

Article on Place of Effective Management (POEM)

Brief Introduction of POEM

Taxability of the Foreign Company was narrow in scope up to the FY 2014-15 which allowed tax avoidance opportunities for the foreign Companies to artificially escape the residential status by shifting insignificant or isolated events related with control and management outside India. However, with the introduction of concept of POEM in section 6(2) of the Income Tax Act 1961 (Act) vide Finance Act 2015, all those companies which artificially escaped residential status earlier including shell companies or companies incorporated to retain income outside India are now likely to be treated as Indian Tax residents. CBDT vide circular 6/2017 has introduced guidelines that define key terms such as Head office, Key Managerial Person and factors that are important to identify whether the POEM of the company is lying in India or outside India.

POEM has been defined to mean *“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”*.

As mentioned above, the aforesaid amendment for determining the residential status of foreign companies was introduced by the Finance Act, 2015 to bring it in line with the international best practices. The concept of POEM has also been dealt with in detail in the commentary issued by United Nations (UN) and Organisation for Economic Co-operation and Development (OECD).

Determining the residential status of the company on the basis of the POEM is not a new buzz in the World. Most of the countries like China, Netherland, Russia, Spain and South Africa have already introduced POEM in their domestic tax law or as a tie breaker rules in the treaties they have entered with different countries. The POEM definition in all the countries is more or less the same, which is in line with the definition given in OECD or UN Model. Further there are certain countries like United State of America (USA), United Kingdom (UK) which determine the residential status of Overseas Incorporated Company on the basis of the place where the Central Management & Control exist which is almost similar to the concept of POEM.

Adoption of the concept of POEM in the domestic law India open the door of ambiguity which exists in the World regarding the interpretation of the POEM and at times, the meaning accorded is coloured or influenced by internal approach of various jurisdictions regarding residential status of Foreign Company.

Authors like Prof. Klaus Vogel and Philip Baker in their commentary about POEM has mentioned that there is no unanimity as to factors to be taken into account for determination of POEM. Following observation is extract from their commentary *“The POEM criterion is a factual test following the ‘substance over form’ principle. As stated in No. 24 OECD MC Comm. On Article 4, the POEM ‘is the place where key management*

and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management'. However, no further guidance is given on its meaning. Even though the POEM serves as the tiebreaker criterion in most DTCs, there is no unanimity as to which facts are to be considered and what weight should be given thereto."

The similar opinion is given by the judge in the overseas jurisdiction in case of Small Wood.

OECD provides various factors to be considered in respect of determining the POEM of a company.:

- a) Place where Board meeting of the company are usually held;
- b) Place where the chief executive officer and other senior executives usually carry on their activities;
- c) Place where the senior day-to-day management of the person is carried on;
- d) Place where the person's headquarters are located;
- e) Place of which country's laws govern the legal status of the person;
- f) Place where its accounting records are kept.

It may be noted that India does not adhere to the OECD interpretation of POEM. In its view the place where the main and substantial activity of the entity is carried on is also to be taken into account while determining POEM.

The United Nation also provides the tie breaker rule for determining residence of a dual resident company which is based on the POEM of that company in a particular jurisdiction. Factors which may help in determining POEM of a company are as under

- a) Place where a company is actually managed and controlled,
- b) Place where the decision-making at the highest level on the important policies essential for the management of the company takes place,
- c) Place that plays a leading part in the management of a company from an economic and functional point of view, and
- d) Place where the most important accounting books are kept.

Important factor which should be consider by the Foreign Company to shift their POEM outside India

- a) Board Meetings
 - i) All Board meeting of the company should be held outside India,
 - ii) Memorandum of Article (MOA) may specifically provide that the Board meeting should not held in India.
 - iii) Participant from India do not dominate the decision making process
 - iv) Meeting should be conducted on quarterly basis outside India to demonstrate that the decision making is made by the director in Board meeting

- v) Full and Accurate Board minutes should be prepared
- vi) Agenda and documentation of the meeting should be circulated in advance of meeting so that the director can get time to take informed decision making
- vii) Other Ancillary documents regarding the Hotel Bill & Airline tickets should also be properly documented
- b) Decision making
 - i) The Company director should make all decision affecting the company business at the board meeting which is held outside India for example financing the business, Investment Policies, Business production, marketing and expansion of company business.
 - ii) The Board should make informed decision, it should not merely seen follow up and implement instruction from person resident in India
 - iii) Where Board resolution are passed in writing they should be sign in offshore jurisdiction
 - iv) Company should ensure that the Correct Constitution organ of the organization is not being usurped or side stepped.
- c) Director
 - i) Majority of the Board of Director of the company should not be resident of India
 - ii) There should not be Quorum unless the majority of director resident outside India
 - iii) Such director who is outside India should include those with senior management role & person capable of making significant control
 - iv) Ensure that the director in India doesn't participate in Meeting via Telephone or Video facility especially when they are in India.
 - v) Chairman of the Board having casting vote he/she should not be resident of India.
- d) Professional Advisor
 - i) The Company can engage the service of Indian resident professional advisor. The professional advisor can propose advices and influence the company but cannot dictate management decision
 - ii) Profession advisor can always ask the directors whether they are willing to accept the term in a document and if so to sign a particular document rather than sending a letter asking the director to sign the document
 - iii) All communication and documents should be worded in the way one would expect for a company that is truly managed and controlled by it director
 - iv) Board minutes should not be drafted in advance by the advisor particularly before meeting,
- e) Administration
 - i) Books of account & record should be kept outside India
 - ii) All time company Secretary should preside outside India
 - iii) Obtain Tax Residential status (TRC) which shows the residential outside India.

iv) Company having bank account outside India

Benefit due to introduction to POEM

- a) If a foreign company is resident in India on account of POEM in India then, it should be eligible to claim FTC in respect of taxes paid in foreign jurisdiction which is doubly taxed.
- b) The transactions between the associated enterprise (POEM in India) and the Indian company should not be considered to be within the ambit of Specified Domestic Transactions under Indian transfer pricing regulations.
- c) Transactions between the associated enterprise (POEM in India) and its group companies outside India should also not be considered within the ambit of International Transactions under Indian transfer pricing regulations.

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