NALSAR

Place of Effective Management (POEM)

Key highlights

Dec 2022

CONTENTS

Background

Background

- A company inter-alia can be regarded as a resident in India in any previous year, if its POEM is in India in that previous year.
- POEM has been defined in the Explanation to section 6(3) of the Income Tax act, 1961 as a place where:
  - Key management and commercial decisions;
  - Necessary for the conduct of the business of the entity as a whole;
  - are, in substance, made

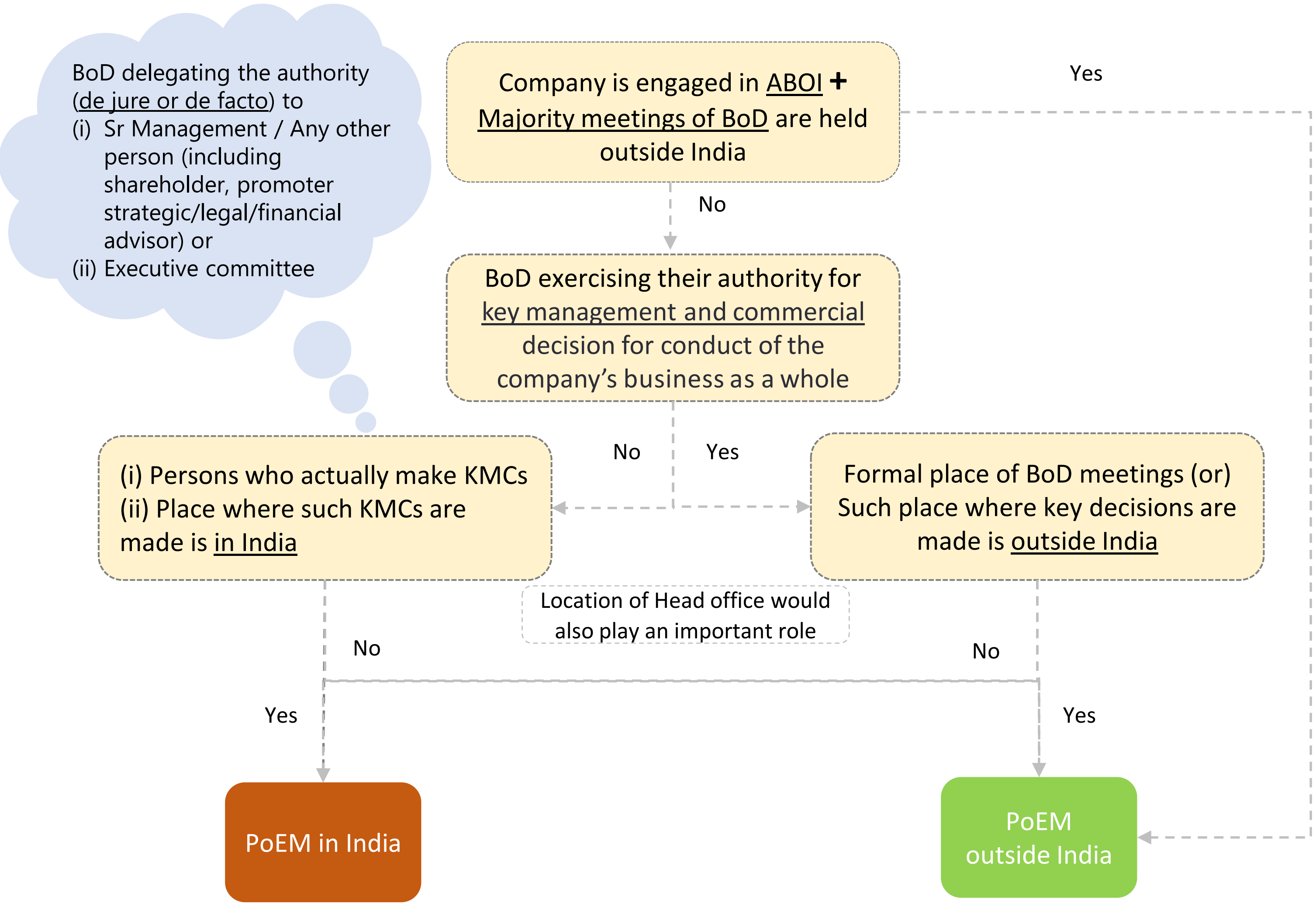
- Prior to the introduction of PoEM, a foreign company was considered resident in India in any year if during that year the control and management of its affairs was situated wholly in India
- The concept of PoEM, though introduced by the Finance Act, 2015, was made effective from 1 April 2016
- Guidelines for determining PoEM have been issued by CBDT on 24 January 2017

Circular No. 06_2017.pdf

- For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature
- Where by reason of the provisions of OECD, a person other than an individual, is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.
- Whereby reason of the provisions of OECD an individual is a resident of both Contracting States, then his status shall be determined based on the Tie-breaker rule

POEM - Guidelines issued by CBDT

POEM Guidelines - Broad Framework under the Act



#	Criteria for ABOI (To be satisfied cumulatively)
1	Passive income* (wherever earned) < 50% of total income
2	Assets situated in India < 50% of total assets
3	Employees situated in India (or) are resident in India < 50% of total number of employees
4	Payroll expenses incurred on such employees < 50% of total payroll expenditure

Notes:

a) Passive income shall be aggregate of (i) Income from the transactions where both the purchase and sale of goods is from/ to its associated enterprises (ii) Income by way of royalty, dividend, capital gains, interest or rental income. Interest shall not be considered to be passive income in case of a company engaged in the business of banking or is a public finance institution

b) In determining quantum of passive income, assets, number of employee and payroll expenses., average of the data of the previous year and two years prior to that to be taken into account. In case the company is in existence for a shorter period, the data of such period to be considered

c) Where the accounting year for tax purposes, in accordance with the laws of country of incorporation is different from the previous year, the data of the accounting year that ends during the relevant previous year and two accounting years preceding it to be considered

POEM Guidelines - Key management & commercial decisions (Illustrative)

A. <u>Key Managerial & commercial decisions</u>

Management decisions	Commercial decisions
Appointment or termination of KMP and their remuneration	Selection of distributors and its quality control, marketing and distribution
Reporting structure and key organization / management policy	Negotiations or execution of contracts
Code of Conduct, Group ethos and Ethics	Product Portfolio, methods of manufacture
Global IT systems policy and MIS reporting	Expansion and modernisation
M&A and restructuring (including divestment)	R&D, Brand, Patents registration (licenses), IPR, Pricing of products and services
Common procurement, sourcing for the group	Fund Raising (Borrowings, Debt Financing, Capital Sourcing etc.)
Capital Expenditure –Funds/ resource allocation/ utilisation	Legal and regulatory matters

B. <u>Decisions are necessary for the conduct of the business of the entity as a whole</u>:

- POEM to be tested for overall decisions of the company i.e., ’Majority’ and not ‘some or ‘few’ key decisions

C. <u>are, in substance, made’</u>:

- Emphasis is on the place of decision making and not place of signing or executing documents;,
- Emphasis is on ‘reality’, ‘actual state of affairs’ i.e., place where ‘key management & commercial decisions are, in substance, made and not simply where the board resides
- ‘Dummy directors’ have often been disregarded

POEM Guidelines

‘Day-to-Day operating decisions’ vs ‘Key management and commercial decisions’

Particulars	Description of decisions	Remarks
Day-today routine operations decision undertaken by junior and middle management	a) Examples of operational decision: • a decision by the plant manager (appointed by senior management) to run the facility • decision concerning repairs and maintenance • decision relating to the implementation of company wide quality controls and human resources policies b) Examples of key management and commercial decisions: • a decision to open a major new manufacturing facility • a decision to discontinue a major product line	• The operation decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision • Not relevant for determining PoEM

In case if the person responsible for taking operational decisions and key management and commercial decisions is the same person, it will be necessary to distinguish the two type of decision and thereafter assess the location where the key management and commercial decisions are taken

POEM Guidelines

'Shareholders decisions' vs 'Directors decisions'

Particulars	Description of decisions	Remarks
Matters which are reserved for shareholder decision under the company laws	a) Such decision may include: • sale of all or substantially all of the company's assets • dissolution, liquidation or deregistration of the company • modification of rights attaching to various classes of shares or the issue of a new class of shares, etc.	• Not relevant for determining PoEM • These decision typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective
Shareholders involvement turning into effective management	b) Either formally by way of shareholder agreement or by way of conduct: • Shareholders limit the authority of board and senior management of a company and thereby remove the company's real authority to make decision	• The shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder

POEM Guidelines

'Delegation of authority by BoD'

Who takes the KMC decisions	Role of BoD	Relevance for POEM
Board of Directors	• BoD retains and exercises their authority to govern the company • BoD in substance makes such decisions necessary for the conduct of the company's business as a whole	• Place where BoD regularly meets and makes such decisions • If such decisions are not taken at board meetings (i.e., if these meetings are a mere formality), then place where such decisions are in fact taken by the directors
Senior management [such authority may also be delegated to shareholder, promoter, strategic or legal or financial advisory, etc.]	• BoD delegates authority to senior management • BoD routinely ratifies these decisions that have been made	• Place where the senior management or other persons who makes such decisions
Committee [executive committee consisting of key members of senior management]	• BoD delegates some or all of its authority to committee • BoD merely gives a formal approval to decisions made	• Place where the member of the committee are based and where that committee develops and formulates the key strategies and policies

Note: The delegation of authority may be either de jure (by means of a formal resolution or Shareholder Agreement) or de facto (based upon the actual conduct of the board and the executive committee)

POEM Guidelines

‘Role of Head office in determining POEM’

Particulars	Place of Senior Management	Place of Head office
Centrally located	• They are based in a single location at a place which is identified as head office	• Such place would be the Head office
Decentralised	• They operate from time to time at offices located in different countries	• Location where the senior management - is primarily or predominantly based - normally return to (after travel to other locations) - meet when formulating or deciding key strategies and policies for the company as a whole
Further decentralised	• They operate from different locations on a more or less permanent basis and participate in meetings via telephone or video conferencing	• Location where the highest level of management (such as Managing Director or Finance Director) and their direct support staff are located
Highly decentralised	• Company’s senior management is too decentralised	• Location of head office not relevant as it is not possible to determine the head office with a reasonable degree of certainty

Role of Head Office is an important factor as it often represents the place where key management and commercial decisions are made

POEM Guidelines

'Modes of decision-making process in determining PoEM'

Mode of making KMC	Place of persons taking such decisions	Relevance for POEM
Meetings via telephone or video conferencing	• The directors, senior management or committee(s) taking decisions physically not present at a particular location	• Place where the directors or the persons taking the decisions or majority of them usually reside may be relevant
Circular resolution or round robin voting	• Factors like the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located, etc. are to be considered	• It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct, it would be required to determine the person who has authority and who exercises authority to take decision; location of such person would be more important

POEM Guidelines

'Other factors'

If all of the above discussed factors do not lead to clear identification of POEM	
Secondary factors to be considered	• Place where main and substantial activity of the company is carried out • Place where the accounting records of the company are kept

Isolated factors by itself do not establish POEM	
Ownership	• The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that conditions for establishing PoEM in India have been satisfied
Permanent establishment	• The fact that there exists PE of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing PoEM in India have been satisfied
Director's residential status	• The fact that one or some of the directors of a foreign company reside in India will not be conclusive evidence that conditions for establishing PoEM in India have been satisfied
Local management	• The fact of local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing PoEM have been satisfied
Support activities carried out in India	• The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing PoEM in India have been satisfied

POEM Guidelines

‘Other administrative safeguards’

Administrative safeguards:

- Assessing Officer (AO) shall, before initiating inquiry for POEM in case of a taxpayer, shall seek approval from Principal Commissioner / Commissioner
- The AO shall also obtain approval from collegium of Principal Commissioners or Commissioners before holding that POEM of a non-resident company is in India. The collegium of Principal Commissioners or Commissioners to be constituted by the Principal Chief Commissioner of the region
- The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter

Consequences:

- Impact on the tax rates and the tax base:
- Also, refer Notification No. 29 of 2018 for other aspects (viz., applicability of Withholding tax provisions, Transfer Pricing regulations, foreign tax credit mechanism, computation of WDV of depreciable assets, brought forward losses etc.)

Notification29_2018.pdf

Particulars	R/NR	Taxation of Global Income	Tax Rate
Domestic Company	R	Yes	15%~30% (plus SC and Cess)
Foreign Company			
POEM during the FY in India	R	Yes	40%+SC
POEM outside India	NR	No	40%+SC

POEM - Guidelines of OECD

POEM Guidelines - Broad Framework under OECD and UN

Income Tax Act, 1961	OECD Commentary	UN Commentary
• Place where **key management** and **commercial decisions** that are necessary for the conduct of the business of an entity as a whole are, in substance made • Set of guiding principles for determination of PoEM have been issued for the benefit of the taxpayers as well as for tax administration	• 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 • All relevant **facts** and **circumstances** must be examined to determine the place of effective management • An entity may have more than one place of management, but it can have **only one place of effective management** at any one time	• Place where the company is **actually managed and controlled** • where the **decision-making at the highest level** on the important policies essential for the management of the company takes place • that plays a leading part in the management of a company from an **economic and functional** point of view • where the most important **accounting books** are kept

Protocol to India- Belarus DTAA:

2. 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.

Judicial Precedence

POEM Guidelines - Judicial precedents

Saraswati Holding Corporation Inc. vs. DCIT 16 SOT 535 (DELHI) (2007)

Key observations of Delhi Tribunal w.r.t C&M of affairs vs C&M of day-to-day operations:

- Assessee, a Mauritius entity, purchased and sold shares of Indian companies through the stock markets in India through different share brokers. The assessee had authorized three persons, viz., ‘M’, ‘S’ and ‘R’ as its authorized representatives in India to carry on activities on its behalf through a specific power of attorney.
- The terms of the power of attorney by which persons in India were authorized to conduct the business on behalf of the assessee merely empowered the persons in India to conduct the day-to-day affairs of the company. Further, the copy of the boards resolution filed by the assessee clearly showed that the decisions regarding investments were taken only by the directors of the company, who were stationed at Mauritius or United States.
- Control and management of affairs refers to head and brain of the company.
- The fact that discretion to conduct operations of business was given to some person in India would not be sufficient. The words ‘control and management of affairs’ refer to head and brain, which direct the affairs of policy, finance disposal of profits and such other vital things consisting the general and corporate affairs of the company.

POEM Guidelines - Judicial precedents

Radha Rani Holdings (P.) Ltd. vs. ADIT 16 SOT 495 (Delhi ITAT) (2007)

Key observations of Delhi Tribunal w.r.t country of residency of the shareholder:

- Assessee is a Singapore company (has TRC) whose 99 shares are held by an Indian resident (G) and 1 share is held by a Singapore resident (J).
- The Assessing Officer also noticed that the extracts of the minutes of the meeting of the board of directors allegedly held on 18-4-2001 at the registered office of the company in Singapore showed that the meeting of the board of directors took place on 18-4-2001 at Singapore, but 'G' was in India and, in fact, she left India on the same day for Bangkok and came back to India on 2-5-2001, and thus there was no possibility of her being present in Singapore and attend a meeting there on 18-4-2001.
- All board meetings held outside India. One board member (chairman) was present in Singapore and other board member may have participated in the meeting through telephone or video conferencing. It would be incorrect to state that one director holding 99% share of the company was having special power over other

POEM Guidelines - Judicial precedents

ADIT v Bay Lines (Mauritius) - (2018) 91 taxmann.com 110 (Mum)

Key observations of Mumbai Tribunal w.r.t POEM in the context of Article 8:

- Assessee, a shipping company incorporated at Mauritius, had claimed its entire income not to be taxable in India in view of provisions of Article 8 of the India-Mauritius DTAA inter alia dealing with profits from the operation of ships in international traffic, supporting its claim by furnishing TRC issued by the Mauritian tax authorities.
- AO denied the said relief to the assessee holding that the effective management of the assessee was situated at a place which was other than India and Mauritius.
- The Tribunal held that it was not necessary that effective management had to be only between two contracting states and, based on facts in the present case, the same was neither in Mauritius nor in India. Further, relying on the views of Klaus Vogel, it held that if the effective management of an enterprise was not in one of the contracting state, but was situated in the third state, the benefit of Article 8 of DTAA, could not be extended.

POEM Guidelines - Judicial precedents

France Case 323592, 16 April 2012 (Supreme Administrative Court)

Key observations of France Supreme court:

- Place where the persons exercising the highest functions in the enterprise and make the strategic decisions that determine the conduct of the business of an enterprise as a whole. Recruiting employees, assigning functions and payment of salary had no strategic significance for the management of entity as a whole

Netherlands Case 23 877, 1 July 1987 (Supreme Court)

Key observations of Switzerland Supreme court w.r.t country of residency of the shareholder:

- Switzerland company X AG having two shareholders - one holding entire share capital (less one share) (Netherlands resident) and other holding one share by a lawyer in Switzerland.
- A Swiss entity was appointed as management company and was entrusted to perform investments functions, administrative functions, etc.
- Decisive influence on choice of investment and delegation of control with regard to X AG's investments and the investment management which lies with the entity in Switzerland

Italy Case No. 27113/16, 28 December 2016 (Supreme Court)

Key observations of Italy Supreme court Financial holding company:

- A passive holding company performs limited economic functions - management of participation and cashing in of dividend distributed by its subsidiaries.
- In the absence of involvement of much positive outward activity, management cannot be said to be overtaken by parent.
- So long as management functions related to the object of passive holding company are truly performed by the holding company, POEM lies with that company only.
- Lack of significant economic activity does not mean per se that a financial holding company does not meet the requirements of POEM.

Impact of MLI

Impact of MLI

- **Recommendation under MLI**:

  "1. As per the provisions of a Covered Tax Agreement(CTA), person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. <u>In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.</u>

  2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement that provide rules for determining whether a person other than an individual shall be treated as a resident of one of the Contracting Jurisdictions in cases in which that person would otherwise be treated as a resident of more than one Contracting Jurisdiction. Paragraph 1 shall not apply, however, to provisions of a Covered Tax Agreement specifically addressing the residence of companies participating in dual-listed company arrangements."

  3 A Party may reserve the right:

  a) for the entirety of this Article not to apply to its Covered Tax Agreements ..
  b) …..
  c) ….
  d) ….
  (e) to replace the last sentence of Paragraph 1 with the following text for the purposes of its Covered Tax Agreements: "In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement.";

Impact of MLI

- **Note on Discretionary relief by Competent authorities**: The underlined portion refers to discretionary relief by Competent Authorities, if they are unable to reach a consensus on dual residency i.e., POEM of an entity.
- **India's position**:
  - Pursuant to Article 4(4) of the Convention, India considers that the following agreements contain a provision described in Article 4(2) that is not subject to a reservation under Article 4(3)(b) through (d). The article and paragraph number of each such provision is identified below.
  - Thus, India has adopted Para 1 as is, including the discretionary relief.

1. Prior to MLI, India has several treaties where only POEM was used as a resort to resolve dual residency viz., UK, Mauritius, Singapore etc.

2. Other countries viz., US, Canada, Luxemburg, Sweden, Norway, South Africa did contain the provision of resolving dual residency through Competent Authorities .

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