CORPORATE RESIDENCY

CA Prerna Peshori

CORPORATE RESIDENCY

- The residency for the corporates is based on two criteria
- Incorporation Tests (USA) – where the legal seat is based.
- Economic tests – management/business tests (Germany, India)

India uses the combination of 2 approaches

RESIDENCY OF CORPORATES

Prior to 2015 amendment	Post 2015 amendment

• A company is said to be resident in India if:
  • It is an Indian company
  • During that year, the control and management of its affairs is situated wholly in India
	• A company is said to be resident in India if:
	  • It is an Indian company
	  • Its place of effective management in that year is in India
	• Place of effective management means a place where key management and commercial decisions that are necessary for conduct of the business of an entity as a whole are in substance made

EVOLUTION OF CORPORATE RESIDENCY

Control & management test

- Control & management means where the head & brain lies.
- The Courts have looked into where the BOD makes the key decisions
  - Policies of the company
  - Financial matters
  - Disposal of profits
  - General & corporate affairs of company
- Radha Rani Holdings (P) Ltd. v. Director of Income Tax,
- The Singapore Co was alleged by the AO to be managed from India through a majority shareholder and director resident in India. This was based on the fact that there had been one key board meeting which considered the issue of granting a loan to a sister concern, wherein the concerned director was in India. The Court held that the presence of single director in India would not led to C&M in India as the management lies with entire board. The other BOD member was resident of Singapore.

EVOLUTION OF CORPORATE RESIDENCY

POEM under DTC 2010

- Direct Tax Code Bill, 2010, Cl. 4(3) - "A company shall be resident in India in any financial year, if— (a) it is an Indian company; or (b) its place of effective management, at any time in the year, is in India"
- Direct Tax Code Bill, 2010, Cl. 314(192) - "Place of effective management means (i) the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or (ii) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions"
- The Standing Committee on Finance suggested that terms such as 'executive directors' and 'officers' should be deleted as it leads to uncertainty. Instead the definition should confirm to the international standard contained in the OECD Commentary.

RATIONALE FOR CHANGE

Circular No 19/2015 explaining provisions of Finance Act 2015

- The pre-amended condition of residency linked to whole of C&M in India is too strict and practically inapplicable, permitting companies to avoid residency by simply holding a BOD meeting outside India.
- The present condition facilitates creation of Shell Companies outside India
- POEM is an internationally recognized residency concept adopted in tie-breaker Rule of Indian treaties as also adopted in many jurisdictions
- POEM is also recognized and accepted by OECD which defines POEM to mean the place where key management and commercial decisions necessary for the conduct of the business of the entity as a whole, are, in substance, made.
- Most of the tax treaties entered into by India recognise the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation. Many countries prefer the POEM test to be appropriate test for determination of residence of a company

Is POEM an anti-abuse provision or a test of residency?

CORPORATE RESIDENCY

Section 6(3) of the Income-tax Act 1961 w.e.f. AY 2017-18

- “A company is said to be a resident in India in any previous year, if—

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

Explanation.—For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.”

CBDT Circular No. 8 dt. 23 Feb 2017- POEM not applicable to FCo having turnover or gross receipts of Rs. 50 crores or less in a financial year

UNDERSTANDING POEM

Place of effective management means a place where key management and commercial decisions that are necessary for conduct of the business of an entity as a whole are in substance made

Decision Test	Necessity Test	Pervasiveness Test	Substance Test
Place where key management & commercial decisions are taken	Necessary for the conduct of the business	Of an entity as a whole	Are in substance made

UNDERSTANDING POEM

Place of effective management means a place where key management and commercial decisions that are necessary for conduct of the business of an entity as a whole are in substance made

Term	Meaning
Key	Central importance, vital element
Management	Government, control, superintendence, the act of managing by director or regulation or administration
Commercial	Relating to commerce, dealing with commerce from point of view of profit
In substance	In essence, reality, distinguished from form
Made	Cause to exists or happen, put into existence

JUDICIAL DECISIONS

- Subbayya Chettaiar (HUF) vs. CIT (19 ITR 168) (SC): C&M signifies the controlling and directive power, the head and brain and “situated” implies the functioning of such power at a particular place with some degree of permanence.
- Nandlal Gandalal (40 ITR 1) (SC) -the expression “control and management” means de facto control and management and not merely the right or power to control and manage.
- Erin Estate, Galah, Ceylon v CIT (1958)(34 ITR 1)(SC): What is relevant is de facto control and power actually exercised in the course of the conduct and management of the affairs of the firm is relevant, and not the de jure control. Control and management evidently refers to the controlling and directing power.
- Narottam & Pereira Ltd. (23 ITR 454) - distinguished between doing of business and C&M of business. HC disregarded presence of strong manager overseas in favour of controlling directors being situated in India.

JUDICIAL DECISIONS

- Bay Lines (2018) (Mum AT)
  - Tribunal affirming following facts that that POEM of Taxpayer is in UAE
  - POEM is place where key commercial decision that is necessary for the business is taken or in substance the POEM will originally be a place where the most senior person or a group of person make its decision
  - UAE Directors attended BoD only on calls, Mauritius directors were only to satisfy Mauritius Law, BoD transacted no other business except Mauritius Law compliances, even items like letter to AO signed by UAE parent representative – POEM was not in Mauritius
- SMR Investment (2010) (Del AT) - Order for sale and purchase of shares for the Mauritius Company given by Indian Resident Shareholder from Phone then effective place of management is in India

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JUDICIAL DECISIONS

- **AB Holdings – Mauritius II**
- It was alleged that POEM of Mau Co is in US and it is not eligible for treaty benefits
- AAR held that holding company could have a role to play in affairs of the subsidiary. The C&M was not in US but in Mauritius
- Movements of the directors in and out of Mauritius could not alone conclude that control and management was not in Mauritius
- Physical absence of one director in board meeting and his attendance through telephone or video conference from US was a valid communication
- The other two directors of M1 were well qualified to engage in meaningful discussions and were involved in the decision making process
- Investment holding companies such as M1, did not require huge offices/staff or incur multiple account expenses as opposed to manufacturing or trading companies
- TRC of Mauritius, Board meetings took place in Mauritius
- Mauritius Authorities Certificate on Place of Business in Mauritius
- Shares held in Mauritius company name – Legal & Beneficial Owner

ANALYSING THE DEFINITION

General guiding principles

- POEM to be examined every year per facts / circumstances
- Substance over Form
- There can be many places of control / management but only one POEM
- POEM not intended to tax global income of FCo merely because of their PE or business connection
- POEM targets shell companies & companies incorporated outside India for retaining income outside India but controlled and managed from India
- Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India

ANALYSING THE DEFINITION

Illustrations of management & commercial decisions

- Illustrations of management decisions
  - Appointment / Termination of key management personnel and their remuneration
  - Organizational reporting structure and key organization / management policy decisions
  - Code of Conduct, Group ethos and Ethics
  - Global IT systems policy and MIS reporting
  - M&A and company restructuring decisions, including divestment
  - Common procurement or sourcing for the group, including master agreements
- Illustrations of commercial decisions
  - Sourcing of Raw Materials, selection of distributors and its quality control. Procedure and manner in relation to negotiations/execution of contracts, particularly long term contracts, including on lease-in, lease-out.
  - Borrowings, Debt Financing, Capital Sourcing
  - Product Portfolio, methods of manufacture
  - Pricing of products and services
  - Expansion and modernization
  - Accounting policies, R&D, Brand / patents registration (licenses)

DETERMINATION OF POEM

CBDT Circular No. 06 of 2017, dated 24 January 2017

POEM Tests

Companies engaged in Active Business Outside India (ABOI)

- POEM outside India if majority BOD Meetings outside India (General Rule)
- However, if de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India

Companies other than those engaged in Active Business Outside India (ABOI)

- **2 stage test:**
- Identify the persons who actually make the key management and commercial decision
- Determine the place where these decisions are in fact being made –important than the place where implemented

PRESS RELEASE DATED 24 JANUARY 2017

- ABOI test has been provided so as not to cover companies outside India which are engaged in active business
- The intent is not to target Indian MNC which are engaged in business activity outside India
- The intent is to target shell companies and companies which are created for retaining income outside India although real C&M of affairs is located in India
- Intend is not to cover foreign companies or to tax their global income merely on the ground of presence of PE or BC in India

ABOI TEST

Passive income (wherever earned) is less than 50% of total income	More than or equal to 50% of total assets are situated outside India	More than 50% of total number of employees are not situated in India or are not resident of India	Payroll expenditure on such employee is more than or equal to 50% of total payroll expenditure

- Aforesaid conditions needs to be cumulatively satisfied
- Average data of previous 3 years needs to be considered
- Essential to have board meeting even if laws of FCO has no such mandate

- POEM of company engaged in ABOI is presumed to be outside India if majority meetings of BOD are held outside India – unless, BOD are not exercising powers
- Merely because BOD follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside

MEANING OF TERMS

- **Passive Income**
- Income transact transactions where both purchase and sale of goods is from/to its AE
- Income by way of
  - Royalty
  - Dividend
  - Capital gains
  - Interest (Other than for the banks or PFI)
  - Rental income
- Income - As computed for tax purpose in accordance with tax law of FCO or as per Books of account – where laws of incorporation does not require computation

- **Assets**
- (a) Individually depreciable asset, - the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and
- (b) Pool of a fixed assets being treated as a block for depreciation, shall be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
- (c) In case of any other asset, shall be its value as per books of accounts

- **No of employees -** Average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees
- **Pay roll** shall include the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.

NON - ABOI TEST

Situation	Place to be considered as POEM
Where BOD retains and, in substance, exercises authority to govern company	• Place where BOD regularly meets and does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole. • Mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place.
If the key decisions by the directors are in fact being taken in a place other than place where formal meetings are held	Place where key decisions are made
Where authority delegated by BOD to senior managers, shareholders, financial advisors etc. "Senior Management" means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. May include: MD/CEO/CFO/COO/heads of various divisions	Place where these senior managers or the other person make those decisions

NON - ABOI TEST

Situation	**Place to be considered as POEM**
When authority delegated formally or de facto to one or more committees	• Place where committee is based and where it develops and formulates key decisions for mere formal approval by BOD
Virtual meetings	Place where the majority of directors or the persons taking the decisions usually reside
Circular resolution or Round Robin voting	Location of person who has authority to take decisions
Decisions by shareholders on managerial issues (The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant)	Location where such decision is taken
If not conclusive	ii. Place where main or substantial activity of the company is carried out. iii. Place where accounting records of the company are kept.

HEAD OFFICE OF COMPANY AN IMPORTANT FACTOR

"Head Office" of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets

- Centralised Co - company's principal place of business or headquarters
- Multiple locations – location where senior managers (i) are primarily or predominantly based; or (ii) normally return to following travel to other locations; or (iii) meet when formulating or deciding key strategies and policies for the company as a whole.
- Decentralised – HO is not relevant

KEY QUESTIONS TO BE ASKED

- Where is the Location of BoD Meetings?
- Whether BoD retains and exercises authority to govern the company in the said meeting?
- Whether in the meeting, the BoD makes in substance the key management and commercial decision for the company's business as a whole? Are such decisions made elsewhere?
- Whether BoD has board delegated its authority de facto to shareholders, promoter, strategic or legal or financial advisor? Whether BoD routinely ratifies the decision that have been made? Where are such persons based and where are such decisions made?
- Whether BoD has delegated its authority to one or more committee consisting of senior management?

IRRELEVANT FACTORS

- FCO is completely owned by ICO
- FCO PE exists in India
- One or some of the directors of foreign company reside in India will not be conclusive evidence that conditions for establishing POEM in India
- Local management being situated in India in respect of activities carried out by FCO in India will not be conclusive evidence by itself
- Existence in India of support functions that are preparatory and auxiliary in character will not by itself be conclusive evidence that conditions of POEM have been satisfied

CHECKLIST

- TRC and POEM provisions in the Other State
- Constitution of BoD / Committee – their numbers, locations, Indian / Foreign, Residential status, etc.
- Director's qualification, experience, capability , Independence, terms of appointment, remuneration and other roles / responsibilities.
- How many meetings held? where? Who sets Agenda? Who are drivers?
- Notice / Debates & Minutes / Quorum / Meeting Mode / Email ids -Signatures / Secretarial framework
- MoA / AoA / Agreements with & role of shareholders and consultants
- Information in Internal and Public Domain (Website, Linked in, News item, press release, corporate announcements, etc.)
- Registered office and other places of business as per corporate records
- SM qualification, terms and place of employment, roles / responsibilities
- Travel details and reasons of travel
- Third party evidences such as tickets, hotel stay, etc.
- Secretarial records / minutes of such meetings and operations.
- Public profile of SM (Linked-in)
- How has the decision been concluded in the meeting? Is it through majority or left to one / selected person ? Where is such person located?
- Business Website, description of activities and places of business mentioned therein

PROCEDURAL SAFEGUARD

- AO to seek prior approval of collegium of 3 members consisting of PCIT
- Collegium shall provide an opportunity of being heard
- Unlike GAAR – panel consists of revenue members
- Not explicit requirement of providing copy of direction to assessee
- Possible to invoke writ jurisdiction since direction per se is not appealable

CONSEQUENCES OF POEM

- Worldwide Income taxable in India at 40% (plus surcharge/cess)
- Applicability of TP provision including reporting of international transaction and maintenance of TP documentation
- Applicability of withholding provisions – unless payment falls within source rule exclusions under domestic law
- Compliance in form of filing of ROI, TDS return, equalisation levy etc
- Interest and penalty in cases where POEM is determined in India during tax scrutiny

TRANSITIONAL PROVISIONS

Transitional provisions u/s 115JH notified vide Notification No. 29/2018

- Fco subjected to TDS as if it is a NR – S. 195 applicable
- Foreign Tax Credits eligible on same proportion as income offered / assessed to tax
- Provisions applicable to Foreign Company and Residents to apply to FCo having POEM in India
- Preparation of P&L and B/Sh where accounting year is different from financial year
- C/f of unabsorbed depreciation and Losses – proportionate computation
  - If assessed to Tax - as per Tax Records of Foreign Country
  - If not assessed to Tax – as per Books
  - C/f as per the Act for the remaining years taking the year of incurrence as first year
  - They can be set-off only against income taxable of FCo due to becoming Resident
- Computation of Depreciation
  - If assessed in Foreign Country - as per Tax records post depreciation allowed / allowable
  - If not assessed to Tax – as per Books

TIE-BREAKER RULE IN THE TREATY

- OECD MC 2017 – New Article 4(3) pursuant to OECD BEPS AP 6 (2015)
  - Dual Resident Entities (DREs) cases to be examined case by case as could involve tax avoidance.
- OECD Model Commentary provides that while deciding residency, Competent authorities to consider
  - The place where the key management & commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made
  - The place where the actions to be taken by the entity are as a whole determined
  - Place where majority of BOD or equivalent body usually meet
  - Location of and functions performed at head quarters of the entity
  - The place where the CEO and other senior executives usually carry on their activities
  - Corporate books are located
  - Which country's laws govern the legal status of the person
  - Whether determining POEM in one contracting state would lead to improper use of benefits under DTAA

India's position on OECD Commentary on Article 4(3) reads as follows: "11. India does not adhere to the interpretation given in paragraph 24 that the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. It is of the view that the place where the main and substantial activity of the entity is carried on is also to be taken into account when determining the place of effective management."

TIE-BREAKER RULE IN THE TREATY

- . UN MC (1979) in the context of residency tie-breaker, reads as under:
- “It may therefore be inferred that in the OECD Model Convention the term “place of effective management” is to be interpreted as meaning the place where the business of a body corporate is managed and controlled, that is, for example, where the business has offices in which the regular managerial activities are carried out on a permanent basis.”
- The updated UN MC (2011) provides the following guidelines on determination of POEM:
  - Place where a company is actually managed and controlled,
  - Place where the decision-making at the highest level on the important policies essential for the management of the company takes place,
  - Place that plays a leading part in the management of a company from an economic and functional point of view.
  - Place where the most important accounting books are kept

TIE-BREAKER RULE IN THE TREATY

- Reference may also be made to Protocol to the India-Belarus DTAA, which provides the understanding of POEM in Article 4 of that DTAA. The protocol to the treaty provides following understanding of the treaty negotiators :
- "With reference to Article 4, it is understood that when establishing the "place of effective management" as used in paragraph 3 of Article 4, circumstances which may, inter alia, be taken into account are the place where a company is actually managed and controlled, the place where the decision making at the highest level on important policies essential for the management of a company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the relevant accounting books are kept."