

ALL THE ASPECTS OF PLACE OF EFFECTIVE MANAGEMENT (POEM)

On 24th January 2017, Central Board of Direct Taxes (CBDT) has issued final guideline for determination of POEM of Non-Indian Company. It majorly depends upon whether company has active business outside India.

A. BACKGROUND

Before amendment in the definition of residency as per Indian Tax Laws, a company said to be a resident if it is an Indian Company or if during that year, the control and management of its affairs is situated wholly in India. This allowed Tax avoidance opportunities to escape the Indian residency by shifting insignificant/isolated events related with control and management outside India.

To cover the Tax avoidance opportunities, definition of Resident is amended, which states: A company is said to be 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.**

The POEM guidelines shall not apply to companies having turnover or gross receipts of INR 500 million or less in a financial year (CBDT press issue dated 24 January 2017 but has not been stated in the guidelines).

The Assessing Officer shall initiate POEM determination only after prior approval of the Principal Commissioner/ Commissioner.

Consequences of Indian Residency

- Entity's global income shall be Taxed in India.
- It will have to file its Tax returns, audit reports etc. with the Indian Tax Department.
- If company fails to file Tax returns, its global income shall be considered as concealed

B. WHAT IS POEM

- It is an internationally recognized test for determination of Residence.

- 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.
- Is effective from 1st April 2017 and will apply to Assessment Year 2017-18 and subsequent assessment years.

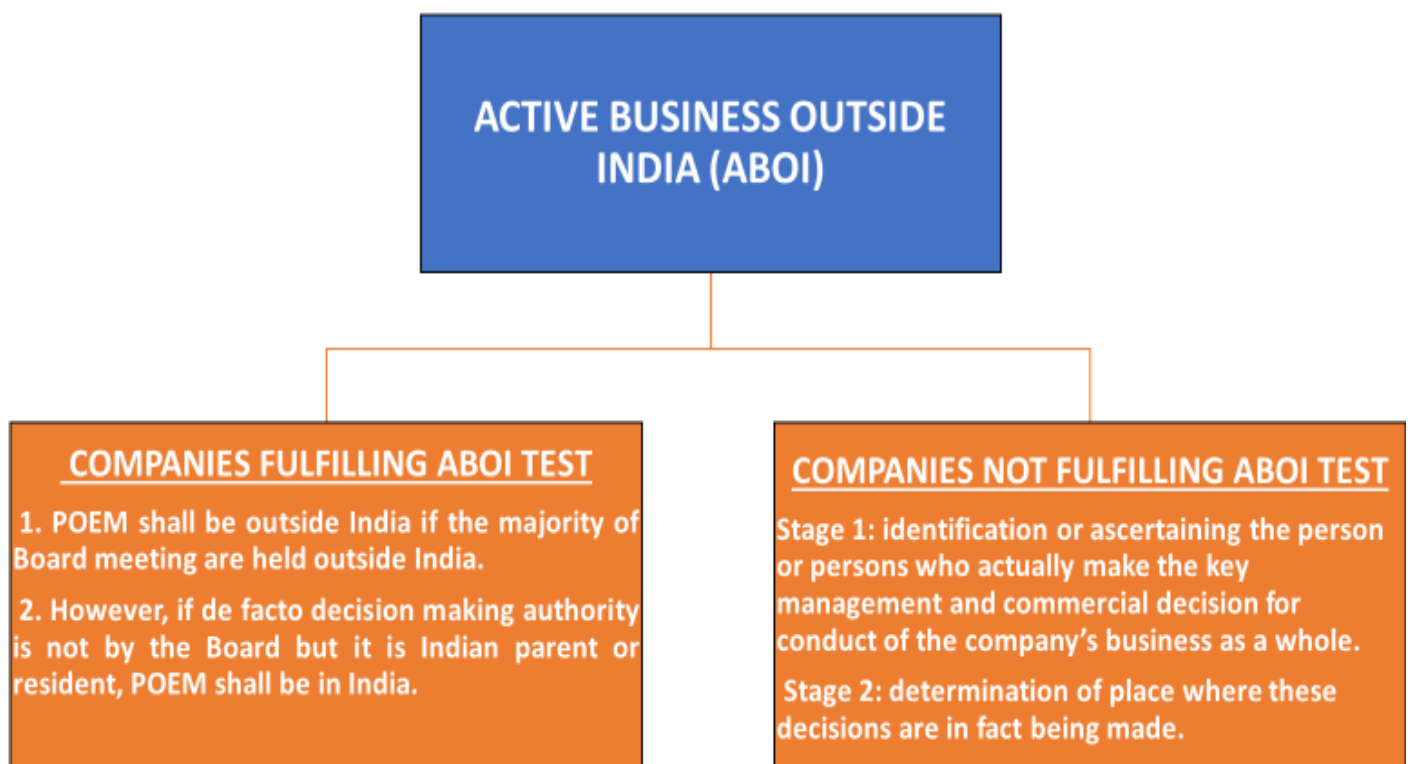
C. GENERAL PRINCIPLES FOR DETERMINING POEM

The test of determination of POEM would generally be:

- Depends on the facts and circumstances of a given case for each year.
- Driven by substance over form.
- Shall be based on the place where decisions are taken not where decisions are implemented.
- Day to day operational decisions are not relevant.
- Entity may have more than one place of management.
- All the principles in guideline shall be given equal weightage. Thus, cannot be based on single isolated principle.

D. TEST FOR DETERMINING POEM OF A FOREIGN COMPANY

Test shall be different for companies having active business outside India and for the companies not having active business outside India, which is as follows:



E. DETERMINATION CRITERIA FOR ACTIVE BUSINESS OUTSIDE INDIA

A company shall be deemed to be engaged in ABOI if it meets all the below criteria:

1. if its passive income (wherever earned) is not more than 50% of total income.
2. The following are less than 50% of its total in each case:
 - Its total asset in India.
 - Total number of employees in India or Indian residents.
 - Payroll expenses incurred on the employees under the employee test over total payroll expense.

Note: An average of the above tests of the three prior years or a shorter period for which the company has been in existence must to be taken into account for the ABOI test.

F. DETERMINATION OF POEM WHEN COMPANIES ARE NOT FULFILLING ABOI TEST

The determination shall be through two stage process as explained in chart above keeping in mind the following principles:

1. Location of BOD:

POEM shall be the place where the company's board regularly meets and makes decisions, provided that the company's board:

- retains and exercises its authority to govern the company; and
- does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

If the key decisions by the directors are being taken in a place other than the place where the formal meetings are being held, then such other place would be relevant for the determination of POEM.

2. Delegation of committees:

Where that committee develops and formulates the key strategies and policies for approval of the board, will be considered as the POEM.

3. Location of Head office:

A company's head office would be a very important factor in the determination of its POEM.

The head office-

-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.

4. Use of modern technologies

Place of residence of directors when modern technologies are used.

5. Round robin voting

Location of the parties involved and frequency in case of circular or round robin voting.

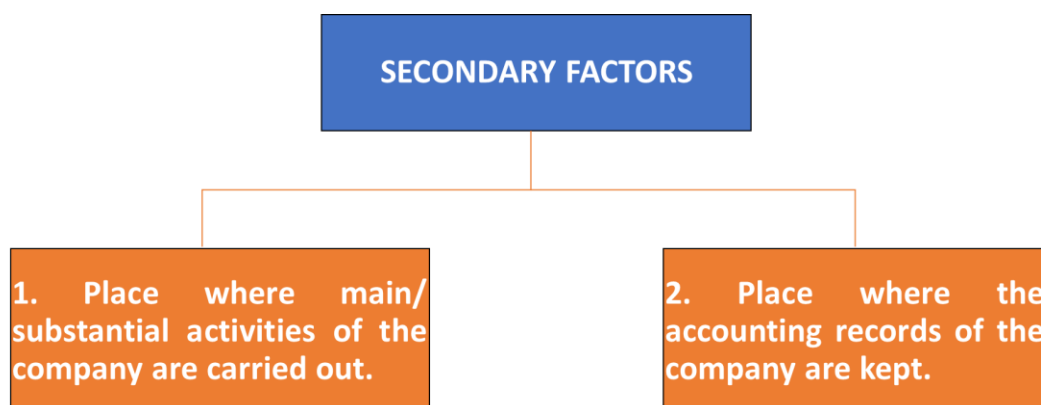
6. Decisions by shareholder:

Decisions taken by shareholders on the matters which are reserved for shareholder decision only shall not be considered for POEM.

7. Daily routine operational decisions shall not be relevant.

G. SECONDARY FACTORS WHERE ALL ABOVE CRITERIAS ARE FULFILLED

If all the above factors fail to determine clear POEM, the following secondary factors can be considered:



H. CIRCUMSTANCES WHERE POEM SHALL NOT BE ESTABLISHED MERELY BECAUSE ONE OR MORE CONDITIONS ARE ESTABLISHED:

1. Foreign company is completely owned by an Indian Company.
2. There is a permanent establishment of a foreign company in India.
3. Where some of the Directors of a foreign company resides in India.
4. Local management in India relates to activities carried out by a foreign company in India.
5. Support functions that are preparatory and auxiliary in character in India.

I. IMPACT OF POEM

The entities which are most impacted are those Indian individuals and companies which have set up foreign joint ventures and others and routinely take decisions for such entities from India.

It shall also affect the group where the executives of Indian entity are also on the board of subsidiary company. These companies shall now come under the purview of Indian residency and shall be taxed in India for its global income.

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