

Place of Effective Management (POEM)

BACKGROUND FOR INTRODUCING POEM PROVISIONS

With Globalization of Businesses, India witnessed many foreign players doing business in India. Also, many Indians ventured to expand their business across the world by outbound investments through entities held outside India.

Earlier, a Company was regarded as Resident for the purpose of taxation in India, only if, the control and management of its affairs was wholly situated in India during the year. Hence, outbound business entities owned by the Indians could go out of the Indian tax purview. This led to tax evasion opportunities for some taxpayers creating artificial outbound sources by shifting certain insignificant events related with control and management of the company outside India and thus escaping tax instances in India.

POEM PROVISIONS

In order to curb this loophole, the existing provisions pertaining to Residential Status of Company were amended vide Finance Act, 2016 and concept of POEM provisions were introduced. POEM is an internationally recognized test for determination of residence of a company incorporated in a foreign jurisdiction. POEM is “Substance over form” as the determination of POEM depends upon the facts and circumstances of a given case. A Company may have more than one place of management, but it can have only one place of effective management at any point of time.

As per recently issued POEM provisions,

Company would be resident in India if:

It is an Indian Company, or

Its place of effective management (POEM) in that year is in India

POEM is defined as a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole, in substance are made.

POEM provisions shall be effective from FY 2016-17 onwards.

In order to give relief to small companies, CBDT has clarified¹ that POEM guidelines shall not apply to a company having turnover or gross receipts of Rs. 500 million or less in a financial year.

GUIDING PRINCIPLES FOR DETERMINATION OF POEM

CBDT has laid down certain guiding principles² for determination of POEM which are discussed hereafter:

Broadly, companies are classified in two categories, as there are different set of principles for determining POEM:

Company engaged in active business outside India	Companies other than those engaged in active business outside India
<p>A Company shall be said to be engaged in "Active Business Outside India" if :</p> <p>Passive income < 50% of total income, and</p> <p>Assets situated in India < 50% of Total Assets, and</p> <p>< 50% of total number of employees are situated in India or are resident in India, and</p>	<p>If the company does not satisfy any of the conditions mentioned in previous column, then such company would be considered as companies other than those engaged in active business outside India.</p>

¹ Circular 08 of 2017, dated 23rd February, 2017

² Circular No. 06 of 2017, dated 24th January, 2017

Payroll expenses incurred on such employees is < 50% of total payroll expenditure.	
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Explanation:

“Passive Income” of a Company shall be aggregate of:

- (i) Income from transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- (ii) Income by way of royalty, dividend, capital gains, interest or rental income.

DETERMINATION OF POEM

The determination of POEM depends upon whether the company is engaged in an active business or not:

For a Company engaged in active business outside India:

The POEM shall be presumed to be outside India if the majority meetings of the Board of Directors of the company are held outside India, except where Board of Directors do not exercise their power of management and such powers are being exercised by any other person, resident in India. In such a case, POEM shall be considered to be in India.

However, merely following the general and objective principles of global policy of the group in the field of HR, Accounting, IT Infrastructure and network problems, etc. for the entire group of entities and not being specific to an entity does not constitute a case where Board is not exercising their power of management.

It has also been clarified³ that so long as Regional Headquarter operate within the above policy, it shall by itself, not lead to Board standing aside.

³ Circular No. 25 of 2017, dated 23rd October, 2017

For a Company other than those engaged in active business outside India:

The POEM determination for such companies would be a two-stage process where the first stage would be identification of persons who actually make the key management or commercial decision for conduct of the business as a whole, and the second stage would involve determination of place where these decisions are in fact being made. The place where these management decisions are taken would be more important than the place where such decisions are implemented.

FEW GENERAL GUIDING PRINCIPLES FOR DETERMINATION OF POEM

- i) The location of a company's head office is a very important factor in determination of the company's POEM as it often represents the place where key decisions are made.

If the company is more decentralized, then the head office shall be, the location where senior management are primarily or predominantly based, or where they normally return after travelling, or meet when formulating/deciding key strategies & policies for the company as a whole.

If the company is so decentralized that it is not possible to determine the Company's Head Office (HO) with reasonable certainty, then HO may not be of much relevance in determining POEM.

- ii) The location where a Company's Board regularly meets and makes decisions may be the company's place of effective management provided it retains and exercises its authority and makes key management and commercial decisions.

Mere formal holding of board meeting would itself not be conclusive evidence of POEM, if key decisions are in fact taken at other place.

- iii) Also, due to the use of modern technology, it is no longer necessary for the persons taking decision to be physically present at a particular place, and hence in such cases, the place where the majority of the directors taking the decisions usually reside, may be a relevant factor for determining POEM.

- iv) The decisions made by the shareholders on matters reserved for shareholders are not relevant for determination of POEM except where it results into effective management, which can happen through shareholder agreement or actual conduct and has to be decided on case to case basis.

- v) It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM.

In addition to the above, there are certain guidelines relating to delegation of authority by Board of Directors expressly or otherwise to executive committee or any other person including shareholders, advisors, etc. operation of senior management from various locations, meetings via telephone/video conferencing, circular resolution or round robin, etc. which are also covered under the Circular.

If the above factors do not lead to clear identification of POEM, the following secondary factors may be considered:-

- i) Place where main and substantial activity of the business is carried out.
- ii) Place where the accounting records of the company are kept.

FACTORS THAT BY ITSELF DO NOT ESTABLISH POEM

POEM determination is to be based on all relevant facts related to the management and control of the company and is not to be determined on the basis of isolated facts.

Following examples by itself shall not be conclusive evidence of POEM in India:

- i) The fact that a foreign company is completely owned by an Indian company.
- (ii) The fact that there exists a Permanent Establishment of a foreign entity in India.
- (iii) The fact that one or some of the Directors of a foreign company reside in India.
- (iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India.
- (v) The existence in India of support functions that are preparatory and auxiliary in character.

The above principles are to be seen over a period of time and Snapshot approach should not be adopted.

If POEM is determined to be in India as well as outside India, then it shall be presumed to be in India if it has been mainly/predominantly in India.

ADMINISTRATIVE SAFEGUARDS BEFORE INVOKING POEM

The Assessing Officer shall seek prior approval of the Principal Commissioner or Commissioner before initiating any proceedings for holding a company incorporated outside India as resident in India, on the basis of POEM.

- (b) The AO shall seek the prior approval of the collegium of three members consisting of the Principal Commissioners or commissioners constituted by the Principal Chief

Commissioner, for holding a company incorporated outside India as resident in India on the basis of POEM. The collegium shall provide the company with an opportunity of being heard before issuing any directions in the matter.

CONCLUSION

CBDT has provided quite a few guidelines to assist taxpayers in determination of decisive factors of POEM. However, such determination is based on facts in substance comprising of actual conduct, management, capital investment, etc. which need to be considered and accordingly there shall still be subjectivity in its application.

Income Tax has different provisions for domestic and foreign company, i.e. tax rates, TDS, etc. It is not clear whether such provisions applicable to a domestic company will apply to a foreign company which is deemed to be considered as resident in India because of provisions of POEM. Clarifications regarding various such issues are awaited.

Disclaimer:

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