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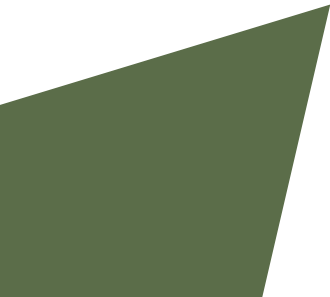
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Place of Effective Management – The Indian Evolution

Aditya Sarkar

INTRODUCTION TO THE CONCEPT OF 'POEM'

Despite it not being defined explicitly in any statute or legislature, the global understanding of the concept of the Place of Effective Management is “a place where key management & commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made”¹. The same is also in line with the definition provided to it in the OECD Model Tax Convention, to which it owes its origin. Now before we step into a discussion of the evolution of idea, along with an analysis of its key/salient features as well as its subsequent impact on companies in India, let us clearly understand what the concept is and what is the purpose behind incorporating it.

POEM is used to determine the residence of a company in a particular country for the purpose of taxation as per the laws of that country. Earlier, companies used to incorporate themselves in countries other than those where it primarily used to conduct its business in order to avoid higher rates of taxation. They had gotten away with it until the OECD introduced certain guidelines with regards to it, and this was shortly followed by the introduction of the concept of POEM. The POEM test is basically used to understand and analyse as to where the real effective control of a particular company resides, despite the place of its incorporation, and tax it accordingly. An ideal example of this would be, if suppose, company A is incorporated in The Bahamas but its effective control resides in the United States of America i.e. the Board of Directors and other members of the senior management meet there and important executive decisions with regards to the conducting of business by the company are taken there, then A will be liable for paying taxes in the United States of America by means of the determination of the same using POEM guidelines, as if it were incorporated there only.

While determining the POEM of a company, the basic factors that are often taken into consideration are present in its above-mentioned definition itself. These, however, have been termed to be general factors and the ambit of it often varies from one country to another:

(1) Key Management & Commercial Decisions²

This part somewhat emphasizes on the fact that the country/place where important key management and commercial decisions are taken are the only criteria for the determination of

¹ Shah DC, “Place of Effective Management (POEM)” (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

² Shah DC, “Place of Effective Management (POEM)” (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

POEM. The country/place where the company's day-to-day operations are conducted or where the shareholders' body meetings are held are not important factors in determining POEM.

(2) Necessary for the Conduct of Business³

This clause in the definition of POEM restricts its ambit to only Executive level Management decisions, which are aimed at the overall conducting of business by the company and are in line with the broad strategies and policies as decided by the Board of Directors. It does not include other mid-level or lower-level Management decisions. It, thus, takes a more 'continental approach'.

(3) Of an Entity as a Whole⁴

This phrase only further emphasizes the second clause as mentioned above. This means that only decisions regarding to the overall functioning of the company as a whole will play a significant part in determining its POEM. Day-to-day operations and other lower level decision making, involving a particular department or a group of departments within the company, do not play a role in doing the same.

(4) In Substance Made⁵

This clause reiterates the fact that the substance of the functioning and conducting of business by a company will be given more emphasis in comparison to the manner/form in which it is being done. Hence, if the Board meeting of a company are being held in country A but a substantial amount of essential executive level decisions are being taken in country B, the latter will be taken as the POEM.

'POEM' IN AN INTERNATIONAL CONTEXT

Today, POEM is one of the primary tests used in determining the residence of a company in a particular jurisdiction across the world. The primary test used before this, on an international stage, was the OECD Model Tax Convention. Even though this was replaced by the POEM, the latter still models around the concept inculcated by the former. Internationally, POEM considers a lot of factors in addition to the ones discussed above, such as:

³ Shah DC, "Place of Effective Management (POEM)" (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

⁴ Shah DC, "Place of Effective Management (POEM)" (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

⁵ Shah DC, "Place of Effective Management (POEM)" (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

- The country where the Board Meetings are held or the Board of Directors meet.
- The country where the CEO and other members of the senior level management make important decisions and conduct the various important functions of the company.
- The country where the company is actually headquartered.
- The country whose laws provide the company with its legal status.
- The country in which the accounting body of the company is present⁶.

Other than these factors, various countries across the globe have developed their own rules and regulations within which they analyse the POEM of a company.

For instance, South Africa, unlike the ‘Continental Approach’, not only takes into consideration the country/place where the senior and executive-level management operates but also where the day-to-day operations are conducted by mid-level or lower-level managers⁷. Thus, it identifies the POEM of a company not only on the basis of where its strategies and policies are formulated and developed (functions of the senior or executive level management), but also on the basis of where these strategies and policies are executed on a ground level (functions of mid-level or lower-level management).

China, too, deviates from the ‘Continental Approach’ to POEM. Other than the general internationally accepted factors, it also takes into consideration the place where the management supervising various manufacturing and business operations, human resources and other accounting/legal functions resides⁸. Hence, it can clearly be understood that China takes into consideration a lot of on-ground factors while determining the POEM of a company.

Unlike South Africa and China, European countries generally endorse a more of a ‘Continental Approach’ and usually do not take into consideration factors relating to mid-level and lower-level management functions of a company. Both Russia and France, for instance, considers the following factors while determining POEM:

- The country/place where the BOD meets.
- The country/place where the senior/executive management resides and carries out its functions.

⁶ “CBDT Issues Final Guidelines for Determination of POEM” (January 25, 2017)

<https://www.pwc.in/assets/pdfs/news-alert-tax/2017/pwc_news_alert_25_january_2017_cbd_t_issues_final_guidelines_for_determination_of_poem.pdf>

⁷ Shah DC, “Place of Effective Management (POEM)” (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

⁸ Shah DC, “Place of Effective Management (POEM)” (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

- The country/place where the CEO resides and carries out his/her functions⁹.

‘POEM’ IN AN INDIAN CONTEXT

I. INTRODUCTION AND EVOLUTION OF ‘POEM’ IN INDIA

The concept of POEM was first introduced in the DTC Bill in 2010. However, the idea back then was that the control and management of a company has to be ‘wholly’ based or situated in India in order for it to qualify as a resident for the purpose of taxation in India. However, this ‘wholly’ clause was actually too high a threshold and companies began taking advantage of this clause by engaging in practices such as shelling, conduiting etc. Other than that, taxation in India could also be very easily avoided by having just one or two BOD meetings outside India. Hence, the need to amend the Bill was felt in order to put the same in line with international standards, rules and regulations.

The DTC Bill was amended in 2015 with the introduction of a Finance Bill and the word ‘wholly’ was removed in order to include a list of other factors that had to be taken into consideration.

II. GENERAL PROVISIONS RELATING TO ‘POEM’ IN INDIA

The Location Criteria for the determination of POEM of a company is one of the fundamental provisions required to be taken into consideration while determining the POEM of a company. It was introduced by the DTC Bill in 2010. However, it is very similar to the ‘Continental Approach’ to POEM i.e. it does not take into consideration any mid-level or lower-level management functions. As per the Location Criteria, some of the guidelines for the determination of POEM is as follows:

- Executive Committee¹⁰: The POEM is determined on the basis of where the executive committee operates. The Executive Committee consists of the Board of Directors and all other senior-level management. The place/country where the executive committee

⁹ Shah DC, “Place of Effective Management (POEM)” (*Tax Guru* September 26, 2015) <<https://taxguru.in/income-tax/place-effective-management-poem.html>>

¹⁰ “CBDT Issues Final Guidelines for Determination of POEM” (*Tax Insights from India Tax & Regulatory*

Services January 25, 2017) <https://www.pwc.in/assets/pdfs/news-alert-tax/2017/pwc_news_alert_25_january_2017_cbdt_issues_final_guidelines_for_determination_of_poem.pdf>

formulates and develops strategies, plans, policies etc for the functioning of the entire company becomes the 'Place of Effective Management' of that company.

- Head Office of the Company¹¹: The Head Office of the Company is also a very important factor in determining its POEM. The Head Office is basically the place where the executive-level management is based out of, along with their direct support staff. It does not necessarily have to be the office with the highest population of employees or the place where the BOD frequently meets.
- Shareholders' Meeting¹²: Even though not a substantial factor, the place where the Shareholders' Meetings are held and where the Shareholders vote about the various aspects of the company needs to be taken into consideration while determining the POEM of the company as well. However, this being a secondary factor only has persuasive value.
- Other Secondary Factors¹³: Other secondary factors that do not have substantial value in the determination of POEM but have pervasive value are
 - (i) Other places where a substantial amount of the company's functioning is conducted
 - (ii) The accounting/book-keeping or the legal base of the company.

After the amendment as made by the Finance Bill in 2015, several other factors were also introduced in this process. These factors somewhat deviated from the "Continental Approach" earlier followed by India and hence, increased the scope of determination of the POEM of a company for the purpose of taxation in India. They are as follows:

- Ignorance of Isolated Facts¹⁴: The determination of the POEM of a company has to be made on a fact-to-fact basis, based on the facts and circumstances of each case. There

¹¹ "CBDT Issues Final Guidelines for Determination of POEM" (*Tax Insights from India Tax & Regulatory Services* January 25, 2017) <https://www.pwc.in/assets/pdfs/news-alert-tax/2017/pwc_news_alert_25_january_2017_cbd_t_issues_final_guidelines_for_determination_of_poem.pdf>

¹² "CBDT Issues Final Guidelines for Determination of POEM" (*Tax Insights from India Tax & Regulatory Services* January 25, 2017) <https://www.pwc.in/assets/pdfs/news-alert-tax/2017/pwc_news_alert_25_january_2017_cbd_t_issues_final_guidelines_for_determination_of_poem.pdf>

¹³ "CBDT Issues Final Guidelines for Determination of POEM" (*Tax Insights from India Tax & Regulatory Services* January 25, 2017) <https://www.pwc.in/assets/pdfs/news-alert-tax/2017/pwc_news_alert_25_january_2017_cbd_t_issues_final_guidelines_for_determination_of_poem.pdf>

should not be a specifically accepted guiding principle which should be put to use in each and every case as the determination of POEM is a very complex matter.

- Exercise of Control by Shareholders and Holding Companies¹⁵: The effective exercise of control and power of the shareholders and the other holding companies of the main company are also important factors in the determination of the POEM of that company. This includes the place where the Shareholders' Meeting take place, where decisions with regards to the sale or purchase of company assets take place or even where the decisions with regards to the dissolution or liquidation of the company assets take place.
- Location of Circular Resolutions¹⁶: The amendment also included guidelines with regards to the inclusion of the place where various circular resolutions with regards to the functioning of the company take place as part of the process of the determining its POEM.
- Procedural Safeguards¹⁷: The amendment further included that when the authorities seek to determine the POEM of a foreign company conducting business in India, the prior permission of the Principle Commissioner (PC) or the Commissioner of Income Tax (CIT) has to be taken before the proceedings are initiated.

The amendment also issued guidelines with regards to certain factors which are to be considered irrelevant while determining the POEM of a company if taken in isolation with the facts and circumstances of the case. These factors are:

- The fact that the foreign company is completely owned and managed by an Indian company.

¹⁴ "PLACE OF EFFECTIVE MANAGEMENT - REVISED GUIDELINES ISSUED: INHERENT SUBJECTIVITY STILL A CONCERN" (February 1, 2017) <<http://www.nishithdesai.com/information/news-storage/news-details/article/place-of-effective-management-revised-guidelines-issued-inherent-subjectivity-still-a-concern.html>>

¹⁵ "PLACE OF EFFECTIVE MANAGEMENT - REVISED GUIDELINES ISSUED: INHERENT SUBJECTIVITY STILL A CONCERN" (February 1, 2017) <<http://www.nishithdesai.com/information/news-storage/news-details/article/place-of-effective-management-revised-guidelines-issued-inherent-subjectivity-still-a-concern.html>>

¹⁶ "PLACE OF EFFECTIVE MANAGEMENT - REVISED GUIDELINES ISSUED: INHERENT SUBJECTIVITY STILL A CONCERN" (February 1, 2017) <<http://www.nishithdesai.com/information/news-storage/news-details/article/place-of-effective-management-revised-guidelines-issued-inherent-subjectivity-still-a-concern.html>>

¹⁷ "PLACE OF EFFECTIVE MANAGEMENT - REVISED GUIDELINES ISSUED: INHERENT SUBJECTIVITY STILL A CONCERN" (February 1, 2017) <<http://www.nishithdesai.com/information/news-storage/news-details/article/place-of-effective-management-revised-guidelines-issued-inherent-subjectivity-still-a-concern.html>>

- The fact that the permanent establishment of the company is in India.
- The fact that some of the directors of the company are residents of India.
- The fact that the local management of the company is based in India¹⁸.

III. UNIQUE PROVISIONS RELATING TO 'POEM' IN INDIA

One of the salient and most unique features of the 'POEM' guidelines in India is the ABOI Test. ABOI Test stands for 'Active Business Outside India' test, which is a test used to determine whether a company's POEM is outside India despite it having a substantial amount of control, decision-making and management placed within India. Thus, it can be said to be an exception to the main objective of the concept of POEM and usually serves as an advantage for foreign companies with a substantial amount of operations in India.

A company is, thus, said to be engaging in 'Active Business Outside India' despite having a substantial amount of operations based in India if the passive income of the company is not more than 50% of its total income, and:

- Less than 50% of its total assets are based in India
- Less than 50% of its total employees are based out of or are residing in India
- The payroll expenses incurred by the aforementioned employees is less than 50% of its total payroll expenses¹⁹

The word 'Passive Income' is defined as the aggregate of:

- Income from the respective transactions where both the purchase/sale of goods have been made by the company from/to its associate enterprises
- Income by the way of royalties, dividends, capital gains, rent or other interests²⁰

Other than that, several other guidelines/clarifications have been issued with regards to the ABOI test over time. For instance, even though income from interest is to be considered as

¹⁸ Pandey A, "Place of Effective Management (POEM Guidelines)" (*iPleaders* November 20, 2017) <<https://blog.ipleaders.in/place-effective-management-poem-guidelines/>>

¹⁹ Garg I, "Guiding Principles for Determination of POEM" (*Tax Guru* July 31, 2018) <<https://taxguru.in/income-tax/guiding-principles-determination-poem.html>>

²⁰ Garg I, "Guiding Principles for Determination of POEM" (*Tax Guru* July 31, 2018) <<https://taxguru.in/income-tax/guiding-principles-determination-poem.html>>

‘passive income’ for a company, the same shall not be applicable if the company is a banking company or a public finance institution. Further guidelines have also been issued with regards to the valuation of assets and the number of employees. These include guidelines with regards to what all falls within the ambit of the definition of an ‘employee’. Similarly, the final guidelines have also mentioned that where the ‘accounting year for the purpose of taxation’ is different from the ‘previous year’, then the data of the accounting year that ends during the relevant previous year and the two years preceding it shall be considered.

In addition to the above-mentioned guidelines, several clarifications were brought about after the amendment took place in 2015²¹. They were as follows:

- The term ‘Payroll’ consists of salaries, wages, bonuses and all other forms of employee compensation including pension and other social costs.
- Additional guidelines were issued with regards to the definition of the term ‘value of assets’ and the various means of its computation.
- The term ‘Number of Employees’ includes the average of the total number of employees working in the company from the beginning to the end of the relevant year. This also includes people who fulfil the same duties as an official employee of the company would do but are not directly employed by the company.
- Income of a company has to be calculated as per the laws of the country where it has been incorporated. However, if a specific country of incorporation does not require such computation (income tax), the same has to be done as per the company’s financial books.

IV. IMPACT OF THE GUIDELINES ON COMPANIES IN INDIA

The largest base which has been impacted by the issued guidelines and the subsequent amendments are Indian individuals as well as foreign corporations operating within India (including Joint Venture companies and Wholly Owned Subsidiaries)²². Being exempted from taxes in India earlier, these companies have seen their Indian counterparts subject to taxation at as high rates as 40% and the same has been detrimental to their accumulated profits. Another

²¹ Pandey A, “Place of Effective Management (POEM Guidelines)” (*iPleaders* November 20, 2017) <<https://blog.iplayers.in/place-effective-management-poem-guidelines/>>

²² “Place of Effective Management : Concept and Impact” (CNK RK) <<http://www.arkayandarkay.com/place-of-effective-management-concept-and-impact/>>

repercussion faced with regards to this is that both multinational corporations as well as start-up companies²³ have been discouraged from basing themselves out of India.

The 2015 Finance Bill amendment further brought in modifications to the process of determining POEM. In the amendment, it was mentioned that a company having its POEM 'at any time' in India to be a resident of India and liable to be taxed²⁴. This has, however, brought about various complications with regards to the manner in which the companies function i.e. even if a company holds a single board meeting or makes one major decision in India, they will be liable to pay taxes at rates as much as 40%. The same has made companies more precautionous with regards to conducting any form of business in India.

Other than that, companies may have their POEM in two or more different countries where board meetings have been conducted or a substantial amount of decision-making has commenced²⁵. DTAA's generally do not have any legal provision in them to prevent these kinds of issues. POEM is not a dual concept and should be restricted to only one place. That is why it is called 'Place of Effective Management' and not 'Place(s) of Effective Management'. However, due to the absence of provisions and lack of clarity, a certain duality is being provided to the concept, which is against the intention of its law-makers.

CONCLUSION

The POEM guidelines had initially been introduced in India for the benefit of the people living within its borders. Companies who had been carrying out some of their major operations in India were avoiding taxation by the authorities here by officially incorporating the company somewhere else. The introduction of the POEM guidelines made these companies liable to taxation. However, the problem that arose after the initial implementation of these guidelines was the abidance of a 'Continental Approach', whereby only if executive-level policy formulation and development was made can India was the company liable to pay taxes. The ABOI test also aided the case of these companies, who would then hold a few Board Meetings and other executive meetings abroad so as to fall within the said exception. Companies eventually found a way to avoid taxation because of the 'Continental Approach' of the POEM theme.

²³ "Place of Effective Management : Concept and Impact" (CNK RK) <<http://www.arkayandarkay.com/place-of-effective-management-concept-and-impact/>>

²⁴ Garg I, "Guiding Principles for Determination of POEM" (*Tax Guru*) July 31, 2018) <<https://taxguru.in/income-tax/guiding-principles-determination-poem.html>>

²⁵ Garg I, "Guiding Principles for Determination of POEM" (*Tax Guru*) July 31, 2018) <<https://taxguru.in/income-tax/guiding-principles-determination-poem.html>>

The 2015 amendment, as introduced in a Finance Bill by the CBDT (Central Board of Direct Taxes) brought about a change to the 'Continental Approach' followed earlier. Other factors such as mid-level or lower-level policy implementation, Shareholder meetings, Residential qualifications of employees and various other factors were included in the process of the determining a company's POEM. This resulted in the widening of the ambit of the concept of POEM and more and more companies fell under the scope of taxation by the Indian authorities. The progress seems beneficial and is in the right direction. However, there are some major issues that still prevail.

Taxation at a rate of 40% has discouraged a lot of companies from establishing their major operations in India. One of the highly affected sectors has been that of Start-Up companies, who have been highly discouraged from operating in India because the 40% taxation rate makes a significant impact on the profits that it generates. Lack of business operations by major multinational corporations as well as Start-Ups have had an adverse effect on the Indian economy as these companies would have otherwise provided employment to thousands of people. Other than that, there have been certain issues with regards to the absence of legal provisions and the lack of clarity with regards to the interpretation of these guidelines. One such problem could be that of duality of the concept of POEM. Due to the lack of clarity with regards to the guidelines and the various factors that it inculcates, companies have been liable for taxation in more than one country. This is contrary to the concept of POEM as it is not a dualistic concept. A company, after all, can only have one place where its effective management is located. The same can be ascertained from the meaning of the POEM itself, which says 'Place of Effective Management' and not 'Places of Effective Management'.

Other than that, one more problem that the POEM guidelines in India has faced is its deviation from the OECD guidelines²⁶, surrounding which the former is supposed to be based. There have been observations with regards to major departures of the POEM guidelines from the OECD guidelines. The 'at any time' clause in the POEM guidelines, for instance, has widened the ambit of taxation of foreign companies and this has been a major deviation from the intention of the OECD guidelines. Foreign companies now have to be very careful with their Indian management as well as the government structure so as to avoid unnecessary taxation. This has also increased the probability of prolonged litigation.

²⁶ Mehta A, "India: POEM Guidelines Introduced In 2017 In India - A Discussion" (*Mondaq* August 3, 2018) <[http://www.mondaq.com/india/x/725282/Income Tax/POEM Guidelines Introduced In 2017 In India A Discussion](http://www.mondaq.com/india/x/725282/Income+Tax/POEM+Guidelines+Introduced+In+2017+In+India+A+Discussion)>

The government of India has also been said to have taken a very non-adversarial approach²⁷ when it comes to these guidelines. Even though changes have been proposed so as to match with global standards and norms, the implementation of the guidelines have been nowhere near how it has been implemented globally in other countries, especially first world nations.

However, irrespective of all the problems, change seems to be evident and for the better. The amendment made in 2015 aided a lot in this positive and progressive change and only good things can be expected in the future. What must be of critical importance and must be of utmost priority is clarifying the guidelines even further, along with providing an explicit legal backing to them. Then only will India be able to match up to the implementation of these guidelines as perfectly as how it has been done in other countries.

²⁷ Mehta A, "India: POEM Guidelines Introduced In 2017 In India - A Discussion" (*Mondaq* August 3, 2018) <[http://www.mondaq.com/india/x/725282/Income Tax/POEM Guidelines Introduced In 2017 In India A Discussion](http://www.mondaq.com/india/x/725282/Income+Tax/POEM+Guidelines+Introduced+In+2017+In+India+A+Discussion)>