

Guiding Principles for Determination of Place of Effective Management for Section 6(3) of Income-tax Act, 1961



The taxability of a Company under the Income-tax Act, 1961 (the Act) mainly depends upon the residency status of a company. Prior to the Finance Act 2015, Section 6(3) of the Act provided that a company is said to be resident in India in any previous year, if it is an Indian company or if during that year, the control and management of its affairs is situated wholly in India. This allowed tax avoidance opportunities for companies to artificially escape the residential status under these provisions by shifting insignificant or isolated events related with control and management outside India. The existing provisions of Section 6(3) of the Act were amended vide Finance Act, 2015, and consequently Guiding Principles for determination of Place of Effective Management were issued by CBDT vide Circular no. 06 of 2017 and F. No. 142/11/2015-TPL dated 24th Jan 2017. Read on to know more...



CA. Sachin Sharma

(The author is a member of the Institute. He can be reached at sharma.casachin@gmail.com.)

The existing provisions of Section 6(3) of the Act were amended vide Finance Act, 2015, to provide that 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** in that year is in India.

Think of ways to grow with Greater Professional Loan



Special loan offers for :

Doctors, CAs, Pharmacists, Architects, Fashion Designers, Beauticians, etc.

**LOAN
AMOUNT
FROM
₹1 LAKH
TO
₹5 CRORE**

PURPOSE OF LOAN:

- For Business Expansion
- For Office / Clinic set up
- To Purchase Machinery / Equipment / Medical Equipment
- To Purchase / Construct / for Renovation of Premises



SIMPLE APPLICATION PROCESS



FAST LOAN
APPROVAL



GET FUNDS
EASILY



GREATER BANK

The Greater Bombay Co-operative Bank Limited
(Scheduled Bank)

Call on:

9930600996 / 9769988220

022-61285803 / 61285809

*Terms & Conditions apply

International Taxation

As per the Finance Act 2015, the amended provisions are applicable from 1st April 2016 but the Finance Act, 2016 said that the said amendment to Section 6(3) of the Act would now be effective from 1st April 2017 and will apply to Assessment Year 2017-18 and subsequent assessment years.

"Place of effective management (POEM)" is defined in the Act 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.

Objective of Guidelines

The primary objective of POEM is to address the issues related to determination of place where effective management of a company as per Section 6(3) of the Act is made.

Principles for determining the POEM are for guidance only. No single principle will be decisive in itself, 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

Various circulars and notifications have been granted accent by the various courts unanimously and held that circulars and notification are equivalent to the letter of the act, however, circulars are binding on the authorities only and not on the Assessee and can be challenged by the assessee.

Date of Effectiveness of Amended Provisions u/s 6(3)

As per the Finance Act 2015, the amended provisions are applicable from 1st April 2016, but the Finance Act, 2016 said that the said amendment to Section 6(3) of the Act would now be effective from 1st April 2017 and will apply to Assessment Year 2017-18 and subsequent assessment years.

Whether Place of Effective Management is to Determine Every Year?

Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Determination of Residency: Determination of Residency by applying Place of Effective

Management guidelines is a three-stage systematic process.

STAGE 1- Active Business 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.

A company shall be said to be engaged in "active business outside India", if it satisfies all the four conditions simultaneously i.e.

- i. Its passive income is not more than 50% of its total income; and
- ii. Assets situated in India is less than 50% of its total assets; and
- iii. Employees situated in India or are resident in India is less than 50% of total number of employees; and
- iv. The payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Income shall be as computed for tax purpose as per the laws of the country of incorporation or in any other case as per books of account.

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

However, any income by way of interest shall not be considered to be passive income in case of a banking or public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.

Value of Assets- (a) Individually depreciable asset- Average of its value at the beginning and at the end of the previous year for tax purposes in the country of incorporation.

(b) Fixed assets treated as a block for depreciation- Average of its value at the beginning and at the end

Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis. Determination of Residency by applying Place of Effective Management guidelines is a three-stage systematic process.



Get GST ready.

DCB GST Current Account Package

- Avail complete solution for GST Filing, GST Compliant Invoicing and Purchase Reconciliation.
- Package available for both existing as well as new customers.

Give a missed call to 7097299472 and get help for your GST accounting & filing and details about the unique Do-It-Yourself GST solution by DCB Bank.

DCB 24-Hour Customer Care

Call Toll Free: 1800 209 5363

Email: customercare@dcbbank.com

Web: www.dcbbank.com

DCB BANK

Terms and conditions apply. The GST filing and accounting services are enabled by an Application Service Provider (ASP), a third party and DCB Bank Limited shall not be liable and responsible for the ASP services mentioned herein.

International Taxation

of the year for tax purposes in the country of incorporation.

(c) Any other asset- Its value as per books of account.

Number of employees- 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 like labourers, etc.

Payroll shall include the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.

Period of Data to be used- For the purpose of determining whether the company is engaged in active business outside India, 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.

STAGE 2- Active Business and Board Meetings Outside India

If the company is engaged in active business outside India, the Place of Effective Management shall be presumed to be outside India if the majority of meetings of the board of directors of the company are held outside India.

However, if on the basis of facts and circumstances it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India, then the place of effective management shall be considered to be in India.

“Senior Management” 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. While designation may vary, these persons may include:

- (i) Managing Director or Chief Executive Officer;
- (ii) Financial Director or Chief Financial Officer;
- (iii) Chief Operating Officer; and
- (iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

STAGE 3- If Company is not engaged in Active Business Outside India

In cases of companies that are not engaged in Active Business outside India, the determination of POEM would be a two-step process, namely:-

First step- Identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole.

Second step- Determination of place where these decisions are in fact being made.

The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.

Some of the Guiding Principles Which may be Taken into Account For Determining POEM Are as Follows:

1. **Location of Board Meeting:** The location where a company's Board regularly meets and takes decisions may be the company's place of effective management 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.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held, then such other place would be relevant for POEM.

2. **Location of Members of Delegated Committee in case of Delegation of Power by Board:** A company's board may delegate some or all of its authority to one or more committees such as an executive committee. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.



NEXT GENERATION BUSINESS OWNERS ARE TAKING THE BIG STEP

ISB's Post Graduate Programme in Management for Family Business (PGP MFAB) is a general management programme for the next-gen of family businesses who aspire to grow the existing business or start a new venture.

AMAN JAIN

Next Gen Business Owner,
M D Movers, Surat.

- Taught from a Business Owner's Perspective • World Class Learning Experience
- Peer Group of Next Gen Business Owners • 15 months • Modular Format
- Top-notch Global Faculty • International Immersions in USA & Europe

Eligibility: Bachelor's degree is mandatory.



Indian School of Business
Hyderabad | Mohali

Gachibowli, Hyderabad-500 111, Telangana.

CIN: U80100TG1997NPL036631

Connect with us

Contact: +91 40 2318 7700, +91 91334 17700
mfab@isb.edu | www.isb.edu/mfab

International Taxation

- 3. 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:-
- **Centralised Location-** If the 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 headquarters, then that location is the place where head office is located.
 - **Decentralised Location-** If the company is more decentralised (for example where members of senior management may operate at offices located in various countries), then the head office would be the location where these senior managers,-
 - (i) 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.
 - **Members participate in Meeting via telecommunication mode-** Members of the senior management may operate from different locations and may participate in various meetings via telephone or video conferencing rather than by being physically present in a particular location. In such situation the head-office would normally be the location, if any, where the highest level of management and their direct support staff are located.
 - **Others-** In situations where the senior management is so decentralised 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.
- 4. Residence location of decision taking Authority:** 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, etc. 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.
- 5. Location of person who has the authority:** In case of circular resolution or round robin voting factors, it cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.
- 6. Decisions made by shareholders are not relevant:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. However, the shareholder's involvement can, in certain situations, turn into that of effective management. For example, if the shareholders limit the authority of board and senior managers of a company and thereby remove the company's real authority to make decision, then the shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.
- 7. Operational decisions are not relevant:** It may be clarified that day-to-day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of 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.



Why worry about falling deposit rates? Invest in Mutual Funds

An Investor Awareness Initiative By



Pramerica

MUTUAL FUND

www.dhflpramericamf.com | Toll-free: 1800 2662 667 | Connect with us on 

Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.

Pramerica is a trade name used by Prudential Financial, Inc., (PFI) a company incorporated and with its principal place of business in the United States, and by its affiliated companies in select countries outside the United States. None of these companies are affiliated in any manner with Prudential plc, a company incorporated in the United Kingdom.

International Taxation

Place of effective management is not to be determined on the basis of isolated facts that by itself do not establish effective management. It can be better understood with the help of examples:

- (i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (iv) The fact of 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 that the conditions for establishing POEM have been satisfied.
- (v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM have been satisfied.

Duties of Assessing Officer

The (AO) shall take prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India.

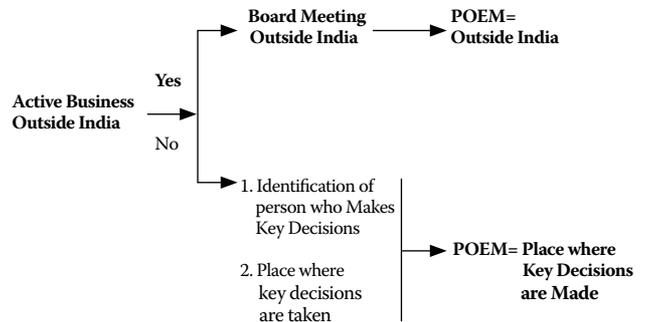
The Assessing Officer shall take prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India. In case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then the AO shall take prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners.

POEM is one more method by which the government wants to find evaders, especially those using their residential status to avoid taxes in India. The above principles are primarily intended to ascertain whether or not the company is engaged in active business outside India. These guidelines are not intended to cover foreign companies or to tax their global income merely on the ground of presence of PE.

In case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India, then A.O shall take prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Conclusion

Principles for determination of place of effective management can easily be understood with the help of the following diagram:



POEM is one more method by which the government wants to find evaders, especially those using their residential status to avoid taxes in India. The above principles are primarily intended to ascertain whether or not the company is engaged in active business outside India. These guidelines are not intended to cover foreign companies or to tax their global income merely on the ground of presence of PE. It is imperative to note that having PE in India is vastly different from having POEM in India, since having a PE shall mean the income related to PE is taxable in India; however, having POEM in India means that the worldwide income of the foreign company is taxable in India. ■