurisdiction while in the US both the federal and states governments concurrently exercise the substantive jurisdiction. However, the South African regime is totally at variance with that of the US.

The Canadian Constitution allocates taxing jurisdiction over income to both the federal and the provincial government.[178] However, in 1940 the Canadian Provincial and the Federal Governments signed the Wartime Tax Agreement under which the provinces temporarily ceded their income tax jurisdiction to the Federal Government in consideration of the annual grant to the state.[179] After the expiration of the agreement in 1946, seven out of the nine provinces signed another agreement extending the previous one.[180] Under the current arrangement, the tenet of the agreements mentioned above is maintained. Thus, with the except of Quebec, the Federal Government exercises substantive income tax jurisdiction and the Canada Revenue Agency centrally administers and enforces income tax. Under the Canadian regime the income tax jurisdiction allocated to both the Federal and Provincial Governments remains in force. However, the Federal Government now exclusively exercises both substantive and enforcement tax jurisdiction pursuant to the agreements. Because of the Quebec deviation from the rest of the provinces, the Canadian regime is similar to that of South Africa because they both have central individual income tax systems, but the Canadian system totally differs from that of Nigeria.

[178] Sections 91 and 92 of the Canadian Constitution Act of 1867

[179] Alarie, B and Bird, RM 'Tax Aspects of Canadian Fiscal Federalism' available at http://papers.ssrn.com/sol3/Data_Integrity_Notice.cfm?abid=1689311 at 107 See La Forest, GV 'The allocation of the taxing power under the Canadian Constitution' (1980) (2nd ed) Canadian Tax Foundation, at p. 42.

[180] Except Ontario and Quebec see Ibid (Alarie) at 108

In Australia, the federal and states governments' tax jurisdiction is unique because the Australian Constitution grants both substantive and enforcement income tax jurisdiction to the provinces.[181] However, as a result of WW II, the federal government enacted the Uniform Income Tax Act of 1936 to finance the war and to streamline the income tax administration during the war period.[182] In 1942, the federal government enacted four Acts whose provisions explicitly removed the provincial taxing jurisdiction over income, and the Australian Tax Office was saddled with the responsibility of enforcing the income tax jurisdiction.[183] On two occasions, the Australian provinces challenged the federal government taking over of the income tax, but the court[184] dismissed their claims and upheld the validity of the Act passed by the Federal government. Therefore, the current position of the law is that both substantive and enforcement income tax jurisdiction lies with the Australian Federal Government. The South African individual income tax regime shares the same feature with the Australian regime.

The South African regime has addressed the complexity inherent in the operation of the residence-based system in a federal or quasi-federal state. The South Africa regime centralizes both the substantive and enforcement tax jurisdiction in respect of individuals that prevents any potential intra-provincial jurisdictional conflict. It is arguable that in the US, which is a federal state, the federal and state governments share both substantive and enforcement income tax jurisdictions for the individual and corporation. However, the US is a federal state with a well-developed political and economic structure compared

[181] Sections 106 and 107 of the Commonwealth of Australia Constitution Act 1900

[182] Stewart, M 'Tax aspects of fiscal federalism in Australia' in G. Bizioli, G and Sacchetto, C (ed) 'Tax Aspects of Fiscal Federalism A Comparative Analysis' (2011) IBFD Publication, Amsterdam 134 at 156

[183]The Income Tax Act 1942; the Income Tax Assessment Act 1942; the States Grants (Income Tax Reimbursement) Act 1942 and the Income Tax (War-time Arrangements) Act 1942 see Ibid at 156

[184]South Australia v. Commonwealth (1942) 65 CLR 373 and Victoria v. Commonwealth (Second Uniform Tax Case) (1957) 99 CLR 575

to Nigeria and South Africa. Nigeria should learn many lessons from South Africa especially the issue of the definitional rules for determining individual tax residence. Furthermore, there is a network of DTAs entered into by both Nigeria and South Africa.[185] However, the above analysis of Nigeria-South Africa DTA reveals that complexity and uncertainty characterise the DTA regime.

On the definitional rule, the South African regime adopts a facts and circumstances test alongside with an objective test. That is the ordinary residence test and where it is not applicable, the physical presence test applies. Conversely, the Nigerian regime is primarily statutory, and there is virtually no judicial guidance on the connotation of the key terms. The difference between the two regimes centres on balancing the inconsistencies inherent in the fact and circumstances test and the complexities associated with the objective criterion. The mixture of the two tests by the South African regime exposes the system to the issue of the inconsistency and complexity[186] whereas, the objective test adopted by Nigeria renders the regime a complex one.[187] It is submitted that notwithstanding the challenges of being inconsistent and complex, the South African regime is more comprehensive and better than the Nigerian regime because the Nigerian regime applies a different objective test that is not clearly

[185] As shown in Appendix A and B.

[186] The South African regime on the definition of individual residence is unstable. This could evident from the series of amendments made to the initial provisions. From 2001 when the Nigeria – South Africa DTA was signed to date the definition of individual residence underwent amendment for almost six times. (amended by Section 2 *(h)* of Act 59 of 2000 Revenue Laws Amendment Act 59 of 2000; Section 6 (1) *(p)* of the Revenue Laws Amendment Act No.74 of 2002; Section 33 (1) of the Exchange Control Amnesty and Amendment of Taxation Laws Act No. 12 of 2003 and Section 12 (1) (i), (j), *(k)* of the Revenue Laws Amendment Act No. 45 of 2003; section 3 (1) (j) of the Revenue Laws Second Amendment Act No. 32 of 2005 up to section 2 (1) (w) and (x) of the Taxation Laws Amendment Act No. 22 of 2012) The question is how can the DTA withstand this amendments in the light of the usual obligation imposed by the DTA that each party must ascertain the residence status of a taxpayer under the domestic laws of the other?

[187] Because even the UK which in 2013 introduced a sole 'Statutory Residence Test' under the UK Finance Act 2013 is now facing criticism and challenges on the ground of the complex nature of the regime.

based on the days spent by the individual in the state.[188] However, it is based on a 'place of residence' or a 'principal place of residence' defined in a more complex manner. The 183 – day rule mentioned in the PITA is not of general application.

6.5 Conclusion

In the light of the above, the Nigerian individual tax residence regime differs from all the three federal jurisdictions highlighted above. In Nigeria, the federal government has the exclusive substantive income tax jurisdiction and shares enforcement jurisdiction with the state governments. Thus, Nigeria operates a regime that is entirely different from the rest of the world. This is evident from the connecting factors use in determining individual residence at the states level; the 'place of residence' and the 'principal place of residence.' Therefore, the Nigerian regime is very complex and inconsistent. It fails the basic criteria of a good tax system; equity, efficiency and simplicity. The South African regime, on the other hand, is more in tune with international best practice as it reflects the norm for determining individual residence. Therefore, Nigeria should learn many lessons from South Africa about the design and administration of the individual residence-based tax system.

The above critique on the bilateral treaty regime existing between Nigeria and South Africa shows that the complexities and inconsistencies inherent in the Nigeria regime cannot resolve any potential dual tax residence conflict between Nigeria and South Africa. Thus, a comparative analysis is the panacea for the double taxation situations. A comparative analysis as a means of achieving cooperation among the states could allow the states to amend their definitional

[188] Which is the global norm for any objective test.

rules of tax residence to ensure that they are as effective as those obtainable in the other state.

CHAPTER SEVEN

A COMPARATIVE ANALYSIS OF THE NIGERIAN AND SOUTH AFRICAN REGIMES ON THE CORPORATE TAX RESIDENCE

7.0 Introduction

The allocation of the taxing power is premised on the relevant connecting factor between the taxing state and the potential taxpayer. The concept of residence is one of the key factors that link a state with the taxpayer. This chapter focuses on the establishment of corporate residence in Nigeria and South Africa. The determination of corporate residence is pivotal in asserting taxing rights over a corporation by the state under both their domestic law and tax treaty. Thus, the states primarily formulate the definitional rule of tax residence through their respective national legislation. And where there are jurisdictional conflicts, the states derive their respective taxing right through a bilateral tax agreement entered into with one another.

The interface of state tax sovereignty and economic globalisation questions the effectiveness of the bilateral treaty regime in resolving the tax jurisdictional conflict, particularly on the definition of tax residence. Globalisation brings the States closer to each other to the extent that the tenet of bilateral treaties could solve the potential jurisdictional conflicts. The concept of tax sovereignty, on the other hand, hinders any move for switching to multilateral treaty regime. Despite these obstacles, the states need to co-operate with each other. This chapter makes a case for a comparative analysis of the rules adopted by the states in defining the concept of residence as a jurisdictional link. It provides an in-depth analysis of the definitional rule of corporate fiscal residence in Nigeria and South Africa. By this method, the states preserve their tax sovereignty and at the same time achieve cooperation by way of understanding their respective definitional rules.

7.1 Residence-Based Taxation of Corporations in Nigeria

Corporate tax in Nigeria applies to all duly registered corporations.[1] There is various legislation that imposes different types of tax on the corporate income.[2] However, the determination of corporate residence in Nigeria is governed by two separate items of legislation. That is the Companies Income Tax Act[3] (CITA) and the Petroleum Profit Tax Act[4] (PPTA). All registered companies that engage in all kind of businesses apart from upstream petroleum operations are taxable under the CITA. While the PPTA imposed a tax on all companies that engage in the upstream petroleum business. Thus, under the Nigerian regime, the nature of the corporate business activities determines the law applicable for purposes of the corporate taxation. The duality of the legal regime is premised on the distinction between the downstream and upstream sector of the petroleum industry.[5]

[1] The duly registered companies here referred to those companies incorporated under part A of the Companies and Allied Matters Act Chapter C20 Laws of the Federation of Nigeria (LFN) 2004 (CAMA). Because the operating words in section 9 (1) of Companies Income Tax Act 2007 (as amended) are *"trade or business"* which suggest that the tax is imposed from the corporate income derived from trade or business. The Supreme Court in Arbisco v. FBIR (1966) NCLR 401 at 410 held that the determination of 'trade or business' is a question of fact not law. Furthermore, by section 23 (1) (a –d) of the Companies Income Tax Act all other corporate bodies, such as 'Registered Trustees' of certain organisations whose object is to engage in non-profit venture are being established under part C of the CAMA are exempted from tax. Also section 23 (2) and (3) exempted corporation that promotes sport activities and a company limited by guarantee respectively. Therefore, the Nigerian corporate tax regime is only applicable to companies. All other entities and body of persons are subsumed under the individual tax regime.

[2] The Companies Income Tax Act Chapter C21 LFN 2004, Petroleum Profit Tax Act Cap P8 LFN 2004 and Tertiary Education Trust Fund Act 2011 (By section 60 of the Petroleum Profit Tax, whenever a company paid tax under the Act, the profit of that company is not liable to again under PITA or CITA. But this provision is not applicable to the tax impose by the Tertiary Education Trust Fund Act see section 1 (4) of the Tertiary Education Trust Fund Act)

[3] Chapter C21 Laws of the Federation of Nigeria 2004

[4] Chapter P8 Laws of the Federation of Nigeria 2004

[5] The CITA imposes tax on the income of all corporations except those carrying on upstream petroleum business. This includes businesses in the downstream sector of the petroleum industry. The PPTA, on the other hand, taxes the income of the corporations operate in the upstream sector of the petroleum industry. Section 2 of the PPTA defines upstream petroleum operation to include survey, exploration, drilling, production and transportation of the crude oil to the loading platforms as well as other operations connected with the upstream operation. See the case of Shell Petroleum Development Company (Nig.) Ltd v. FBIR (1996) 8 N.W.L.R (Pt. 466) 256 and the case of Gulf Oil Company (Nig.) Ltd V. FBIR (1997) NWLR (Pt. 514) at 12 The businesses in the downstream sector include;

The two regimes impose tax on companies that fall within their respective coverage. It follows, therefore, that notion of corporate residence under these regimes may vary. The separate legal regime may not be unconnected with the fact that the upstream petroleum sector is the hub of the Nigerian economy.[6] That could be the reason for a tax regime different from the one applicable to other areas of the economy. Therefore, analysis of the corporate residence under the Nigerian regime needs to be carried out through the lens of the dichotomy mentioned above.

7.1.1 Corporations Carrying on Business other than upstream Petroleum

As stated above, the taxation of all companies under this category is primarily governed by the Companies Income Tax Act.[7] The Act provides that:

> "Subject to the provisions of this Act, the tax shall, for each year of assessment, be payable at the rate specified in subsection (1) of section 40 of this Act upon the profits of *company accruing in, derived from, brought into, or received in Nigeria* in respect of - (a) any trade or business for whatever period of time such trade or business may have been carried on;…"[8] (emphasis added)

And

> "(1) *The profits of a Nigerian company shall be deemed to accrue in Nigeria wherever they have arisen and whether or not they have been brought into or received in Nigeria* (2) The profits of a company other than Nigeria company from any trade or business shall be deemed to be derived from Nigeria (a) if that company has a fixed base in Nigeria to

1) transportation of the crude from the loading platforms to other countries or to the oil refinery; 2) refining of the crude oil; 3) refined oil distribution and marketing; 4) servicing the upstream operations; and 5) gas utilization. See David-West, JO 'Oil, gas and Minerals taxation' a paper presented at the Special Training Programme of the Chartered Institute of Taxation of Nigeria on 22/5/2013

[6] Lawal, KT 'Taxation of Petroleum Profit under the Nigeria's Petroleum Profit Tax Act (2013) 4 (2) Int'l Journal of Advanced Legal Studies and Governance 1 at 2; Nlerum, FE 'Reflections on the attitude of the courts to tax incentive mechanism in Nigeria' (2012) NIALS Journal of Business Law 111

[7] Cap C21 LFN 2004

[8] Section 9 (1) of Companies Income Tax Act 2007 (as amended)

> the extent that the profit is attributable to the fixed base …"[9] (emphasis added)

The combined effect of the above provisions establishes the Nigerian residence-based tax regime for corporations applicable to the companies that engage in businesses other than upstream petroleum operation. The provisions of section 9 (1) envisage that all a company's profits accrued in, derived from, brought into, or received in Nigeria are taxable. That is to say; it imposes a corporate tax on both active and passive incomes of all companies that in one way or the other connected to Nigeria. Having imposed corporate tax, section 13 (1) delimits the scope and extent of the tax imposed. In defining the scope of the tax jurisdiction, the section uses the terms 'a company,' 'a Nigerian Company' and 'a company other than Nigerian Company.' Thus, the section makes a Nigerian company taxable on its Nigerian-sourced income, and foreign-sourced income brought into Nigeria.[10] The non-Nigerian company is liable to tax on the profit attributable to the business or trade carried on in Nigeria.

The above provisions set out the Nigerian notion of the residence-based taxation of corporate income whereby all Nigerian companies are taxable on their global income whether or not accrued, derived or brought to Nigeria. Therefore, in ascribing tax liability, it is crucial to determine the residence of a company for income tax purposes. The Nigerian regime uses the terms 'Nigerian company' and 'foreign company' to describe the subjects of the corporate taxation. Thus, it does not use the usual terms; 'resident' and 'non-resident' companies. However, for the purpose of this analysis, it is assumed that 'Nigerian company' means resident company and 'foreign company' means non-resident company. A Nigerian company is subject to worldwide taxation while a foreign company

[9] Section 13 (1) CITA
[10] Arogundade JA 'Nigerian Income Tax & Its International Dimension' (2005) Spectrum Books, Ibadan at 31

is taxable on income derived from Nigeria. The main question is what constitutes the residence of a Nigerian company for tax purposes? Therefore, in answering that question the CITA provides that:

> "The incorporation number of a company to which the provisions of section 8 apply, shall serve as the identification number of the company and shall be displayed by the company on all business transactions with other companies and individuals and on every document, statement, returns, audited account and correspondence with Revenue Authorities, including the Board of Customs and Excise, Ministries and all Government agencies."[11]

The adoption of the incorporation number as the income tax identification number suggests that the Nigerian regime has adopted 'the place of incorporation test' as the sole determinant. Therefore, any company that fails the test is a foreign company.

7.1.1.1 Place of Incorporation

The Nigerian corporate tax regime adopts 'incorporation test' as the sole test for the determination of the tax residence of companies that engage in businesses other than the upstream sector of the petroleum industry. The application of the incorporation test is premised on the framework set up by the corporate law of the state. Therefore, in analysing the incorporation test for determining the corporate residence, there is a need to highlight the import of the Nigeria corporate law. The principal corporate law in Nigeria is the Companies and Allied Matters Act (CAMA).[12] The CAMA set the framework for the participation of foreign companies in Nigerian economy by stating that:

[11] Section 10 CITA
[12] Cap C20 LFN 2004,

> "Subject to provisions of any enactment regulating the right and capacity of alien to undertake or participate in trade or business, an alien or a foreign company may join in forming a company."[13]

However, section 54 of the CAMA provides:

> "Subject to Sections 56 - 59 of this Act, every foreign company which, before or after the commencement of this Act, was incorporated outside Nigeria, and having the intention of carrying on business in Nigeria shall take all steps necessary to obtain incorporation as a separate entity in Nigeria for that purpose, but until so incorporated the foreign company shall not carry on business in Nigeria or exercise any of the powers of a registered company and shall not have a place of business or an address for service of documents or processes in Nigeria for any purpose other than the receipt of notices and other documents as matters preliminary to incorporation under this Act."[14]

The above section makes it mandatory for any foreign company that intends to carry on business[15] in Nigeria to first be incorporated under Nigerian law before it commences business.[16] Moreover, whenever a foreign company starts a business without being incorporated in Nigeria, all transactions entered into are void.[17] A foreign company that has not been incorporated can only sue and be sued in its name for any business conducted outside Nigeria, but it cannot carry on any business.[18] In addition to that provision, the incorporation requirement for a foreign company seeking to run business in Nigeria has been echoed by the Nigerian Investment Promotion Commission Act which provides:

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[13] Section 20 (4) of the Companies and Allied Matters Act Cap C20 Laws of the Federation of Nigeria 2004

[14] Section 54 of the CAMA

[15] 'To carry on business' has been held In E.I.I.A v. C.I.E Ltd (2006) 4 NWLR (PT 969)114 at 125-126 to mean to conduct, prosecute or continue a particular business continuously. It also means to hold oneself out to others as engaged in the selling of goods or services.

[16] Section 54 (1) of the CAMA see also Unipetrol Nigeria Plc v. Agip Nigeria Plc (2002) 14 NWLR (PT. 787) 312 at 330-331.

[17] Shall be liable to fine under section 55 of CAMA. See Section 54 (2) CAMA. See also E.I.I.A v. CIE (2006) 4 NWLR (PT 969) 114 at 125-127

[18] Section 60 (b) of the CAMA see the case of Ritz & Co. KG v. Techno Ltd (1999) 4 NWLR (Pt 598) 298 at 300; Watanmal (Singapore) v. Liz Olofin & Co (1998)1 NWLR (PT 533) 311 AT 319, (To deny a foreign company the right to sue to recover, its money simply because it is not incorporated in Nigeria could turn Nigerian companies and individual doing business with foreign companies abroad into potential fraud syndicate.)

> "Except as provided in Section 18 of this Act any Nigerian or any non-Nigerian may invest and participate in the operation of any enterprise in Nigeria. The provisions of this Act shall not apply to enterprises on the "negative list" as defined in Section 33 of this Act. Subject to this Act, a person who intends to establish an enterprise to which this Act applies shall do so by the Provisions of the Companies and Allied Matters Act, 1990."[19]

Given the above provisions, the Nigerian corporate and investment laws do not allow a foreign company to conduct business freely in Nigeria.

Moreover, a foreign company not registered in Nigeria may legally do business in Nigeria through a company registered in Nigeria. In the case of FBIR v. Halliburton (WA) Ltd,[20] the respondent was a foreign company that did not satisfy the requirement of section 54 CAMA but derived income from Nigeria through its Nigerian affiliate company. The court addressed the meaning of "carry on business" within the context of section 54 CAMA. Thus, the crucial issue was whether the provision of equipment and technical staff to handle the equipment from overseas by the respondent to its Nigerian affiliate, amounts carrying on business in Nigeria as defined by section 54 of CAMA? The court held that the respondent was a contractor who was not registered in Nigeria. Also, the respondent's activities were a mere sourcing of contract in Nigeria, but it did not carry on business in Nigeria in the context of section 54 CAMA.[21] In the light of this decision, a company that is not registered in Nigeria can still be liable to tax once it derived its income through an affiliate registered in Nigeria.

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[19] Sections 17 – 19 of the Nigerian Investment Promotion Commission Act Cap N117 Laws of the Federation of Nigeria 2004

[20] (2014) LPELR-24230(CA) 1 at 16 - 18

[21] The court cited the cases of *Edicomsa International Inc. and Associates v. Citec International Estates Ltd. (2006) 4 NWLR (pt. 969) 114 at 125 136; Olorunfemi v. Asho (1999) 1 NWLR (pt.585) 1 at 9 and the case of Chukwueke v. Okoronkwo (1999) 1 NWLR (pt.587) 410 at 418*. As corollary to this Where, however, a non-Nigerian company is not resident in Nigeria, the fact that a non-resident foreign company is a beneficial owner of share capital of a Nigerian company does not make such non-Nigerian company subject to Nigerian tax. See the Supreme Court decision in *Aluminum Industries v. Federal Inland Revenue Board (1971) 7 NSCC 6 at 10.*

The Companies Income Tax Act, on the other hand, makes the following provisions:

> "*"company"* means any company or corporation (other than a corporation sole) established by or under any law in force in Nigeria or elsewhere*; "foreign company"* means any company or corporation (other than a corporation sole) established by or under any law in force in any territory or country outside Nigeria; *"Nigeria company"* means any company incorporated under the Companies and Allied Matters Act or any enactment replaced by that Act;"[22]

The above provision envisages the existence of foreign companies alongside Nigerian companies.[23] To show its recognition of the foreign companies, the Act imposes a residence-based tax on the Nigerian companies and sourced from the foreign companies.[24] Therefore, there is a serious conflict between the provisions of CAMA and that of CITA. Under the Nigerian legal system, the two items of legislation are concurrent in status, because they are both Acts of the National Assembly. The CITA imposes a tax on the company while the CAMA regulates the formation and management of the company. It follows that the provisions of CITA apply to the companies registered under the provisions of the CAMA. Therefore, the crux of the conflict between the two laws is that the CAMA forbids unregistered foreign companies from carrying on any business in Nigeria. The CITA, on the other hand, allows such type of

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[22] Section 105 of the CITA 2007 (as amended). Equally, the recognition of the foreign companies has been re-echoed by section 30 (1) (b) of the CITA (while empowering the Federal Inland Revenue Service to assess the turnover of a company instead of profit in certain situations.): " Notwithstanding section 40 of this Act, where in respect of any trade or business carried on in Nigeria by any company (whether or not part of the operations of the business are carried on outside Nigeria) … (b) if that company is a company other than a Nigerian company …"

[23] Section 105 and 13 (2) of the CITA see also section 2 and 18 of the Petroleum Profit Tax Act

[24] John, D C 'Corporate taxation laws in Nigeria: a review' (2011) 2 (1) Int'l Journal of Advanced Legal Studies and Governance, 236 at 238; Gwangdi, MI and Garba, A 'Administration of Companies Income Tax in Nigeria: Issues of compliance and enforcement' (2015) 7 (8) European Journal of Business and Management 18 at 21.

companies to operate and generate taxable income. The question is which of these legislation takes precedence over another?

Furthermore, it could be argued that the provisions of section 54 are only applicable where the foreign company seeks to earn an active income. By the combined effects of sections 20 and 80 of the CITA, all passive income (such as dividends, interest, royalty and rent) earned by a non-resident company are taxable by way of withholding tax.[25] That is to say, a foreign company can earn this type of income without the need of complying with the provision of section 54 of the CAMA. However, the provision of Section 54 is very clear and unambiguous in prohibiting all kind of business by a foreign company before its registration.

The test operates on the framework set up by the corporate law. The Nigerian corporate law regime does not recognise a foreign company thereby rendering the tenor of the test nugatory. Therefore, the 'incorporation test' adopted for the determination of the corporate residence in Nigeria is a flaw.

7.1.2. Corporations carrying on upstream Petroleum Business

One of the unique features of the Nigerian corporate tax system is the duality of the legal regime. All companies that engage in upstream petroleum operations are treated differently from all other companies. Thus, they are subject to different tax at a different rate. The rationale behind this separation is still questionable. Both the companies running upstream oil business and other companies followed the same process to acquire their respective legal status. Therefore, they are all companies within the context of the CAMA. It is the type of the business carried out by the companies that makes them differ from each

[25] See the case of Oando Plc vs FIRS (2014) 16 TLRN 99.

other.[26] The CAMA allows companies to have more than one object in their Memorandum of Association that is closely related. So it is possible for a company to have two objects; one for dealing in upstream and the other for downstream. In this situation, under which of the Acts (CITA or PPTA) the company pays its tax? Alternatively, is it liable to tax under both Acts? If yes, then the company is exposed to double tax on its income.

Be that as it may, under the current regime the Petroleum Profits Tax Act (PPTA) imposes and regulates the taxation of the profits of the companies that operates in the upstream sector of the petroleum industry. The Act provides:

> "There shall be levied upon the profit of each accounting period of any company engage in petroleum operation during that period, a tax to be charged, assessed and payable in accordance with the provision of this Act."[27]

The above provision imposes a tax on the profit of the companies in petroleum operation. The section does not make reference to the source of the profit. That is whether the profit derived from Nigerian-source only or from both Nigerian and foreign-source. Failure to make that reference questions the true nature of this regime. However, from the content of the section the principal subject of the tax is a company and that brings the question as to what constitute a company for the purposes of the Act? The Act has two different definitions of company as follows:

> "Company" means any body corporate incorporated under any law in force in Nigeria or elsewhere."[28]

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[26] Section 27 (1) (c) of the CAMA Cap C20 LFN 2004

[27] Section 8 of the Petroleum Profit Tax Act Cap P8 LFN 2004.

[28] Ibid at Section 2. See also section 18 (3) of the same Act "In this section "foreign company" means a company incorporated outside Nigeria before 18 November 1968; and having on that date an established business in Nigeria."

> "resident in Nigeria" about a company means a company the management and control of the business of which are exercised in Nigeria."[29]

Superficially, the provisions have adopted two basic tests for the determination of the corporate residence that is the 'incorporation test' and the 'CMC test'. Now let us examine the nature and extent of these tests.

7.1.2.1 Place of Incorporation

As discussed above, the application of the incorporation test is premised on the enabling environment provided by the corporate law. The companies covered by the PPTA are not in any way different from the other types of companies. Thus, they are all regulated by the CAMA. Any attempt to analyse the incorporation test under this heading will amount to a repetition.

7.1.2.2 Centre of Management and Control

By their combined effect the above-cited sections 2 and 17 (3) make any company operating in the upstream sector whose central management and control takes place in Nigeria liable to tax under the PPTA. The provision suggests that the CMC test could be used to determine the residence status of the companies that falls under the Act. However, the Act did not elaborate on the relationship between the CMC test and the incorporation test. That is to say at what stage does the CMC test become applicable? Does it serve as an alternative test to the incorporation test? In the absence of that clarification, mentioning the CMC as a test for companies' residence is misleading.

[29] Section 2 PPTA See also section 17 (3) of the same Act "In this section - Nigerian company means any company the control and management of whose activities are exercised in Nigeria…"

As a corollary, the Act neither defines the concept of CMC nor gives guidance on how to determine it.[30] It follows therefore that even if the Revenue Authority or the companies seeks to invoke the concept of CMC, reliance must be placed on the English courts' decisions on the concept.[31] Therefore, the rule in De Beers and other subsequent decisions that followed and expatiated its principles[32] will apply in Nigeria as guidance on the determination of the CMC of a company for purposes of tax under the PPTA.

The Act did not define the concept of CMC. However, even if it did, the idea of adopting the CMC test in determining the corporate residence of the companies has been rendered nugatory by other provisions of the Petroleum Profits Tax Act. The Act provides that:

> "(1) A company not resident in Nigeria which is or has been in petroleum operations (hereinafter in this section referred to as a "non-resident company") shall be assessable and chargeable to tax either directly or in the name of its manager, or in the name of any other person who is resident in Nigeria, employed in the management of the petroleum operation carried on by such non-resident company, as such non-resident company would be assessed and charged if it were resident in Nigeria; (2) The person in whose name a non-resident company is assessable and chargeable to tax shall be answerable – (a) for all matters required to be done by virtue of this Act for the assessment of the tax as might be required to be done by such non-resident company if it were in Nigeria; (b) for paying any tax assessed and charged in the name of such person by virtue of subsection (1) of this section. The manager or any principal officer in Nigeria of every company which is or has been engaged in petroleum operations shall be answerable for doing all such acts as are

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[30] As at 20th August, 2015 there is no any judicial decision that dealt with the concept of CMC in relation to the companies within the ambit of the PPTA.

[31] Under the Nigerian legal system, all courts are enjoined to follow the line of reasoning of the UK's court and the UK decisions are recognized as part of the persuasive judicial precedence. See Section 10 of the High Court Law of Lagos State which is pari material with all other states High Court laws provides: "The High Court shall in addition to any other jurisdiction conferred by the Constitution of the Federation or by thus or other enactment possess and exercise, within the limits mentioned in, and subject to the provisions of, the Constitution of the Federation and this enactment, all the jurisdiction, powers and authority which are vested in or capable of being exercised by the High Court of Justice of England."

[32] Which were discussed in detail in chapter four of this thesis

> required to be done by virtue of this Act for the assessment and charge to tax of such company and for payment of such tax"[33]

The above provision suggests that the corporate tax liability of the companies that fall under the PPTA has been indirectly shifted to the employees of the companies. In other words, it is the residence of the employee of the companies that is crucial in determining the companies' tax liability. That is to say, both the resident and non-resident oil company could become liable to tax either directly or through their managers and other principal officers. The above provision did not only compound the problem of corporate residence but has also altered the notion of corporate tax as a whole. It raised a question as to whether the Nigerian regime imposes a corporate tax on the companies engages in the upstream sector of the petroleum industry. It should be noted that the CITA contained a similar provision about companies other those operating in the upstream sector. Even though the section is not as detailed as the above sections:

> "The principal officer or manager in Nigeria of every company shall be answerable for doing all such acts, matters and things as are required to be done by virtue of this Act for the assessment of the company and payment of the tax."[34]

In the light of the above, it is clear that Nigerian corporate tax regime is very complex and inconsistent.[35] It follows, therefore, that the issue of corporate tax residence must be flawed as well. Hence the need for serious reform of the system, to bring it in tandem with the international best practice.

[33] Section 25 and 26 of the Petroleum Profit Tax Act

[34] Section 48 of the CITA Cap C21 LFN 2004

[35] Notwithstanding the recent tax reform efforts embark upon by Nigerian government. For discussion on the current tax reform in Nigeria see Sanni, A 'Nigeria Recent Developments in Company Income Taxation in Nigeria' (2010) 65 (1) Bulletin for International Taxation 1; Sanni, A 'Problems of Determining the Applicable Tax Laws in Nigeria: Resolving the Dilemma for FIRS and Taxpayers' (2012) 56 (1) Journal of African Law 55-67.

7.3 Residence-Based Taxation of Corporations under South African Regime

The South African regime discussed in chapter five dealt with the taxation of natural persons. All entities other than natural persons are subsumed into the corporate taxation regime.[36] As mentioned earlier, at the introduction of the income tax system, the South African regime imposes a corporate income tax on the basis of the source of the taxable income. Thus, corporations were liable to pay tax on all the income they derived or deemed to have been derived from South Africa. While describing the nature of the former South African regime, Williams stated that:

> "…the tax liability of a company did not hinge on whether it was resident in the Republic, but on whether or not it was a 'domestic company' as opposed to an 'external company.' The Act defined a 'domestic company' as a South African company or a company that is managed and controlled in the Republic…"[37]

In the year 2000, South Africa switched from the source-based to the residence-based system by removing the word 'person' and replacing it with 'resident' in the definition of gross income. The word 'person' suggested that the focus was on the source of the income rather than the income earner because a person could be a South African resident or non-resident. By this amendment, the determination of who is a South African resident for tax purposes is crucial in determining the tax liability. As to corporations, the Act defined resident as:

> "'resident' means any- …(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include— (A) any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the Governments of the Republic and that other country for the

[36] For the purposes of this chapter reference to corporation or corporate include trust and other entities other than natural persons.

[37] Williams, RC (2006) at 38-39. See sections 4 (1) (f) of Income Tax Act No. 85 of 1974

avoidance of double taxation; or (B) any company if— (AA) that company is incorporated, established or formed in a country other than the Republic; (BB) that company has its place of effective management in the Republic; (CC) that company would, but for the company having its place of effective management in the Republic, be a controlled foreign company with a foreign business establishment as defined in section 9D(1); and (DD) the aggregate amount of tax payable to all spheres of government of any country other than the Republic by that company in respect of any foreign tax year of that company is at least 75 percent of the amount of normal tax that would have been payable in respect of any taxable income of that company had that company, but for this subitem (B), been a resident for that foreign tax year: Provided that the aggregate amount of tax so payable must be determined— (i) after taking into account any applicable agreement for the prevention of double taxation and any credit, rebate or other right of recovery of tax from any sphere of government of any country other than the Republic; and (ii) after disregarding any loss in respect of a year other than that foreign tax year or from a company other than that company: … Provided further that in determining whether a person that is a foreign investment entity has its place of effective management in the Republic, no regard must be had to any activity that— (a) constitutes— (i) a financial service as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002); or (ii) any service that is incidental to a financial service contemplated in subparagraph (i) where the incidental service is in respect of a financial product that is exempted from the provisions of that Act, as contemplated by section 1(2) of that Act; and (b) is carried on by a financial service provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), in terms of a licence issued to that financial service provider under section 8 of that Act''[38]

[38] Section 1 of the Income Tax Act No. 58 of 1962 (as variously amended by Section 2 *(h)* of the Revenue Laws Amendment Act 59 of 2000; Section 6 (1) *(p)* of the Revenue Laws Amendment Act No.74 of 2002; Section 33 (1) of the Exchange Control Amnesty and Amendment of Taxation Laws Act No. 12 of 2003 and Section 12 (1) (i), (j), *(k)* of the Revenue Laws Amendment Act No. 45 of 2003 up to section 2 (1) (w), (x) and (y) of the Taxation Laws Amendment Act No. 22 of 2012) see also Koker, A and Williams, RC 'Silke on South African Income Tax' (2010) LexisNexis; Koker, A et al 'Silke Tax Yearbook 2012 – 2013' (2013) LexisNexis, Durban at D37 – D39

Apart from the exceptions, the above provision contained two basic tests for the determination of corporate residence. That is the ‘place of incorporation’ and ‘place of effective management’ tests. The former is the primary test, because once it is satisfied by a corporation, the latter test will not be considered at all. In other words, the latter test is only applicable where the former failed to bring the corporation into the tax net. Therefore, even if a company or any recognised entity is not incorporated, established or formed in South Africa, it could be a resident if it is managed effectively in South Africa.

7.3.1 Place of Incorporation

The above-quoted provision mentioned three key terms that are relevant to this test: ‘incorporated’, ‘established’ or ‘formed’. These terms represent the various modes of giving legal recognition to some entities under the corporate law. The application of this test is premised on the framework provided by corporate law for the incorporation, establishment, and formation of all persons other than a natural person. The term ‘incorporated’ refers to duly registered companies and close corporations[39] while the terms ‘established’ and ‘formed’ apply to trusts and other entities that are not legal persons.[40] Therefore, once it is proved that a particular entity was incorporated, established or formed in South Africa, then such entity is a resident for tax purposes[41] and it will “permanently remain a resident even if it severs all links with the Republic”.[42]

The fact that the South African ‘incorporation test’ is being operated alongside with the POEM test suggests that foreign entities are allowed to carry out business without being incorporated in the Republic. Thus, the regime allows

[39] Williams, RC (2006) at 37

[40] DU Plessis, I ‘The residence of a trust for South African income tax purposes’ (2009) 21 SA Merc. L. J 322 at 329.

[41] Subject to the exceptions mentioned in section 1 of the Income Tax Act.

[42] Williams, RC (2006) at 37. See also Olivier, L ‘Residence based taxation (2001) J. S. Afr. L. 20 at 25.

the test to operate smoothly without running into conflict with the corporate law as in Nigerian case.

7.3.2 Place of Effective Management

Where a company or other entity is not incorporated, established or formed in South Africa, it could still be a resident, as defined, if it is effectively managed in the Republic. As discussed in chapter 5.3.2.2.2 of this thesis, the concept of POEM was originally designed to serve as a tie-breaker provision in the DTA for resolving dual residence conflicts.[43] However, some jurisdictions adopted a similar concept[44] as a connecting factor in determining the tax residence of corporations. Thus, the concept currently played two significant roles in the determination of tax liability of corporations; as a jurisdictional link and as a tiebreaker rule.[45] By the above-quoted provision, the Republic of South Africa joins the league of the jurisdictions that adopt POEM as a connecting factor.[46]

Despite the adoption of the concept of POEM as a jurisdictional link, the South African Income Tax Act did not define the concept. Thus, it has no meaning under the domestic law. However, immediately after the adoption of the residence-based system, the South African Revenue Service issued Interpretation Note No. 6 of 2002.[47] The Note defined the POEM as the place

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[43] Cockfield, AJ 'International Tax Competition: The Last Battleground of Globalization'(2011) 63 (12) Tax Notes International 867 at 868.

[44] Even though only India and South Africa adopted the OECD notion of POEM. However, most of the civil law Jurisdictions adopted the concept of 'place of management' as jurisdictional link between the state and the corporate taxpayer. See Broe, LD 'Corporate Tax Residence in Civil Law Jurisdiction' in Maisto, G (ed) 'Residence of companies under tax treaties and EC law' (2009) IBFD Publication 95 at 96.

[45] For discussion on the two roles see Merwe, BA 'Residence of a company - the meaning of "effective management" (2002) 14 SA Mercantile Law Journal at 91 Oguttu, AW 'Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective' (2008) 41 Comp. & Int'l L.J. S. Afr. 80 at 84-86.

[46] Other jurisdictions adopted the concept of 'place of management', but South Africa adopted the POEM as it is in the OECD Model convention. Almost all other jurisdictions use the term POEM as a tiebreaker rule not as a connecting factor. See chapter 5.3.2.2.2 of this thesis

[47] As updated by Interpretation Note 6 (issue 2) of 3/11/2016

where the regular day-to-day management by the senior managers of the corporation takes place. Thus, if the day-to-day management occurs in one particular place, then that particular is the POEM. Conversely, if the day-to-day management is exercised at different locations or via video-conferencing, the POEM would be the location where the senior managers carried out the day-to-day operational management and business decisions. However, if the daily business operations take place in different locations, then the POEM would be the place where the corporation has the strongest economic connection.

The Note entirely disregarded the place where the main control of the company or trust is carried out or where the board of directors meets. Thus, based on the provision of Note No. 6, the South African notion of POEM focuses on the location where the lower level management team discharges its duties. That is where the day-to-day policies of the corporation are implemented actually. However, the analysis of the various notions of the CMC and POEM in chapter four revealed that the international trend leans towards the place where the board of directors or top management team meet.

Given the above position of the SARS and the non-binding nature of the Interpretation Notes, there was a need to have a judicial pronouncement on the issue. As at August 2015, there is only one South African court decision that gave guidance on the connotation of the concept of POEM. That is the case of Oceanic Trust Co Ltd v Commissioner of South African Revenue Service.[48] The case involved, among other things, a question of residency of a trust. On this issue Louw J stated that:

> "In my view, for this court to declare that SISM was not a resident of the Republic, will require this court to inquire into the facts and to make factual findings, inter alia on the question where, in South Africa or Mauritius, SISM's key management and commercial decisions that are

[48] (2012)JOL 28880 (WCC)

> necessary for the conduct of SISM's business were in substance made during the years in question… even if the facts are sufficiently clear to make a decision the place where key management and commercial decisions that were necessary for the conduct of SISM's business, were in substance made, has, in my view not been established to be outside South Africa. It would appear to me that at least some key management decisions and at the very least, key commercial decisions necessary for the conduct of SISM's business were in substance made in South Africa. Therefore, applying the Smallwood test, the facts to the extent that they have been established, do not, in my view, establish that the POEM of SISM was in Mauritius, and not in South Africa."[49]

It is submitted that going by the facts and the claim of the parties before the court; the above passage was not the ratio of the judgment. The Court in Oceanic Trust explicitly stated that the determination of the POEM is a question of fact, and the law precludes it to decide. That shows that the court did not digest the required facts to arrive at any decision. Assuming it was the ratio, the decision was purely based on the English case of HMRC v Smallwood and another[50] that dealt with the issue of the POEM of a trust in terms of the UK – Mauritius DTA.[51] Therefore, the decision viewed the POEM as a tiebreaker, not as a jurisdictional link. There is the need to rethink the value of the Oceanic case in determining the corporate residence in South Africa. However, the court propounded that in determining the residence of a trust (and by extension a company) the focal point should be on where the key management and commercial decisions of the trust are taken.

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[49] In arriving at its decision, the court relied on the English case of HMRC v Smallwood and Anor (2010) EWCA Civ. 778 that dealt with the issue of POEM of a trust in terms of the UK – Mauritius DTA. See also the case of CSARS v Tradehold Limited (2012) (132/11) ZASCA 61. The Tradehold's case dealt with the issue of conflict between the DTA and the Income Tax Act. The Court rely on the content of the DTA and held that Tradehold was resident of South Africa, and refused to apply the POEM test on Tradehold.

[50] (2010) EWCA Civ. 778

[51] It should be noted that this case viewed POEM as where the top management of the corporation is located. The question is why the Oceanic case takes different position?

By way of analogy, in Fundy Settlement v. Canada,[52] the Canadian Supreme Court has extended the De Beers principle to the determination of residence of trusts as well. The court held that the trusts were residents of Canada for tax purposes because it is the beneficiaries who exercised the CMC of the trusts, and they exercised it while residing in Canada.[53] The court did not say that the residence of a trust can never be the residence of the trustees if the trustees (not the beneficiaries) exercised the CMC. The trustees, in this case, relied on the earlier decision[54] where it was held that the tax residence of a trust was where the majority of the trustees reside. The rule, in this case, suggests that the focal point in determining the tax residence of a trust is who, in fact, exercised the CMC of the Trust. Thus, it is a question of fact. That is to say, the place of the Trustees meeting or by extension the board of directors meeting is no longer decisive in determining trust or corporate residence.

The absence of clear statutory or judicial decisions on the POEM led commentators to share their views. However, most of the South African tax expert commented on the concept of POEM as a tiebreaker rule as provided by the OECD Model Convention. This thesis will analyse the concept as a jurisdictional link as adopted by South Africa. Therefore, only the view of the commentators that looked at the POEM as a jurisdictional link will be highlighted. Williams[55] described the CMC as the place where the top level strategic policy decisions of the company are taken and contrasts it with the POEM where the company runs its day-to-day activities. De Koker and Williams argued that:

> "the place from where factually and effectively the day-to-day affairs of the company are managed by its executive directors and management – that is, where strategic decisions for the conduct of the company's

[52] (2012) SCC 14
[53] Kroft, ED et al 'SCC upholds new test for residency of trusts' (2013) 23 Int'l Tax Rev. 76
[54] Thibodean Family v. The Queen, 78 DTC 6376
[55] Williams, RC (2006) at 38

> business are in substance formulated and implemented with a degree of regularity – will be the place of effective management. These decisions must pertain to the company's day-to-day activities in terms of managing the ordinary operations of the business."[56]

The above view is closer to paragraph 24 of the commentary on Article 4 (3) of OECD Model Convention. Thus, the view considered the POEM more as a tiebreaker than a connecting factor. Meyerowitz[57] opines that the POEM is the place where directors meet and take a decision on the company's business. He distinguishes it from the place where the directors or staff managed the company or where it carries on its business. He further argues that where the company has executive directors, the POEM is where the executive directors run the affairs of the company. Van der Merwe[58] tries to differentiate the concept of CMC. He argues that the line of distinction between two lies on the role being played by the POEM as a tiebreaker rule which the CMC does not play.

Therefore, the CMC suggests the place where top level management decisions are taken as opposed to day-to-day management role of the POEM. Davis,[59] on the other hand, opines that the POEM is the place the business is entirely or sufficiently managed, "the place where the shots are called." Olivier[60] makes an interesting analysis of the POEM; she argues that where the directors meet is only a factor but not a determinant for the POEM. She further argues that the determination of the POEM always raised the question as to whether or not the directors take decisions for the corporation, or are mere rubber-stamps of the

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[56] De Koker, AP and Williams, RC 'Silke on South African Income Tax' (2010) LexisNexis Butterworth in par 14.45.

[57] Meyerowitz, D 'Meyerowitz on income tax 2002 – 2003 edition' The Taxpayer at 5.19

[58] Merwe Van der, BA 'Residence of a company – the meaning of 'effective management'' (2002) SA Merc. L.J. 79 at 92. This is line with the view of Olivier. See Olivier, L 'Residence based taxation (2001) J. S. Afr. L. 20 at 25

[59] Davis et al 'Juta's income tax' loose-leaf, at 1 resident – 2A (commentary on the meaning of resident in section 1 of the Income Tax Act, 1962

[60] Olivier, L and Honiball, M 'International tax: A South African perspective' (2008) (4th ed), Siber Ink, Cape Town at 66

shareholders. However, she questioned the efficacy of the POEM in a situation where the directors meet via video conferencing.[61]

It is arguable that the notion of the CMC[62] is not new to South Africa, as it has been in use under the source-based regime. For instance in Rhodesia Railways and Others v. COT[63] corporate residence was one of the issues for determination. The Court relied on the English court decision in De Beer[64] that enunciated the CMC test and adopted the test in determining the question of residence. Therefore, the South African regime had at one time given priority to the place where top management decisions took place as opposed to day-to-day activities. However, the CMC test was not a test for establishing a jurisdictional link between South Africa and the companies involved, but rather as a means to determine the companies' eligibility for certain relief or exemption.

Given the above analysis, it is submitted that due to the lack of clear-cut judicial pronouncement on the connotation of the POEM, the South African POEM test is characterised by inconsistencies and uncertainties. Also, the tax experts need to appreciate the distinction between the POEM as a tiebreaker and as a jurisdictional link. Therefore, it is further submitted that as a connecting factor, the concept of POEM is almost the same as the CMC. The thin line of distinction lies in who takes the decision and where the decision was taken.[65] In many situations, it could be difficult to differentiate the personality and the place.

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[61] Ibid at 67

[62] As Williams described the concept of the CMC as the place where the top strategic management decisions are taken. Williams, RC (2006) at 38

[63] (1925) AD 439. The CMC test was also applied in Boyd v. CIR (1951) 3 SA 525

[64] (1906) AC 455

[65]The Indian notion of POEM provides that once a company's POEM is located in India at any time during the year, then the company become an Indian resident. See Rohit Gupta, CA 'Place of Effective Management (POEM) in India & Corporate Taxation' available at http://taxguru.in/income-tax/place-effective-management-india-corporate-taxation-analysis safeguards.html last access 20/6/2015. This makes easier to understand the distinction between POEM and CMC

7.4 Corporate Residence under Nigeria – South Africa Double Taxation Treaty 2000

As discussed in chapter five above, the tenet of the Nigeria – South Africa DTA covers the tax residence of both the individuals and corporations of the two states. Thus, this heading is not repeating the analysis made in Item 5.4 of chapter five, but rather analysing the portion of the DTA that touches the issue of corporate residence. To resolve dual corporate residence conflict between the state parties, the DTA defined resident as:

> "For the purposes of this Agreement, the term "resident of a Contracting State" means: (a) in Nigeria, any person who, under the laws of Nigeria, is liable to tax therein by reason of his domicile, residence, *place of management*, *place of incorporation* or any other criterion of a similar nature … (b) in South Africa, any individual who is ordinarily resident in South Africa and any person other than an individual who has its *place of effective management* in South Africa."[66]

The above provision has adopted the tests being used for the determination of corporate resident in the two states. In the case of Nigeria, the above provision mentioned the terms 'place of management' and 'place of incorporation.' This suggests that a corporation could be a Nigerian resident on the grounds of being incorporated in Nigeria or its place of management is located in Nigeria. Whereas, in the case of South Africa, only the 'place of effective management' was mentioned.[67] No provision in the DTA covers any potential conflict when a corporation falls within the definition of the two states. Therefore, the DTA does not cover the possible jurisdictional conflict on the corporate residence between Nigeria and South Africa. For instance, the provisions of section 48 of the CITA and 25 and 26 of the PPTA made the managers and other principal of sections employees of both Resident and non-resident companies liable to do all that the companies are required to do including the payment of tax. Thus, the

[66] Article 4 (1) of the Nigeria – South Africa DTA 2009

[67] Even though under the South African regime the 'place of incorporation' is the primary test for corporate residence.

residence of the employees of the companies is more relevant than that of the employers. Therefore, the only solution to any potential conflict between the two trading partners (Nigeria and South Africa) is for them to understand the regime of each other through comparative analysis.

7.5 Lesson for the two Regimes

There are two different items of legislation that govern the Nigerian regime on corporate taxation. Superficially, apart from imposing the tax at different rates, the regimes also envisage a different set of rules for the determination of corporate residence. The CITA explicitly adopts the incorporation test as the sole test for the determination of all companies within its coverage. The PPTA defines Nigerian resident to include corporations that have their CMC in Nigeria. However, analysis of the two regimes reveals that the CMC test mentioned in section 2 of the PPTA has been rendered nugatory by section 25 and 26 of the same Act. Therefore, the 'incorporation test' remains the sole test for corporate residence in Nigeria. Some of the legislation that imposes other type of corporate taxes has also adopted the incorporation as the test determining corporate residence.[68]

[68]See section 1(2) of the Tertiary Education Trust Fund (Establishment, Etc) Act 2011 "The Tax at the rate of 2 percent shall be charged on the assessable profit of *a company registered in Nigeria…*" superficially, it could be argued that Nigeria shared similar regime with the US. However, the US corporate law recognised and allowed foreign companies to operate in the US without necessarily being incorporated in the US. But in order to address the challenges of using 'place of incorporation' as a sole test, the US regime categorised the foreign companies into two; those whose income is effectively connected with the US and others whose income is not effectively connected with the US. In the former case the income are taxable regardless of the source, but in the latter case the companies are taxed at the rate of 30% only. For detail discussion on this see Brauner, Y 'United States' in Maisto, G (ed) Residence of Companies Under Tax Treaties and EC Law (2009) 855 at 865-66; Tillinghast, DR 'A Matter of Definition: Foreign and Domestic Taxpayers' (1984) 2 Int'l Tax & Bus. Law. 239 at 240 Available at: http://scholarship.law.berkeley.edu/bjil/vol2/iss2/1 last access 10/4/2014 However, despite the adoption of the above mechanism, the US regime remains exposed to the dangers inherent in the adoption of 'place of incorporation' as a sole test. That is why some commentators are making case for the adoption of CMC alongside with 'place of incorporation' test. See Avi-Yonah, RS 'Beyond territoriality and deferral: The promise of "Managed and Controlled"' (2011) 63 (9) Tax Notes Int'l 667 at 668. See also New York State Bar Association Tax Section, Report on the Management and Control Provision of the "International Tax Competitiveness Act of

The analysis also reveals that the incorporation test is facing a serious challenge from the Nigerian corporate law regime. The Nigerian corporate law regime does not allow foreign corporations to do business in Nigeria without first being incorporated under Nigerian law. The corporate tax system, on the other hand, envisages and recognizes the participation of unregistered foreign corporations in the Nigeria economy. The conflict between the two regimes questions the utility of the incorporation test for the determination of the corporate residence in Nigeria. It also causes misalignment between the substantive and enforcement jurisdiction.[69] Therefore, the Nigerian regime on corporate tax residence is very defective.

South African corporate tax, on the other hand, is governed by a single regime.[70] The South African regime overcomes the challenges being encountered by the Nigerian 'incorporation test' because South African corporate law has accommodated the test. South African corporate law recognises and allows foreign incorporated companies to operate in the Republic if they are registered in South Africa as an external company. The income tax liability of the company arises when it locates its POEM in South Africa. Thus, there is no conflict between the corporate and tax regimes. Furthermore, notwithstanding the inconsistencies in defining the South African POEM test, it is better than not having the test. Therefore, the South African regime has followed the global trend by adopting a fact and circumstances test to augment the incorporation test.

2011," dated 31st January, 2011 (discussing the issues surrounding changing the definition of corporate residence based on "management and control" and ultimately recommending that it be considered in connection with broad-based international tax reform in the future)

[69] Swain, JA 'Misalignment of Substantive and Enforcement Tax Jurisdiction in a Mobile Economy: Causes and Strategies for Realignment' (2010) 63 (x) National Tax Journal, Fox Special Issue at 112

[70] In South Africa, the income and capital gain taxation of both the individuals as well as all non-natural persons are governed by the Income Tax Act 1962 (as amended). Therefore, all the complexities associated with having dual regimes for corporate tax have been prevented.

Moreover, sections 3 (1) of the PITA and section 13 (1) of the CITA define taxable income for both individual and corporation respectively. The definition provided by those sections explains one of the features of the Nigerian corporate tax regime. Whereas, the former section defined taxable income for individual as the aggregate amount of the income earned by the individual both within and outside Nigeria, the latter section, on the other hand, defines it as the total profits of the company accrued, received or brought into Nigeria. In the light of those provisions, the worldwide taxation imposed on individuals differs from that imposed on corporations. In the case of individuals, it is a complete global taxation, because the aggregate income from all sources is taxable whether or not brought into Nigeria. However, in the case corporations, the global taxation only operates if the Nigerian company brought the foreign-sourced profit into Nigeria. That is to say, the foreign earned profits not brought into Nigeria are not taxable at the corporate level.[71] The provisions of the CITA consistently make reference to the word 'profit' instead of the word 'income', while the PITA uses 'income. The questions arise – is there any difference between 'profit' and 'income' in the Nigerian context? What is the rationale for the distinction?

Furthermore, section 30 of the CITA adds to the confusion mentioned above and complexity that characterizes the Nigerian corporate tax regime. The section provides:

> "(1) Notwithstanding section 40 of this Act, where in respect of any trade or business carried on in Nigeria by any company (whether or not part of the operations of the business are carried on outside Nigeria) it appears to the Board that for any year or assessment, the trade or business produces either no assessable profits or assessable profits which in the opinion of the Board are less than might be expected to arise from that trade or business or, as the case may be, the true amount of the assessable profits of the company cannot be readily ascertained, the Board may, in

[71] Arogundade JA 'Nigerian Income Tax & Its International Dimension' (2005) Spectrum Books, Ibadan at 31

> respect of that trade or business, and notwithstanding any other provisions of this Act if the company is a- (a) Nigerian company, assess and charge that company for that year of assessment on such fair and reasonable percentage of the turnover of the trade or business as the Board may determine; (b) if that company is a company other than a Nigerian company and I) that company has a fixed base of business in Nigeria assess and charge that company for that year of assessment on such a fair and reasonable percentage of that part of the turnover attributable to that fixed base…"[72]

The above provision has been reaffirmed by the Nigerian Supreme Court and the Court of Appeal.[73] The implication of the provision is that a Nigerian resident company could be taxed on a reasonable percentage of its turnover from the business carried out both within and outside Nigeria. On the other hand, once a non-resident company has a fixed based[74] in Nigeria, it becomes liable to tax not only on its profit but on its turnover.[75] The assessment of the

[72] Section 30 (1) (a) and (b) of the CITA 2007 (as amended)

[73] See the cases of Offshore International vs FBIR (2011) 4 TLRN 84 and Shell International v. FBIR (2004) 3 NWLR (Pt 859) 46 JGC Corporation v. FIRS (2014) 15 TLRN 105 and Saipem Contracting Nigeria Ltd v. FIRS (2014) 15 TLRN 76

[74] The concept of fixed based is central in the determination of tax liability of a non-resident company in Nigeria. Section 13 (2) of the CITA provides that "The profits of a company other than a Nigeria company from any trade or business shall be deemed to be derived from Nigeria (a) if that company has a fixed base in Nigeria to the extent that the profit is attributable to the fixed base…" The section did not define "fixed based" but it only stated what are not considered as fixed based. Thus, 13 (3) provides "for the purposes of subsection 2 of this section a fixed base shall not include facilities used solely for the (a) storage or display of goods or merchandise. (b) Facilities used solely for the collection of information. Therefore, the fixed based has be a place of business of but the business of the company need not be carried on through that fixed base. The concept of Permanent Establishment (PE), on the other hand, is used as a determinant for exercise of tax jurisdiction by the source-state over the income of a non-resident company. In other words, a source-state can only tax income of a non-resident company if the company has PE located within the state and the income is attributable to that PE. Nigeria adopted the concept of PE in all of the DTAs it entered into. However, under its domestic law, Nigeria adopted different notion of PE that is the fixed based. By the provision of section 13 (2) above, the fixed based must not belong to the company. What is important is that the fixed based is available to the company whether or not it earn the income through the fixed based. Thus, the existence of the fixed based is sufficient to make the company liable. Furthermore, section 6 of the PITA is more line with the concept of PE because it makes it a requirement that the business must be carried on through that fixed based in the case of individual taxpayer.

[75] Profit has been defined as the remaining earning of the company after deduction of all the expenses incurred in making the profit. Turnover, on the other hand, means the total earning of the company before any kind of deduction. Other legislation also use impose levy on the companies based on the companies' turnover. For instance, Section 12 (2) of the National Information Technology Development Act 2007 imposes a levy of 1% of the Profit before tax of the following type of companies whose total turnover is N1 Billion and above. The companies include "(i) GSM Service

companies (especially non-resident companies) based on their turnover instead of earned income makes the Nigerian corporate tax regime different from the rest of the world. The taxation of the turnover of a foreign company implies that the Nigerian regime taxes non-resident companies on their global income. Therefore, the Nigerian regime is a confused and inconsistent system, and the same confusion is extended to the determination of corporate tax residence.[76]

Section 1 of the Income Tax Act, 1962 (as amended) states the features of South Africa residence-based system. The section defines the gross income as "the total amount earned by or accrued to a resident" and after making certain deductions pursuant to the Act, the remainder stands as the taxable income. The section further defines income earner that is the resident as discussed above. Therefore, the South African regime makes it clear that it taxes income, not profit or even turnover. It also provides that a non-resident is taxable on his South African-sourced income. This is in tandem with the international norm on a residence-based system.

7.6 Conclusion

In designing the definitional rule for fiscal residence, states are always faced with two competing goals. That is to provide a definition that could prevent the erosion of their tax base, on one hand, and make the definition transparent and readily appreciated by the taxpayers. To balance these goals, states have formulated tests for the potential taxpayers. Once a person passes the test(s), he becomes liable to tax. However, in formulating the tests for corporate residence,

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Providers and all Telecommunications companies; (ii) Cyber Companies and Internet Providers; (iii) Pensions Managers and pension related companies; (iv) Banks and other Financial Institutions; (v) Insurance Companies." And section 16 of the same Act mandated the Federal Inland Revenue Service to assess and collect the levy as at the time it is collecting the income tax of the company covered by the Act.

[76] The PWC Tax in Africa survey of 2007 revealed that the Nigerian corporate tax system is aggressive and unreasonable. See Tax in Africa Survey 2007 at 7

the states are supposed to understand the role of the chosen tests. It is possible for a particular test to have two functions; as a connecting factor or as a tiebreaker.

The above analysis reveals that the South African regime relies on the decisions that discuss the concept the ‘ordinary resident’ as a mechanism for determining the eligibility of an already taxable person to certain reliefs or exemption. The regime lacks a clear judicial guide on the role play by ‘ordinary residence’ test in determining a jurisdictional link. In the same vein, the regime confuses the function of the POEM as a connecting factor and as a tiebreaker rule. A corporation must be determined as a resident of a party to DTA before the question of applying tiebreaker rule come up. There is a need for a judicial decision in South Africa that can define the concept of POEM as a connecting factor. However, the South African regime is far better than that of Nigeria. The Nigerian regime is totally at variance with the international norm for the residence-based system. Therefore, the only solution to the Nigerian regime is to undergo a total overhaul, not a minor reform that could reshape the South African regime.

As trading partners, Nigeria and South Africa need to co-operate with each other especially in designing the definitional rule of residence. They could achieve the co-operation through understanding details of their respective regimes more than they anticipate from the DTA. The above comparative analysis reveals the silent features of the two regimes that cannot be appreciated through any DTA. By this comparison, the two countries could understand the weakness and strength of their system and the possible areas of reform.

CHAPTER EIGHT

CONCLUSION

8.1 Conclusion

The thesis has established that states' tax jurisdiction is an aspect of the states' sovereignty, and the determination of the residence status of the taxpayers is crucial to a residence-based tax system. The residence-based regime is concerned with the personality of income earner instead of the income itself. However, despite its significance in the tax system, there is no standard rule for determining the concept of fiscal residence. A comparative analysis of the rules for determining tax residence reveals that all the jurisdictions covered accord different connotations to the concept. The diversity and inconsistencies discovered in defining both the individual and corporate tax residence stem from the notion of the states' tax sovereignty. States are protecting their taxing power. The reality of global economic integration vests the states with an exclusive tax jurisdiction; the states' borders are fading. It allows the taxpayers to move freely and exploit the ambiguities created by the divergence of the definition of tax residence between the states. Hence the need for achieving states' cooperation in delimiting their tax jurisdiction without losing their sovereignty.

The traditional method of achieving the cooperation is through both unilateral and bilateral mechanism, that is to say, the double taxation relief provisions in their domestic laws and a bilateral Double Taxation Agreement (DTA). Global economic integration hinders the smooth operation of the DTA, because the DTA binds only parties to it. Besides, the cross-border mobility of persons and trade creates a tripartite scenario, whereby a state that is a non-party to the DTA is involved in the jurisdictional conflict. Superficially, a multilateral treaty regime could be a viable solution to this problem. However, the exercise of the States' tax sovereignty is an obstacle to the formation of any multilateral treaty.[1] The state tax jurisdiction comprises both substantive and enforcement jurisdiction over the taxpayer. Therefore, it is possible for the states to surrender enforcement jurisdiction as a result of any multilateral treaty. However, it could be difficult for the states to surrender their substantive tax jurisdiction because it goes to the root of their sovereignty. Thus, the multilateral treaty is not feasible.

Given the interface between the states' tax sovereignty that led to the diverse and inconsistent definition of tax residence and the need for the states' co-operation, this thesis has argued for a departure from the above traditional approach. That is the comparative analysis of the definitional rules in order to ascertain the level of convergence and divergence and how they could extend mutual respect for each other's tax sovereignty and balance their interests

[1] Due to the global economic integration, regional multilateral treaty regime harmonising the definitional rules of tax residence may not facilitate the desired cooperation, because there could be a situation where the resident of a non-party state is involved.

against that of the taxpayers in defining the tax residence outside the realm of a tax treaty. The in-depth comparative analysis of the different domestic legal regimes prevents states from losing their tax sovereignty to a multilateral treaty regime. Whereas, creating a level ground for the states to cooperate with each other in defining the scope of their tax jurisdiction as dictated by the global economic integration.

Nigeria and South Africa have been selected to serve as two pilot states for the comparative analysis project. This thesis has established that despite some shortcomings; the South African regime is far better than that of Nigeria. As Nigeria will learn a lot from the more elaborate South African regime. It is also establishes that the Nigeria – South Africa DTA was designed without a proper understanding of the intricacies surrounding the definitional rules of the two countries.

8.2 Findings

The thesis found that the network of bilateral DTAs based on the OECD and UN Models is the current mechanism for international tax cooperation. The impact of the global economic integration has eroded the usefulness of the bilateral tax treaty regime. The OECD has recently joined the call for a shift from the bilateral to a global multilateral treaty regime, through its OECD-BEPS initiative. The thesis also found that a multilateral tax treaty regime could be possible in respect of enforcement aspect of states tax jurisdiction.[2] But in their desire to preserve their tax sovereignty, the states are reluctant to surrender the substantive aspect of their tax jurisdiction to a multilateral treaty regime.

[2] For instance, as at 12th July 2016, there were over ninety states participating in the Convention on Mutual Administrative Assistance in Tax Matters (MAATM). The MAATM is not a substitute for DTAs because its coverage is restricted to information exchange and assistance in the recovery of debts and servicing of documents, which is an aspect of enforcement tax jurisdiction.

It has been established that a comparative analysis is the most viable option for achieving the desired States' cooperation in defining tax residence. The proposed comparative model hinges on the need for the states to understanding the intricacies surrounding their respective definitional rules through a comparative study It is usually assumed that tax co-operation envisages a complete harmonisation of the different definitional rules. However, the unique structure of international tax system requires that international cooperation initiative should not be all-or-nothing.[3] This thesis has argued that the international co-operation must be in carried out in a gradual process. Therefore, this thesis has taken a middle ground between the proponents of harmonisation of all the definitional rules applicable in all states and those agitating for maintaining the status quo; that is the use of a unilateral solution that leads to tax competition. In pursuing this alternative, the states need to analyse comparatively and understand the interaction of their different definitional rules.

The comparative model has the significant advantage of improving compatibility between the different definitional rules that the states adopted. It could reinforce the investors' certainty and potential cooperation in tax enforcement among states. The comparative alternative aimed at a gradual cooperation of States. Starting with trading partners and gradually extend to the regional level, where members of a regional organisation may form a body of a tax expert to carry out the comparative analysis of the respective definitional rules. The success of this kind of cooperation at the one regional levels could transcend to other regions. The spread of the model to many regions may transform it to an international norm, in the same non-OECD members adopted the OECD model as a norm for designing DTA.

[3] Brauner, (2003) at 293

Therefore, the findings and recommendations made below are based on a comparative analysis of the Nigerian and South African legal regime on the determination of tax residence. The findings are both general and country-specific. Nigeria and South Africa are trading partners who believe in the bilateral tax treaty regime. There is a subsisting DTA between them, and they each has a network of DTAs with some of their respective trading partners. It is also found that ascertaining the residence status determines the benefits available to the taxpayers under the DTA.

Moreover, almost all the DTA contain a provision that wherever the tiebreaker rules fail to resolve the conflict, the parties should resort to a mutual agreement. Thus, the last item on the list of tiebreaker rules of a DTAs is the mutual agreement between the parties. The tax liability hangs on the potential taxpayer throughout the period of negotiating the agreement. Whenever the parties fail to reach mutual agreement; the taxpayers remain liable to the tax imposed by the two parties simultaneously. Therefore, the co-operation can only be achieved if the parties understand the details of the domestic laws of each other. The parties can only understand the details through comparative analysis of their respective regimes.

The specific findings are based on the tests apply to Nigeria and South Africa in determining the residence status of their taxpayers. The two states adopted different tests for defining the same categories of taxpayers. That is why the findings on those tests are country-specific, and separate findings are for the case of individuals and corporation:

8.2.1 South African regime

The South African regime has adopted two alternate tests: ordinary resident and physical presence tests for determining the residence status of a natural person. It also adopted the place of incorporation and place of effective management tests for all entities other than the natural persons. Below are the findings on each of those tests.

8.2.1.1 Natural Person

It is found that the South African rule for determining the residence of the natural persons is primarily based on the concept of ordinary residence. That is to say, once it is established that an individual is an ordinary resident of South Africa, he automatically becomes liable to income tax. However, the concept of ordinary residence is not statutorily defined. It is also found that all the judicial authorities[4] frequently relied upon in defining the concept predated the South African residence-based regime.[5] The reliance of those cases amounts to confusing the dual roles of the concept of ordinary residence. That is ordinary residence as a jurisdictional link and as a criterion for benefiting tax relief or exemptions. It is found that the cases currently relied upon in South Africa analysed the latter role of the concept. Whereas, under the residence-based regime, the ordinary residence is primarily a jurisdictional link. Therefore, the South African notion of ordinary residence as a basis for exercising tax jurisdiction over individuals is neither statutorily defined nor judicially analysed.

The second test applicable in South Africa in the case of a natural person is the physical presence test. It is found that the application of the South African

[4] Such as Cohen, Kuttel, Soldier etc
[5] Which began in the year 2001

notion of physical presence test is dependent upon the ordinary resident status of the individual involved. Thus, the test is only applicable if the individual is not ordinary resident in the current year of assessment. The lack of an explicit provision or a South African judicial authority that provide the rules for the establishment and cessation of ordinary resident status, puts the application of the test is in jeopardy.

8.2.1.2 Corporations

The second alternative test for corporate residence in South Africa is the place of effective management (POEM). The POEM is not defined statutorily. The thesis found that the role of the POEM as a connecting factor is not appreciated or is being confused with its role as a tiebreaker rule. The OECD designed the POEM originally to serve as a tiebreaker rule in the DTAs. However, South Africa and recently India adopted it as a jurisdictional link. Thus, the POEM serves as both jurisdictional link, and a tiebreaker rule in South Africa. To date, no single South Africa case dealt with the POEM as a jurisdictional link, not a tiebreaker. Even the case of Oceanic Trust that attempted to determine the issue, the pronouncement made in the case was not a ratio. The thesis found that the POEM as a jurisdictional link is similar to the Central Management and Control (CMC) test. A similar version of POEM was adopted by the civil law jurisdictions notably Germany. Thus, in determining the POEM as a jurisdictional link, the relevant place is where the strategic management decision of the corporation was taken.

8.2.2 Nigerian Regime

It is found that despite the above shortcomings of the South African regime, it is far better than that of Nigeria. The Nigerian regime adopted the concepts of ‘place of residence’, ‘place of principal residence’, physical presence and ordinary resident tests for the determination of the individual residence. It also adopted a place of incorporation and CMC tests for the companies.

8.2.2.1 Individuals and other entities

The Nigerian Personal Income Tax Act (PITA) defines the both the 'place of residence' and 'principal place of residence' in a complex and inconsistent manner. It also defines the physical presence and ordinary resident test in the same way. It is found that no Nigerian judicial authority clarifies the ambiguities created by the PITA in the definitions. It is hard to appreciate the intendment of the Legislature in providing the physical presence and ordinary residence tests. The thesis also found that even if the above tests are well defined by the PITA or they received judicial clarifications, the Nigerian federal system of government also hinders the smooth application of the tests. It is also found that the Nigerian notion of ordinary resident and the 183 – day rule apply only to the individuals in the formal employment. Thus, individuals in the informal sector of the economy are not affected by the two tests. Finally, it is found that the two tests being used by the South Africa regime on natural persons can be reform in line with the above findings. However, the Nigerian regime needs to undergo a total overhaul, not a minor reform that could reshape the South African regime.

8.2.2.2 Companies

The thesis revealed that the Nigerian regime provides separate tests for all companies that carry on business other than upstream oil activities and those dealing in the upstream sector of the petroleum industry. In the case of the former companies, the regime makes the place of incorporation as the sole test for ascertaining their tax residence status. For the latter companies both the place of incorporation and CMC tests have been adopted. However, it is found that the place of incorporation test operates on the platform of the corporate law, but there is serious conflict between the Nigerian corporate tax regime and the Nigerian corporate law. This hinders the application of the test. For the CMC test, it is found that a provision of same Act that adopted the test renders it nugatory. The provision makes the manager and any principal officer of the company liable to do all that the company is required to so by the Act. In the whole, the thesis revealed that the Nigerian regime is a totally defective. Thus, Nigeria operates a regime that is entirely different from the rest of the world. The South African regime, on the other hand, is more in tune with the international best practice as it reflects the norm for determining individual residence.

8.3 Recommendations

1. As trading partners, Nigeria and South Africa need to co-operate with each other especially in designing the definitional rule of residence. Therefore, they could achieve the cooperation through understanding details of their respective regimes more than they anticipate from the DTA. The above comparative analysis reveals the silent features of the two regimes that cannot be appreciated through the DTA. By this comparison, the two states could understand the weakness and strength of their system and the possible areas of reform.

2. There is a need for a South African statutory provision or a judicial pronouncement on the establishment and cessation of the ordinary resident status. Given the impact of such establishment and cessation on the application of the physical presence test. Without knowing when an individual ceased to be an ordinary resident, the present provision for physical presence test is useless. Alternatively, the

section 1 of the Income Tax Act 1962 (as amended) be further amended to remove the requirement of the cessation of the ordinary resident status before the application of the physical presence test.

3. The current debate in South Africa is whether the relevant place in POEM is where the day-to-day or strategic management decisions are taken. The notion of POEM as a jurisdictional link should not be confused with its role as a tiebreaker rule. Both the South African tax experts and the South African Revenue Service need to appreciate this fact while taken a stand from the above debate. There is the need for a South Africa judicial authority that directly address the issue of POEM as a jurisdictional link since the South African regime adopted the POEM as such.

4. There is a need for Nigeria to learn from the Australian regime by centralising both the substantive and enforcement jurisdiction on income tax to the federal government. Alternatively, in the alternative to exclusively assign the substantive tax jurisdiction on the individual income tax to the states and allow the federal government to retain the both the substantive and enforcement jurisdiction over corporate income tax.

5. The provision of the Nigerian Companies and Allied Matters Act 2004 should be amended to recognise the foreign companies to participate in the Nigerian economy without being incorporated. Thus, accommodating the provisions of the Nigerian Companies Income Tax Act and the Petroleum Profits Tax Act, about the place of incorporation test. Also to repeal sections 25 and 26 of the Petroleum Profits Tax Act that transferred the companies' tax liability to their employees.

6. The provision of the Nigerian PITA should be amended to provide a clear test for the determination of the residence of individuals and other recognized entities. In line with the recommendation No.4, the current 'place of residence' and the 'principal place of residence' tests should be replaced with either residence or ordinary residence and complemented by a physical presence test. Thus, the present vague and redundant physical presence and ordinary residence tests should be subsumed into the new ones mentioned above. Nigeria should make a shift from the current regime that based the determination on the employment status of the individuals. Thus, the tax net should be extended to the individuals in the informal sector of the economy.

8.4 Further Research

The two primary criteria for exercising income tax jurisdiction are the residence and source basis. The determination of the source of income is an important aspect of the discourse on income tax jurisdiction. Thus, most of the jurisdictions operate a residence-based systems with some element of the source-based system. Also, there is a network of tax treaties involving States that operate residence and source –based regimes. Given the significance of the source-based regime, there is need for further research on the source of income within the theme of this thesis. That is to say, to comparatively analyse the concept of the source of income through the lens of the tax sovereignty and the global economic integration.

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