



EXECUTIVE SUMMARY

Guiding Principles for determination of Place of Effective Management (POEM) of a Company

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- ❖ Existing provisions of Section 6(3) of Income Tax Act, 1961 ('the Act'), provides conditions for determining residential status in respect of Companies. Under the said clause, a company is said to be resident in India in any previous year, if
 - (i) it is an Indian company; or
 - (ii) during that year, the control and management of its affairs is situated wholly in India.
- ❖ Due to the requirement that whole of control and management should be situated in India and that too for the whole year, the conditions has been rendered to be practically inapplicable. Thus, a foreign company can easily avoid becoming a resident by simply holding a board meeting outside India. This facilitates creation of shell companies which are incorporated outside but controlled from India.
- ❖ In order to restrain creation of shell companies, the Finance Act, 2015 amended the existing provisions of Section 6(3) of the Act, and provided that with effect from 1st April, 2016, 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 ('POEM') in that year is in India.
- ❖ POEM is defined in the Act, which means 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. POEM is an internationally recognized test for determination of residence of a company incorporated in a foreign jurisdiction.
- ❖ Subsequently, the Finance Act, 2016 had changed the effectivity of the aforesaid amendment and provided that the same will be effective from 1st April, 2017 and will apply to Assessment Year ("AY") 2017-18 and subsequent AYs.
- ❖ The Central Board of Direct Taxes ('CBDT') has issued guiding principles for determination of POEM in case of a company vide circular no. 06 dated 24th January, 2017. Further, the CBDT vide press release of even date stated that POEM guidelines shall not apply to companies having turnover or gross receipts of Rs. 50 Crore or less in a financial year.

❖ The guiding principles to be followed for determination of POEM in case of a company is summarized as under:

- CBDT has come up with the new concept of Active Business Outside India (ABOI). The intention is to target shell companies incorporated outside India.
- The process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in active business outside India.
- **Criteria for determining company having Active business outside India-**

- A company shall be said to be engaged in “**active business outside India**” if



- “**Passive income**” of a company shall be aggregate of,-
 - (i) income from the transactions where **both** the purchase and sale of goods is from / to its associated enterprises (‘AE’); **and**
 - (ii) income by way of royalty, dividend, capital gains, interest or rental income.
- To determine the above percentage, the **average** of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered.
- **If company’s active business is outside India** then POEM shall be presumed to be outside India, if the majority meetings of the Board of Directors (‘BOD’) of the company are held outside India. However, if powers of BOD are being exercised by either the holding company or any other person (s) resident in India, then the POEM shall be considered to be in India.

- **If company's active business is not outside India** then the determination of POEM would be a two stage process, namely:-
 - (i) **Identifying** the person who actually make the key management and commercial decision for conduct of the company's business as a whole.
 - (ii) **Determination** of place where these decisions are in fact being made. Place where management decisions are taken would be more important than the place where such decisions are implemented.
- **Some other guiding principles for determination of POEM on the basis of substance over form -**

1. Location of Board of Directors-

The location where a company's board regularly meets and makes decisions may be the company's POEM provided, the Board-

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

2. Location of the committee to whom powers of management are delegated-

If a board has delegated the authority to make decisions to senior management or an executive committee or any other person and it only formally approves those decisions, POEM will be the place where these senior managers / other person make those decisions or location where members of the executive committee are based.

3. Location of Head Office-

The location of a company's head office is an important factor in determining the company's POEM as it often represent the place where key company decisions are made.

4. Use of modern technology-

Use of modern technology impacts the place of effective management. Physical presence of a person at a particular location is no longer required. Physical location of board/committee meeting may not be where the key decisions are in substance made.

In such cases places of directors or person taking decisions usually reside may also be relevant factor.

5. Shareholder's involvement

The decisions made by the shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's POEM. However, in certain situations, shareholder's involvement may result in effective management being exercised by the shareholder and thus will be relevant for determining company's POEM.

➤ If the above factors do not lead to clear identification of POEM then the following secondary factors can be considered:-

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

➤ Other Aspects

- The determination of POEM 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.
- The above POEM guidelines shall not apply to companies having turnover or gross receipts of Rupees Fifty crore or less in a financial year.
- If 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.

- The Assessing officer (AO) shall, before initiating any inquiry for POEM in case of an assessee, has to seek prior approval of the Principal Commissioner / Commissioner.
- Further, AO shall take the approval from collegium of three Principal Commissioner / Commissioners before holding non-resident company as resident in India based on POEM.

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