



Place of Effective Management

Discussion on Draft Guiding Principles



Background



Residence Test – till AY 2015-16

- Indian Company always considered Resident
 - Co registered under Companies Act and having registered / principal office in India is Indian Co.
 - Also includes Co established under Central / State / Provincial Act, etc..
- Company other than Indian Company (“Foreign Co.”) considered resident only if control and management of its affairs is *wholly situated in India* during the year
 - Control and management to be “wholly” in India
 - For the entire year
 - Even a single BoD meeting outside India could make Foreign Co. non-resident
 - Situation significantly changed w.e.f. AY 2016-17



Residence Test – AY 2016-17..

- Foreign Co. to be resident, if Place of Effective Management (POEM), ~~at any time during the year,~~ is in India
 - Replaces the condition – control and management wholly situated in India
 - Global income of residents taxable
 - Major impact on Outbound investments with Indian Promoters
 - The phrase – ‘At any time during the year’ proposed in Finance Bill removed subsequently
- Section 6 (3) of the Income Tax Act, 1961 read with Explanation thereto



POEM – Definition

- POEM defined as a 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**”.

Key management and commercial decisions

- Focus on Key Management (not control)
- Key decisions relating to management
- Place of implementation of decisions not relevant

Necessary for overall conduct of business

- Executive level decisions – for overall conduct, in line with broad strategies & policies formulated by BOD

Of an Entity as a whole

- Day to day operations not relevant

In substance made

- Substance over form



Draft Guidelines

- Draft Guidelines on POEM issued by CBDT on 23-12-2015
 - General public comments invited till 02-01-2016
 - Only Guiding Principles
 - POEM depends upon facts and circumstances
 - Substance over Form
 - Emphasis on BoD and Top Management
 - Place of Implementation and day to day operations not relevant



Active and Passive Companies

- Foreign Co. to be classified into Active and Passive Companies
- Active Co to have POEM outside India if BoD Meetings held outside – Liberal Tests
- More Stringent tests for Passive Co
 - POEM to be based on facts and circumstances
 - Location of BoD Meetings, Executive Committee, Senior Management Personnel and their support staff, etc. relevant



Active Companies



Active Companies

Company engaged in
“Active
Business
Outside India”

- Passive Income \leq 50% of Total income AND
- Assets situated in India $<$ 50% of Total assets AND
- No. of employees situated in / resident of India $<$ 50% of total no. of employees AND
- Payroll expenses on employees situated in / resident of India $<$ 50% of total payroll expenses

Passive Income

- Royalty, dividend, capital gains, interest, rental income +
- Income from transactions where both purchase and sale of goods is from / to Associated Enterprises

Average data of previous year + 2 years prior to be considered (Shorter period for new companies)



Guidelines for Active Co.

- POEM presumed outside India if majority of BoD meetings outside India
- POEM considered in India if powers of Management not exercised by BoD but managed by holding company or any other person resident in India
 - Cases of nominee Directors
 - Qualification / experience and authorities of members of the BoD very relevant factor
 - Application of mind by the members of the BoD



Passive Companies



Guidelines for Passive Co.

- POEM to be determined in 2 stages
 - **Identification of persons** who actually make the key management and commercial decision for conduct of the company's business as a whole
 - **Determination of place** where these decisions are in fact being made
- Place of management decisions more important than place of implementation
- Some of guiding principles enlisted
 - POEM to be determined after considering all the facts



Guidelines for Passive Co.

Most Relevant

- Board of Directors Meetings
- Executive Committee
- Location of Head Office

Secondary Factors

- Place where main and substantial activity of company is carried out
- Place where accounting records are kept

NOT Relevant

- Day to day routine operational decisions by junior and middle management



BoD Meetings

- Location where BoD **regularly** meets and makes decisions relevant if
 - BoD retains and exercises its authority to govern the company
 - BoD does, in substance, make key management and commercial decisions necessary for conduct of company's business as a whole
- Mere formal holding of BoD meetings by itself not conclusive
 - If decisions by directors are in fact being taken in place other than place of formal meetings, such other place to be relevant
 - Important when meetings held in place distinct from head office or is unconnected with place of Company's predominant activity
- If BoD has de facto delegated authority to senior management / any other person / shareholder and only routinely ratifies the decisions
 - POEM will ordinarily be place where these senior managers or other person make decisions



Executive Committee

- Often, POEM to be Location of members + location of decision making
 - Location where members of executive committee are based; and
 - Where the committee develops and formulates key strategies and policies for mere formal approval by the full board
- Relevant if BoD delegates some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management
 - Delegation may be by means of a formal resolution or Shareholder Agreement or based upon actual conduct of BoD and the committee



Head Office

- Location of Head Office important for determination of POEM
 - As HO often represents place where key decisions are made
- Head Office = place where senior management and their direct support staff are located
 - if more locations, place where they are primarily or predominantly located
 - Not necessarily same as place where majority of employees work or where BoD typically meets
- Senior Management = persons responsible for formulating key strategies / policies and ensuring or overseeing execution and implementation thereof on an on-going basis
 - May include - MD, CEO, Financial Director, CFO, COO, heads of various divisions or departments (Eg. Chief Information or Technology Officer, Director for Sales or Marketing)



Location of Head Office

If single location

- If Senior management and support staff based in single location, HO is located at such place if that location is also held out to public as company's principal place of business or headquarters

If decentralized

- HO is location where senior managers
 - Are primarily or predominantly based; OR
 - normally return to following travel to other locations; OR
 - meet when formulating or deciding key strategies and policies for the company as a whole
- If different locations on more or less permanent basis and participation in meetings by tele / video conferencing
 - Location of highest level of management (Eg. MD and Financial Director) and their direct support staff to be HO
- HO not much relevant factor if determination of location of HO not possible with reasonable degree of certainty



Other Factors

- Place of usual residence of directors / members of executive committee / senior management may also be relevant
 - With use of modern technology, physical location of meeting of BoD / executive committee / senior management may not be where key decisions are in substance being made
- Secondary Factors -
 - Location of main and substantial activity
 - Place of Accounting records
 - Relevant only when other factors do not lead to clear identification of POEM



General Guidelines



General Guidelines

- POEM to be determined on year to year basis
- Co. may have more than one Place Of Management (POM) but POEM can be only at one at a point of time
- Activities performed during the year as a whole to be considered
 - And not at any one point in time
- Guiding principles to be considered cumulatively
 - No single principle / fact to be decisive in itself
- If POEM is in India as well as outside India, POEM to be presumed in India if it were mainly / predominantly in India



General Guidelines

- All relevant factors relating to “Management” and “Control” to be considered
 - Isolated facts not conclusive for determination of POEM
 - Examples of isolated facts that cannot be conclusive for POEM to be in India
 - Complete ownership by Indian Company
 - One / some of directors being Indian residents
 - Local management in respect of activities carried out by foreign company being situated in India
 - Support functions of preparatory and auxiliary character existing in India
- Pre-requisites if POEM proposed to be considered in India –
 - Prior approval of Principal CIT / CIT
 - Opportunity of being heard



Conclusion



Place where BoD makes key managerial and commercial decisions

Place where executive directors or senior management (i) formulate key strategies / policies and (ii) ensure or oversee execution and implementation thereof on an on-going basis

Place where the day to day business activities are carried out / conducted



Questions



Questions – Active vs. Passive

- Passive Income includes income from transactions where both purchase and sale of goods is from / to AEs
 - Entities purchasing material from AEs and selling to AEs after value addition also covered?
 - Needs clarity to include only trading activities
 - Covers transactions even If both the AEs are non-residents?
- Classification of Active Co having loss?
- Average data of 3 years to be considered in determining active / passive nature
 - POEM is to be determined on year to year basis
 - Active test for 3 years may be stringent
 - Entities not active in preceding years but indicating steps taken for change in business model / activities should be considered active



Questions – Active Co

- Only criteria of BoD meeting or other criteria also relevant?
 - Other factors should not be applicable to “Active” Co. – Clarity required
- POEM of Active Co presumed outside India if majority of BoD meetings outside India
 - Meaning of ‘Majority’ needs more objectivity
 - Majority = More than 50%?
 - Majority = meetings held in India exceed meetings held in any other Country?
 - Substance over form
- POEM considered in India if powers of Management exercised by person resident in India
 - No guidance for determination of the same
 - Exclusions for shareholders activity?



Questions – Passive Co

- Various relevant factors given but preference or hierarchy not mentioned
 - Leads to subjectivity and ambiguity
 - While it is clear that day to day operations is not relevant, top as well as mid level of management considered as relevant
 - Location of BOD meetings and location of head office may be at different places



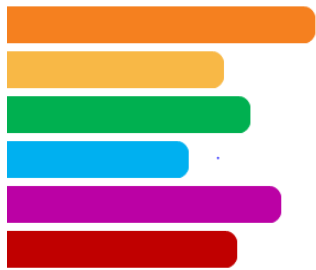
Questions – POEM outside

- If POEM is in India as well as outside India, POEM to be presumed in India if it were mainly / predominantly in India
 - Needs more clarity on factors to determine whether ‘predominantly’ POEM is in India
 - Could be based on Number of events / activities
 - Or based on Number of key managerial persons



Questions – General Principals

- Para 9 mentions that all relevant factors relating to “Management” and “Control” to be considered
 - Control has been specifically excluded from Section 6
 - Mention of control here could lead to confusions
 - The guiding factors mentioned include ‘ownership by India Company’
 - Ownership, in either case should not be relevant, be it in isolation or otherwise
 - The mention of ‘Company’ may also lead to interpretation that ownership by individuals / other persons is not specifically excluded
 - Support functions of preparatory and auxiliary nature should also be excluded as a principal
 - Mention that this in isolation will not lead to POEM appears to mean that in addition with other facts this could also lead to POEM in India
 - Local Management, with respect to the activities carried out in India, not defined



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