Place of Effective Management (POEM)

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Place of Effective Management in India

- Place of effective management' (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction
- Most of the tax treaties entered into by India recognises the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation
- As per the Income-tax Act, 1961 ('the Act'), POEM means the 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

Place of Effective Management in India

- A foreign company is treated as a resident in India if its POEM is in India. These provisions are applicable from Assessment Year 2017-18
- The Central Board of Direct Taxes ('CBDT') on 24 January 2017 has issued guiding principles for determination of POEM of foreign companies **(Refer Circular No 06 of 2017)**
- **Vide Circular 08 of 2017**, it is clarified that POEM provisions shall not be applicable to a foreign company having turnover or gross receipts lower than or equal to **INR 500 Million** in a financial year

Determination of POEM in India

- **Test 1** : ***Active Business Test*** : If the company fulfills the test of ***Active Business outside India***, its POEM will be based on the place where Majority of BOD Meetings are held. However it has also been provided in the guidelines that if de facto decision making authority is not BOD **(i.e BOD of the company are standing aside)**, but Indian Parent or Resident, POEM shall be in India
- If company does not fulfill the ***Active Business outside India*** test then determination of POEM is subjective which will require us to identify based on facts i.e substance over legal form, the persons who actually make the key management and commercial decision for the conduct of the company's business as a whole and then determining the place where these decisions are in fact made with respect to the location of those persons

Active Business Outside India

A company shall be said to be engaged in "active business outside India" if :

- the **passive income** is **not more than 50%** of its total income; **and**
- **less than 50%** of its **total assets** are situated in India; **and**
- **less than 50%** of total number of **employees** are situated in India or are **resident in India; and**
- the **payroll expenses** incurred on such employees is **less than 50**% of its total payroll expenditure.

Data* to be collected for Test 1

- Passive Income of Each company and its %age to the total income
- No of employees in each company and out of that how many are resident in India
- Payroll expense on employees resident in India out of total payroll expense
- No of BOD Meetings held and location
- Who Signs Customer and vendor contracts and residential status of such person (it is most important refer example 4 in Circular No 6/2017)
- Location of MD,CEO,CFO and COO (to determine the location of Head Office….see definition of head office in Circular No 6/2017)

**** Average data of PY and last 2 PY should be taken***

Passive Income

“Passive income” of a company shall be aggregate of, -

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

Key Note : the income shall be, -

(a) as computed for tax purpose in accordance with the laws of the country of incorporation; or

(b) (b) as per books of account, where the laws of the country of incorporation does not require such a computation.

Value of Assets

(a) In case of an **individually depreciable asset**, shall be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and

(b) In case of **pool of a fixed assets** being treated as a block for depreciation, shall be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;

(c) In case of **any other asset**, shall be its value as per books of account;

No of Employees/Payroll

- The number of employees shall be the average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees;
- The term "pay roll" shall include the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.

Determination of POEM in India

Test 2 : Location of Head office : The **location of a company's head office** will be a **very important factor** in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:-

- If the **company's senior management** and their support staff are based in **a single location** and that location is held out to the public as the company's **principal place of business or headq**uarters then that location is the place where head office is located.

Determination of POEM in India

- If the **company is more decentralized** (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company's head office would be the location where these senior managers,-

(i) are primarily or predominantly based; or

(ii) normally return to following travel to other locations; or

(iii) meet when formulating or deciding key strategies and policies for the company as a whole.

Determination of POEM in India

- Members of the **senior management may operate from different locations** on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the **head office would normally be the location**, if any, where the **highest level of management** (for example, the Managing Director and Financial Director) and their direct support staff are **located.**
- In situations where the senior management is so decentralized that it is **not possible to determine the company's head office with a reasonable degree of certainty**, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

Head Office (Test 2)

- "Head Office" of a company would be 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;
- "Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis i.e MD or CEO, FD or CFO, COO and the heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

Testing POEM = “Substance Over Legal Form”

- Say no to “Snapshot Approach”
- Foreign company is completely owned by an Indian company will not be conclusive evidence.
- Permanent Establishment of a foreign entity in India would itself not be conclusive evidence.
- Some of the Directors of a foreign company reside in India will not be conclusive evidence.
- 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
- The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence

Testing POEM = "Substance Over Legal Form"

- The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. **In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor**.

Author's Profile

CA. Saurabh Chhabra is a Tax professional with 6+ years of multi industry experience in handling Tax matters (Direct, Indirect and International Taxation) and currently designated as Associate Manager Taxation in Subex Limited.

He has Qualified his CA in May 2018 with distinction in International Taxation. He is working in Industry since 2013 as Tax Professional and contributed plethora of articles on latest tax matters published by LexisNexis, TaxGuru.com, Taxsutra.com etc.

He has good understanding of Indian Tax Laws (Income Tax & GST) as well as International Tax Laws. He has analyzed more than 100 Double Taxation Avoidance Agreements for Subex Limited and consulted on WHT Implication of proposed customer contracts/ bids. He has significantly contributed in Implementing GST in LexisNexis (A division of RELX India Private Limited). He is very active in sharing updates on latest tax matters like BEPS, GAAR, Thin Capitalization, POEM, Transfer Pricing Reporting and Documentation, DTAA updates, India GST etc. He has participated in various National level seminars, Study Circles as a speaker. He can be reached at casaurabhchhabra2016@gmail.com or WhatsApp: +91-7838781966.

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THANK YOU