

## ***CBDT issues draft guidelines for determination of POEM***

December 25, 2015

### ***In brief***

The Central Board of Direct Taxes (CBDT) has issued the draft guidelines for determination of the place of effective management (POEM) of a company. In brief, the guidelines provide the following:

- Process and guidance for determination of POEM of companies—both that are engaged in active business outside India and those that are not.
- Factors, which by itself would not lead to a conclusion that POEM of a company is situated in India.
- Process to be followed by an Assessing Officer in case of a finding that a company incorporated outside India is resident in India due to its POEM being in India.

### ***In detail***

#### ***Pre-cursor***

The Finance Act, 2015 amended the residency test for companies, whereby a company would be regarded as resident in India, if it was an Indian company or the POEM of the company was in India during the relevant year. POEM was defined as “*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*”. The Explanatory Memorandum to the Finance Act, 2015 mentioned that the CBDT would issue guidelines stating the guiding principles for the determination of POEM, for the benefit of taxpayers and the tax administration. Accordingly, the CBDT has issued draft guidelines for determination of POEM and has invited comments and suggestions on the guidelines from

stakeholders by 2 January, 2016.

#### ***I General guidance***

- The process of determination of POEM would generally be:
  - based on the facts and circumstances;
  - driven by substance over form;
  - based on the place where decisions are taken, rather than the place where decisions are implemented.
- Day to day routine operational decisions shall not be relevant for determination of POEM

#### ***II Guidance for companies engaged in active business outside India***

A company would be regarded as engaged in an active business outside India if the

passive income of the company does not exceed 50% of its total income and:

- less than 50% of its total assets are situated in India; and
- less than 50% of the 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 payroll expenditure.

Passive income of a company is defined as the aggregate of:

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

For the above test, the average of the data of the year and two years prior to that shall be considered. If the company has been in existence for a shorter period, then data of such period shall be considered.

For a company engaged in active business outside India, its POEM will be presumed to be outside India if the majority of the meetings of the board of directors of the company are held outside India. However, if it is established that the board of directors are not exercising their powers of management, and such powers are being exercised by either the holding company, or any other person resident in India, then the company's POEM shall be considered to be in India.

### III Guidance for companies not engaged in active business outside India

For companies not engaged in active business outside India, a two-stage process for determination of their POEM has been specified as follows:

- Identifying or ascertaining the person or persons who actually make the key management and commercial decisions for the conduct of the company's business as a whole
- Determination of the place where these decisions are being taken

The following guiding principles are provided in this context, none of which would be decisive by itself; but will have to be considered in a holistic manner:

#### Location of meeting of company's board

The place where the company's board regularly meets and makes decisions can be considered as the POEM provided 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 determination of POEM.

If the board has de facto delegated the authority to make key management and commercial decisions for the company to the Senior Management or any other person including a shareholder and does nothing more than ratifying such decisions, then the POEM would be the place where such Senior Management or other persons make those decisions. The term Senior Management has been defined and it includes key

managerial personnel such as Managing Director or CEO and the heads of various divisions or departments such as Sales or Marketing.

#### Executive Committee

If the company's board has delegated (de jure or de facto) some or all authority to an executive committee consisting of members of Senior Management, the location where the members of such committee are based and where that committee develops and formulates the key strategies and policies for approval of the board, will be considered as the POEM.

#### Location of Head Office of company

The company's Head Office would be a very important factor in determination of the company's POEM. Head office of a company has been defined as *"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"*.

In this connection, the following points have been provided for determining the location of the Head Office of the company:

Situation	Head office location
Company's Senior Management and their support staff are based in a single location which is held out to the public as company's principal place of business or headquarters	Such principal place of business or headquarters.
Company is more decentralized and hence, Senior Management operates from time to time at offices in various countries	Location where these senior managers: <ul style="list-style-type: none"> <li>are primarily or predominantly based; or</li> <li>normally return to following travel to other locations; or</li> <li>meet when formulating or deciding key strategies and policies for the company as a whole.</li> </ul>

Members of Senior Management operate from different locations on a more or less permanent basis and members participate in various meetings via telephone / video conference	Location, if any, where the highest level of management (e. g.: Managing Director and Financial Director) and their direct support staff is located
Where the Senior Management is so decentralised that it is not possible to determine company's Head Office with a reasonable certainty	Location of the Head Office would not be much relevant in determining POEM

- If due to use of modern technology, it is determined that the physical location of board meeting or executive committee meeting may not be where the key decisions are in substance made, then the place where directors or persons taking decisions or majority of them usually reside may also be a relevant factor.

#### Secondary factors

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

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

#### IV Factors that do not by itself establish POEM

Determination of POEM is to be based on all relevant facts related to management and control of company and not on the basis of isolated facts which do not establish effective management, as illustrated below:

- A foreign company is completely owned by an Indian company
- One or some of the Directors of a foreign company reside in India
- Local management being situated in India in respect of activities carried out by a foreign company in India

- The existence in India of support functions that are preparatory and auxiliary in character

#### V Other points

- The above principles are for guidance only and no single principle will be decisive in itself.
- The principles have to be seen with reference to activities performed over a period of time and no 'snapshot' approach is to be adopted.
- If based on facts and circumstances, 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.
- An Assessing Officer can hold a company incorporated outside India, on the basis of its POEM, as being resident in India only after seeking prior approval of the Principal Commissioner or the Commissioner, as the case may be, in this regard. The Principal Commissioner or the Commissioner shall provide an opportunity of being heard to the company before deciding the matter.

#### The takeaways

- These guidelines have been long awaited; and hence introduction of the draft guidelines with a view to seek comments from the stakeholders is a welcome step.

- The draft guidelines lay down certain principles, which can be considered to determine the POEM of a company. As determining the POEM depends on facts and circumstance, the principles will necessarily involve a holistic factual analysis and should not be applied in an isolated manner.
- Lastly, the principles do serve as a good basis for determination of POEM by the authorities. Further, they provide clarity to taxpayers regarding the factors that would be considered by the tax administration in determining POEM.
- It is important for the industry to provide appropriate inputs to the CBDT, based on practical considerations involved in the management of companies, particularly joint ventures. Further, any stewardship functions undertaken as a holding / parent company should be excluded in determination of the POEM.

#### Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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