

# Discussion on Place of Effective Management

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# Residential status of company

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## **Earlier definition of residential status of company**

- A company is said to be resident in India if:
  - it is an Indian company; or
  - during that year, the control and management of its affairs is situated wholly in India



## **Amended definition of residential status of company [section 6(3) – applicable from 1 April 2016 i.e. for FY 2016-17]**

- A company is said to be resident in India if:
  - it is an Indian company; or
  - its *place of effective management* in that year is in India
- Place of effective management means 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 – Explanation to section 6(3) of Income-tax Act

# Discussion on control and management

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## Indian judicial rulings

<b>Erin Estate, Galah, Ceylon (34 ITR 1) (SC)</b>	Control and management of its affairs means the de facto control and not the de jure and refers to controlling and directive power often described as "head and brain"
<b>Subbaya Chettaiar (HUF) (19 ITR 168) (SC)</b>	Control and management signifies the controlling and directive power, the head and brain and "situated" implies the functioning of such power at a particular place with some degree of permanence
<b>Nandlal Gandlal (40 ITR 1) (SC)</b>	The expression "control and management" signifies controlling and directive power, "the head and brain" as it is sometimes called. Furthermore, the expression "control and management" means de facto control and management and not merely the right or power to control and manage
<b>Narottam and Pereira Ltd vs. CIT 23 ITR 454 (Bom- HC)</b>	The real test to be applied is, where is the controlling and directing power, or rather, where does the controlling and directing power function or to put it in a different language there is always a seat of power or the head and brain, and what has got to be ascertained is, where is this seat of power, or the head and brain
<b>Saraswati Holding Corporation Ltd v. DDIT 111 TTJ 334 (2007) (ITAT- Del)</b>	Control and management of affairs refers to head and brain, which directs the affairs of policy, finance, disposal of profits and such other vital things qua the general and corporate affairs; It does not refer to control and management of the day-to-day affairs of the business; "PoEM not in India since the Board Resolutions for investment decisions were passed from Mauritius / USA"

# Place of effective management

## Discussion on control and management

### Radha Rani Holdings (P) Ltd 110 TTJ 920 (2007)(ITAT Del)

#### Facts

- The assessee-company incorporated under the Laws of Republic of Singapore filed its return of income in the status of a non-resident company.
- The Assessing Officer noticed that the paid up capital of the company consisted of 100 shares; out of which one 'G', who was a resident of India, was holding 99 shares and the other director 'J', who was a resident of Singapore, was holding only one share.
- There was no employee of the assessee company in Singapore and the Company was being operated from New Delhi
- Therefore, as per the AO the Company was being controlled and managed from India only and its control and management was wholly in India.

#### Held

Control and Management not in India since:

- Board meetings are held in Singapore and never in India: Since the BoDs, subject to the overall supervision of shareholders, actually controls and manages the affairs of a company effectively as against the day-to-day operation of the company, the situs of the BoDs of the company should determine the 'place of control and management of the company'
- What is relevant is where the BoDs meets for the purpose of determining the key issues relating to the Company. One of the director based in India not relevant as other member of the Board (who were also the Chairman of Board) were based outside India
- Mere operation of bank account does not determine management / control as it powers conferred by BoD
- A board meeting may be by telephonic conversations or video conferencing or circular resolution and not relevant unless an adverse inference is drawn
- Holding of one of the BoD meeting in India is also not relevant if generally such meetings happen outside India
- Although the director based in India held 99% shareholding, all the directors enjoy equal powers irrespective of their shareholding

# Understanding the concept of place of effective management

# Understanding the concept of place of effective management

## Key terms

Key terms	Meaning
Effective	<ul style="list-style-type: none"><li>Producing the results that is wanted or intended; in reality, although not officially intended (Oxford Dictionary)</li></ul>
Management	<ul style="list-style-type: none"><li>The act of running or controlling a business or similar organization (Oxford Dictionary). The act of managing by direction, or regulation or administration or control or supervisions (Wharton's Law Lexicon). In context of PoEM, management refer to those strategic decisions which are generally taken by the apex body of the company which are by nature guiding and controlling the business. The "Term "effective" should be understood in the sense of the French "effective" which means "real" (UK Case Law: Wensleydale's Settlement Trustees)</li></ul>
Key	<ul style="list-style-type: none"><li>in definition of PoEM may be read as important, main crucial, significant, vital, strategic decision</li></ul>
Commercial	<ul style="list-style-type: none"><li>'engaged in commerce' and 'commercialize (K.J. Aiyar, Judicial Dictionary 15th Edition 2011 – Volume 1). In context of PoEM refer to key commercial decisions may refer to strategic commercial decisions concerning the business of the company</li></ul>
As a whole	<ul style="list-style-type: none"><li>All parts or aspects considered; altogether (The Free Dictionary by Farlex)</li></ul>
In Substance	<ul style="list-style-type: none"><li>'in substance' indicates that in making the necessary comparison, form should be disregarded (The Law Lexicon – 3rd Edition 2012)</li></ul>

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**



# Understanding the concept of place of effective management

## International perspective

### Income Tax Act, 1961

- 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
- Set of guiding principles for determination of PoEM have been issued for the benefit of the taxpayers as well as for tax administration

### OECD Commentary

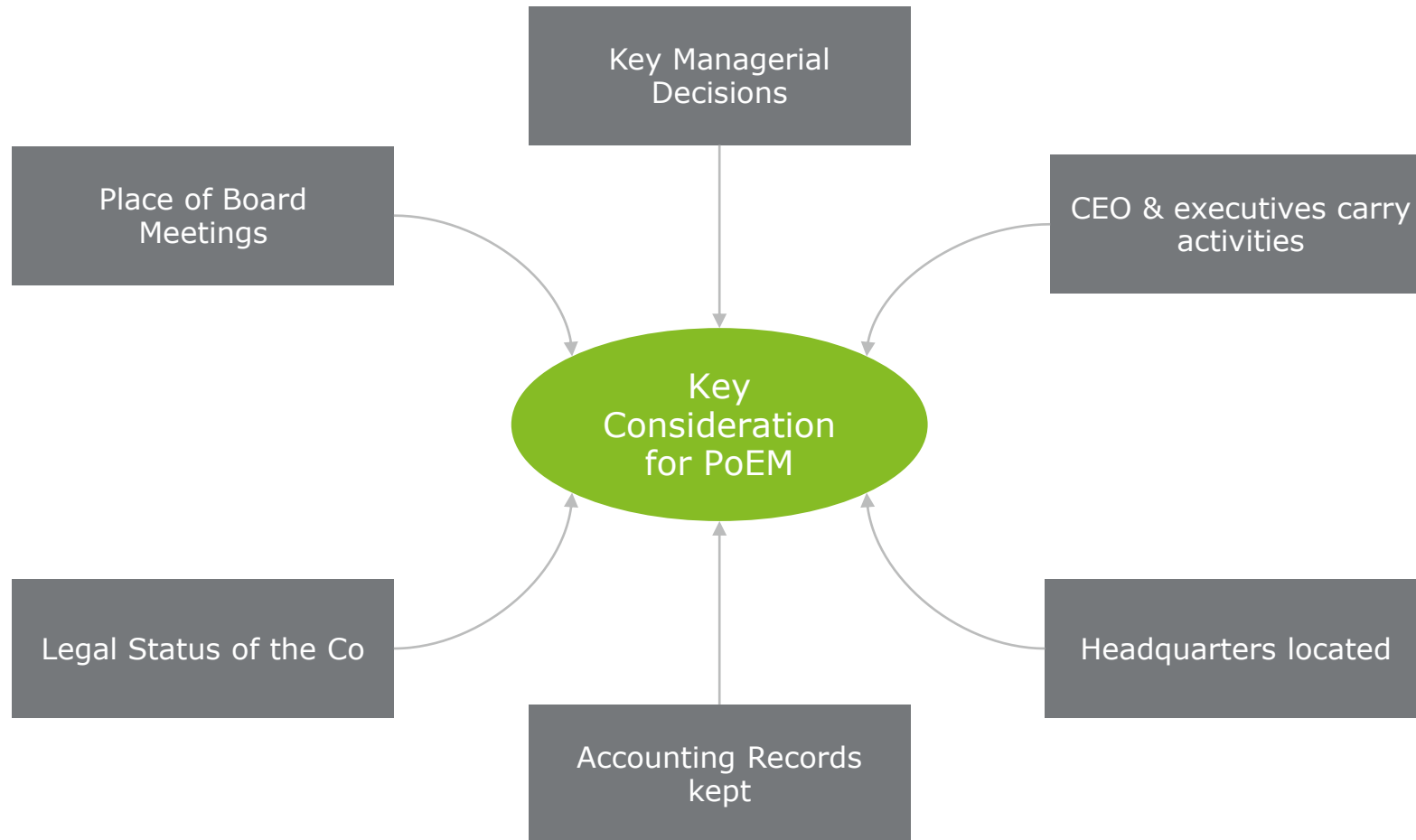
- Place where
  - **key management** and **commercial** decisions that are necessary for the conduct of the entity's business as a whole are **in substance** made
- All relevant **facts** and **circumstances** must be examined to determine the place of effective management
- An entity may have more than one place of management, but it can have **only one place of effective management** at any one time

### UN Commentary

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

# Understanding the concept of place of effective management

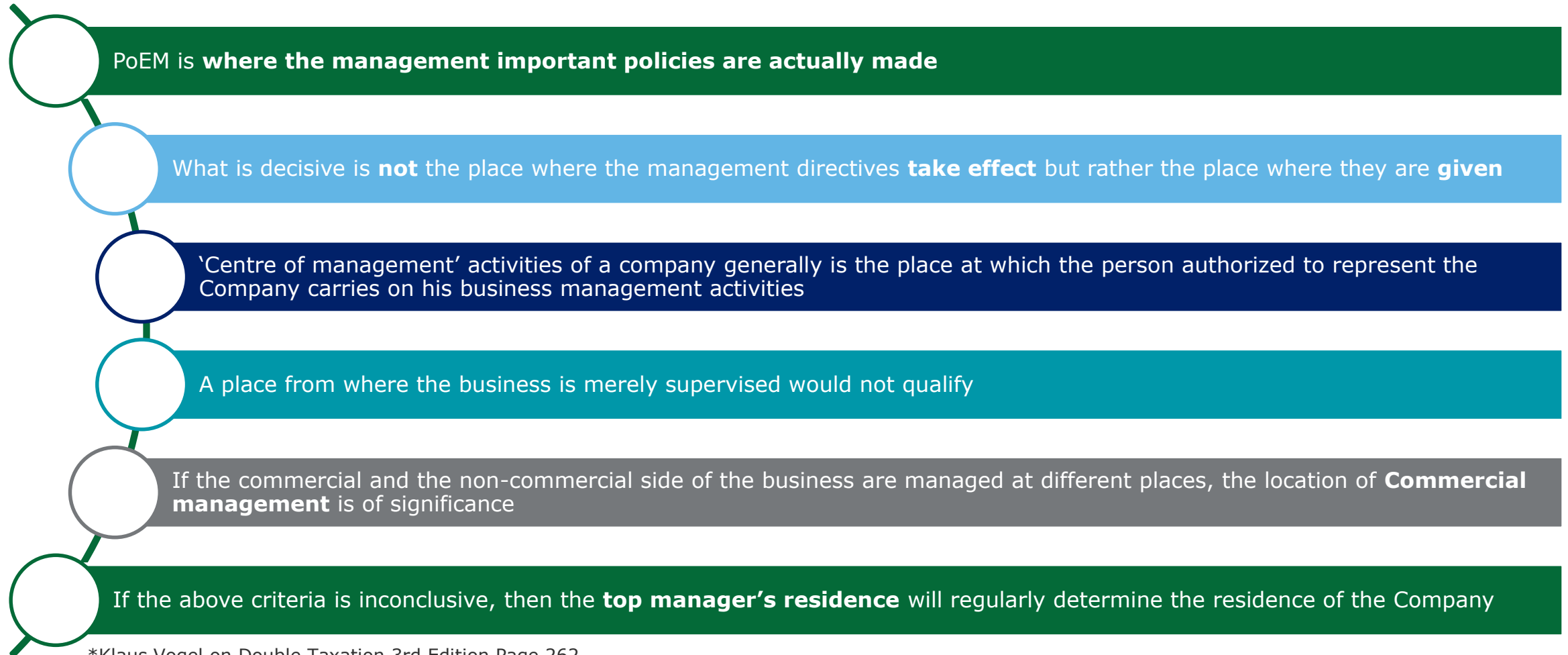
## Place of effective management as per OECD



**PoEM is a very fact specific determination and all the factors would need to be considered**

# Understanding the concept of place of effective management

Klaus Vogel On Double Taxation Conventions \*



\*Klaus Vogel on Double Taxation 3rd Edition Page 262

# Understanding the concept of place of effective management

## Place of effective management under Indian tax treaties

- In terms of Article 4 of the tax treaties, several Indian tax treaties, recognise inter alia, the 'place of management' as the place of tax residence
- If the company is resident of both the contracting states, then most tax treaties recognize the concept of PoEM for determination of residence of a company as a Tie-Breaker Rule for avoidance of double taxation
- India has entered into more than 80 Comprehensive tax treaties with various countries. In most tax treaties, the term PoEM is not defined
- For instance, the term PoEM is defined under a protocol in India - Belarus Tax Treaty as under:
  - A company is actually managed and controlled
  - The place where the relevant accounting books are kept
  - The place where the decision making at the highest level on important policies essential for the management of a company takes place
  - The place that plays a leading part in the management of a company from an economic and functional point of view

# Understanding the concept of place of effective management

## Indian Judicial ruling on place of effective management

### **P. No. 9 of [1996] 86 Taxman 252 (AAR) Natwest case**

In context of India-Mauritius DTAA, the AAR held that the word "place of effective management" refers to the place from where, factually and effectively, the day to day affairs of the companies are carried on and not to the place in which may reside the ultimate control of the company. Further, the BoD meetings and general meeting of the assessee were held at registered office of the assessee (i.e. in Mauritius), hence the PoEM is in Mauritius

### **P. No 10 of 1996 224 ITR 473 (AAR)**

Investments Company's (IC) registered office was in Mauritius and its only transaction was the investment in India. The applications made by the IC and Investment Manager to the Mauritius Offshore Business Activities Authority for residency certificate showed that their place of management would be in Mauritius. Hence, it could not be said that the effective management of the affairs of the company was not in Mauritius unless there were facts to at least prima facie indicate that such control emanated elsewhere than from Mauritius

### **DLJMB Mauritius Investment Co. v. CIT, 228 ITR 268 (AAR)**

Mind and brain of the organization of the assessee company are situated in Mauritius as the BoD meeting took place in Mauritius, where policy decisions were taken. Therefore, the 'Effective Management' is situated in Mauritius. Follows Natwest

### **Integrated Containers Feeder Services v. CIT 278 ITR 182 (2005)**

Follows Natwest case

### **SMR Investment Ltd v. DDIT 2010-TII-66-ITAT-DEL-INTL**

Order given by an Indian resident shareholder via telephone for sale of investments held by Mauritius entity may lead to PoEM in India

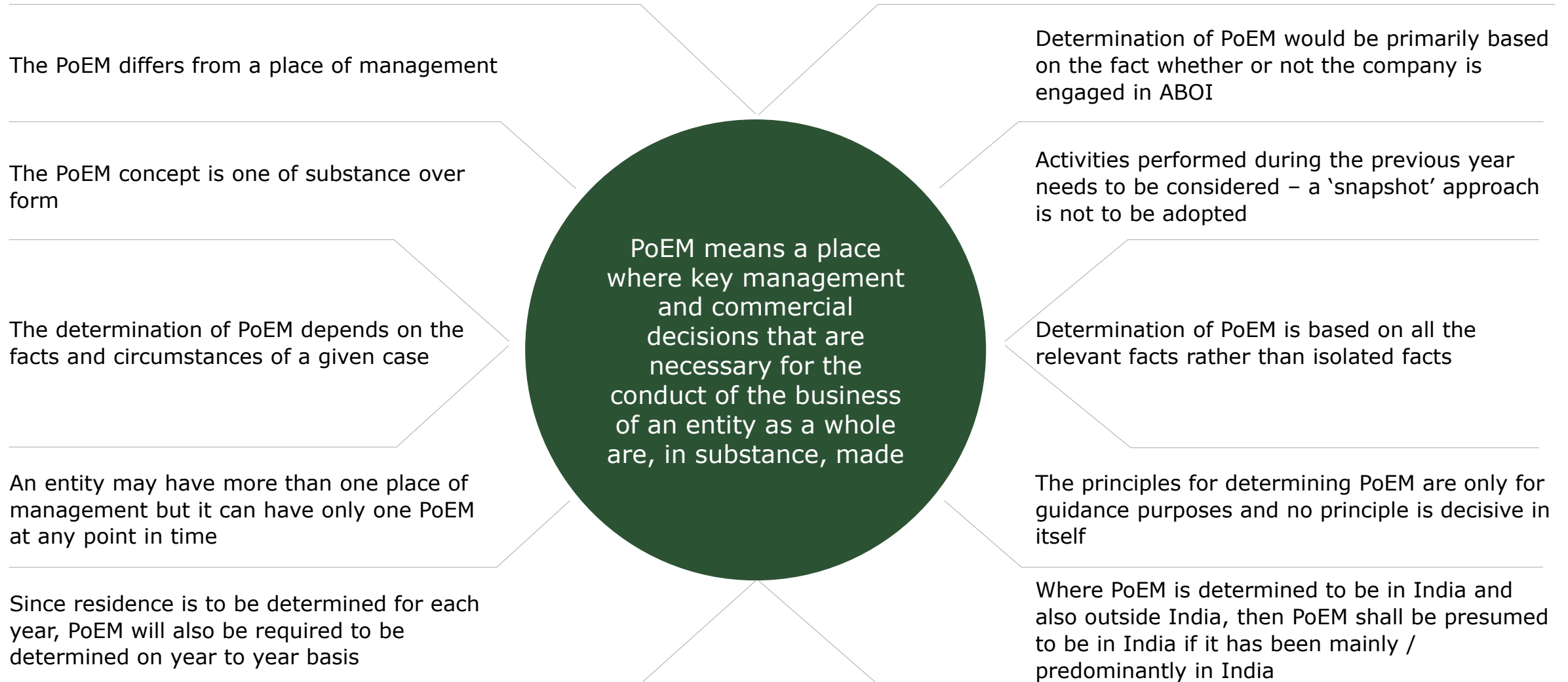
### **Pearl Logistics & Ex-IM Corporation v. Income-tax Officer, International Taxation, Rajkot [80 taxmann.com 217] (Rajkot - ITAT)**

Director is resident of Denmark and has been operating business wholly from Denmark, all the important decisions are taken from Denmark in the form of meeting and therefore, the place of effective management and control is Denmark only

# Guidelines on place of effective management

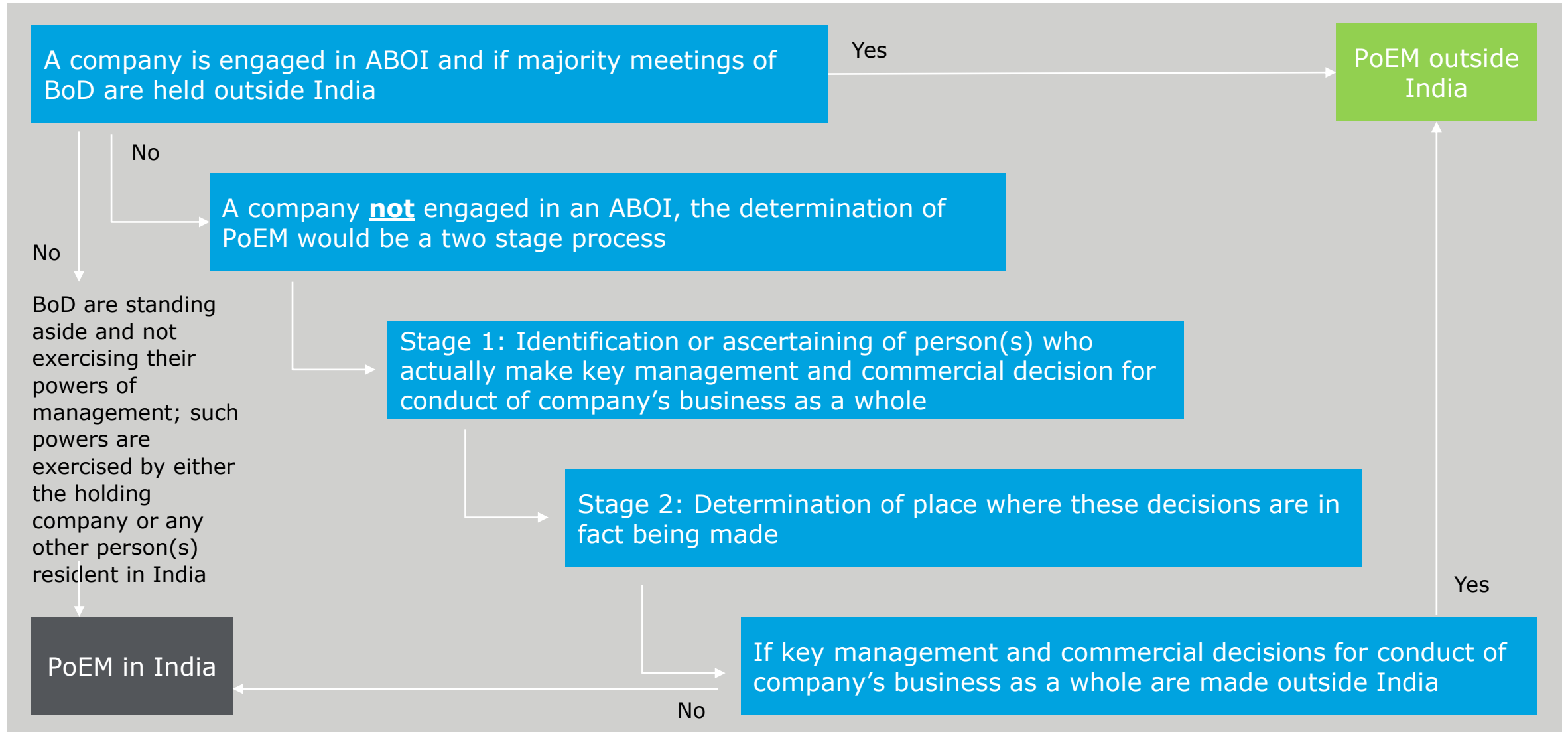
# PoEM guidelines

## Key points



# PoEM guidelines

## Broad framework

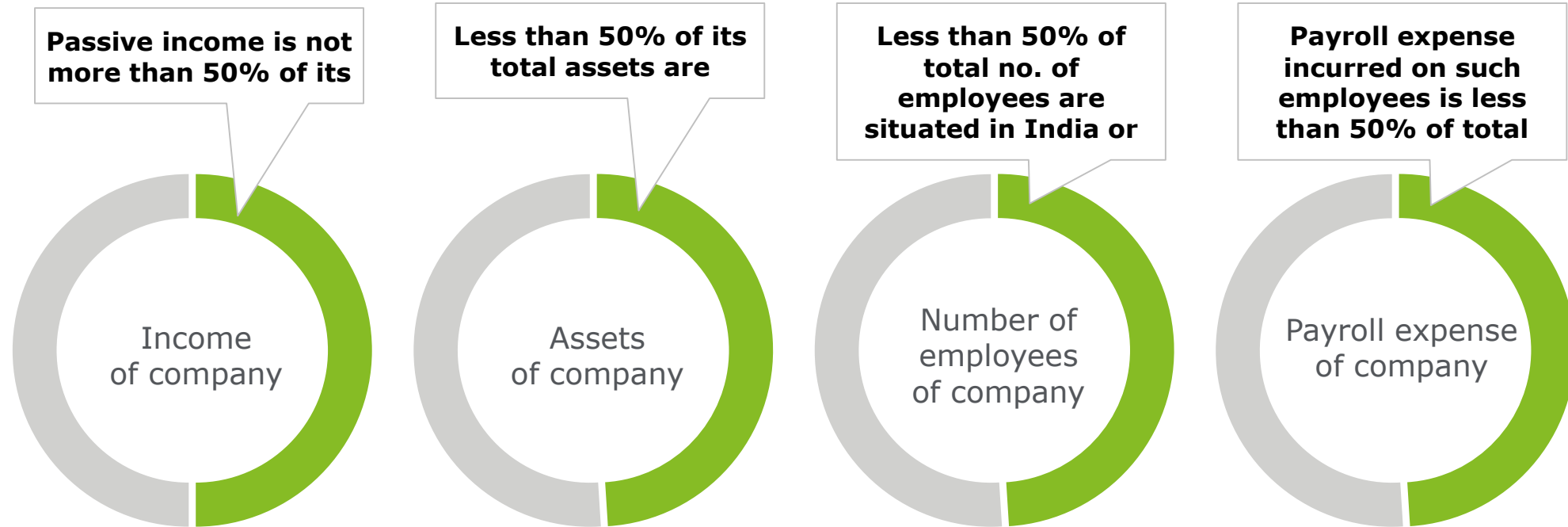




# PoEM guidelines

## Active business outside India

A company is engaged in ABOI if the following conditions are met



Key points in determining quantum of passive income, assets, number of employee and payroll expenses

- Average of the data of the previous year and two years prior to that to be taken into account
- In case the company is in existence for a shorter period, the data of such period to be considered
- Where the accounting year for tax purposes, in accordance with the laws of country of incorporation is different from the previous year, the data of the accounting year that ends during the relevant previous year and two accounting years preceding it to be considered

# PoEM guidelines

## Active business outside India

Passive income will be the aggregate of the following income streams

Income from transactions where both the purchase and sale of goods is from / to its associated enterprises

Royalty income

Dividend income

Capital gains

Interest income

Rental income

Passive  
income  
of  
company

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

# PoEM guidelines

## Active business outside India

<b>Income</b>	<ul style="list-style-type: none"><li>• as computed for tax purpose in accordance with laws of country of incorporation</li><li>• as per books of account, where laws of country of incorporation does not require such a computation</li></ul>
<b>Value of assets in case of an individually depreciable asset</b>	<ul style="list-style-type: none"><li>• 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</li></ul>
<b>Value of assets in case of pool of fixed assets treated as a block for depreciation</b>	<ul style="list-style-type: none"><li>• average of its value for tax purposes in the country of incorporation of the company at the beginning and at the end of the year</li></ul>
<b>Value of assets in case of any other asset</b>	<ul style="list-style-type: none"><li>• value as per books of account</li></ul>
<b>Number of employees</b>	<ul style="list-style-type: none"><li>• average of number of employees as at the beginning and at the end of the year</li><li>• includes persons, who though not employed directly by the company, perform tasks similar to those performed by the employees</li></ul>
<b>Payroll expenditure</b>	<ul style="list-style-type: none"><li>• includes cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer</li></ul>

# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

Who takes the key management and commercial decisions	Role of BoD	Likely place of effective management
<b>Board of Directors</b>	<ul style="list-style-type: none"><li>• BoD retains and exercises their authority to govern the company</li><li>• BoD in substance makes such decisions necessary for the conduct of the company's business as a whole</li></ul>	<ul style="list-style-type: none"><li>• Place where BoD regularly meets and makes such decisions</li><li>• If such decisions are not taken at board meetings (i.e. if these meetings are a mere formality), then place where such decisions are in fact taken by the directors</li></ul>
<b>Senior management</b>  [such authority may also be delegated to shareholder, promoter, strategic or legal or financial advisory, etc.]	<ul style="list-style-type: none"><li>• BoD delegates authority to senior management</li><li>• BoD routinely ratifies these decisions that have been made</li></ul>	<ul style="list-style-type: none"><li>• Place where the senior management or other persons who makes such decisions</li></ul>
<b>Committee</b>  [executive committee consisting of key members of senior management]	<ul style="list-style-type: none"><li>• BoD delegates some or all of its authority to committee</li><li>• BoD merely gives a formal approval to decisions made</li></ul>	<ul style="list-style-type: none"><li>• Place where the member of the committee are based and where that committee develops and formulates the key strategies and policies</li></ul>

# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

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### Location of head office

*(it is an important factor as it often represents the place where key management and commercial decisions are made)*

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#### Scenarios

#### Place of senior management

#### Likely place of effective management

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#### Centrally located

- They are based in a single location at a place which is identified as head office

- Head office

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#### Decentralised

- They operate from time to time at offices located in different countries

- Location where the senior management
  - is primarily or predominantly based
  - normally return to (after travel to other locations)
  - meet when formulating or deciding key strategies and policies for the company as a whole

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#### Further decentralised

- They operate from different locations on a more or less permanent basis and participate in meetings via telephone or video conferencing

- Location where the highest level of management (such as Managing Director or Finance Director) and their direct support staff are location

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#### Highly decentralised

- Company's senior management is too decentralised

- Location of head office not relevant as it is not possible to determine the head office with a reasonable degree of certainty
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# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

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<b>Mode of making the key management and commercial decisions</b>	<b>Place of persons taking such decisions</b>	<b>Likely place of effective management</b>
<b>Meetings via telephone or video conferencing</b>	<ul style="list-style-type: none"><li>• The directors, senior management or committee(s) taking decisions physically not present at a particular location</li></ul>	<ul style="list-style-type: none"><li>• Place where the directors or the persons taking the decisions or majority of them usually reside may be relevant</li></ul>
<b>Circular resolution or round robin voting</b>	<ul style="list-style-type: none"><li>• Factors like the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located, etc. are to be considered</li></ul>	<ul style="list-style-type: none"><li>• It cannot be said that proposer of decision along would be relevant but based on past practices and general conduct, it would be required to determine the person who has authority and who exercises authority to take decision; location of such person would be more important</li></ul>

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# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

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### Is shareholder a person who makes the key management and commercial decisions?

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#### **Matters which are reserved for shareholder decision under the company laws**

Such decision may include:

- sale of all or substantially all of the company's assets
- dissolution, liquidation or deregistration of the company
- modification of rights attaching to various classes of shares or the issue of a new class of shares, etc.

- Not relevant for determining PoEM
- These decision typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective

#### **Shareholders involvement turning into effective management**

Either formally by way of shareholder agreement or by way of conduct:

- Shareholders limit the authority of board and senior management of a company and thereby remove the company's real authority to make decision

- The shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder

# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

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### Does day-to-day routine operational decisions constitute key management and commercial decisions?

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#### **Day-today routine operations decision undertaken by junior and middle management**

Examples of operational decision:

- a decision by the plant manager (appointed by senior management) to run the facility
- decision concerning repairs and maintenance
- decision relating to the implementation of company wide quality controls and human resources policies

Examples of key management and commercial decisions:

- a decision to open a major new manufacturing facility
- a decision to discontinue a major product line

- The operation decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision
- Not relevant for determining PoEM

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In case if the person responsible for taking operational decisions and key management and commercial decisions is the same person, it will be necessary to distinguish the two type of decision and thereafter assess the location where the key management and commercial decisions are taken

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# PoEM guidelines

## Guiding principles when determining PoEM for a company which does not have ABOI

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### If all of the above discussed factors do not lead to clear identification of PoEM

- |   |  |
|---|--|
| <b>Secondary factors to be considered</b> | <ul style="list-style-type: none"><li>• Place where main and substantial activity of the company is carried out</li><li>• Place where the accounting records of the company are kept</li></ul> |
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### Isolated factors by itself do not establish PoEM

- |  |   |
|--|---|
| <b>Ownership</b>                               | <ul style="list-style-type: none"><li>• The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that conditions for establishing PoEM in India have been satisfied</li></ul>   |
| <b>Permanent establishment</b>                 | <ul style="list-style-type: none"><li>• The fact that there exists PE of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing PoEM in India have been satisfied</li></ul>   |
| <b>Directors residential status</b>            | <ul style="list-style-type: none"><li>• The fact that once or some of the directors of a foreign company reside in India will not be conclusive evidence that conditions for establishing PoEM in India have been satisfied</li></ul>   |
| <b>Local management</b>                        | <ul style="list-style-type: none"><li>• 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</li></ul> |
| <b>Support activities carried out in India</b> | <ul style="list-style-type: none"><li>• 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 in India have been satisfied</li></ul>                                |

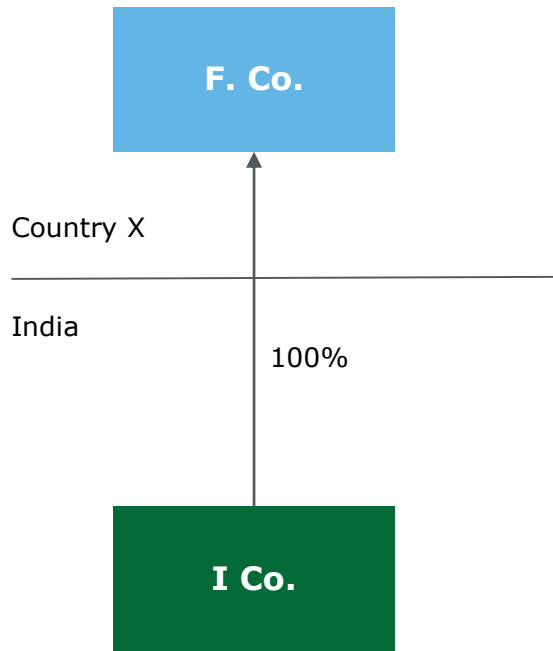
# POEM guidelines

## Administrative safeguards

- Administrative safeguards have been incorporated in the guidelines by mandating that the assessing officer (AO), before initiating inquiry for PoEM in case of a taxpayer, will seek approval from Principal Commissioner / Commissioner
- The AO shall also obtain approval from Collegium of Principal Commissioners of Income-tax before holding that PoEM of a non-resident company is in India
- The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter

# Case studies on place of effective management

# Case studies on place of effective management

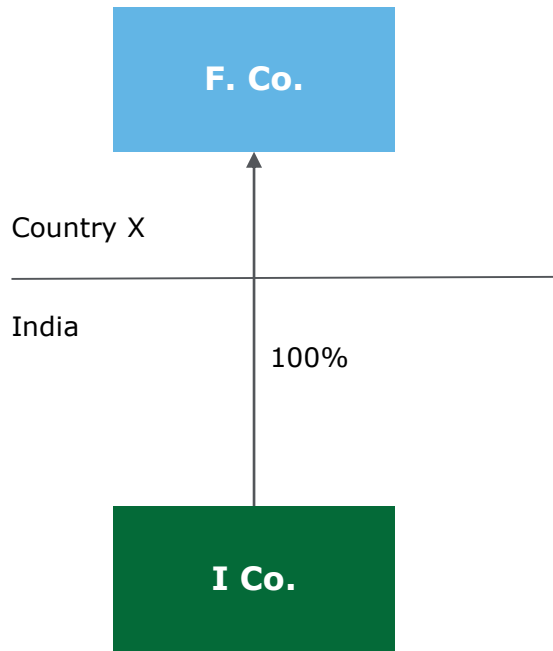


## Case Study - 1

- Indian company (I Co) has a wholly owned subsidiary (F Co.) outside India in country X
- F Co. is a sourcing entity for the Indian multinational group
- Key facts relating to F Co.
  - the warehouses and stock in them are the only assets of F CO. and are located in country X
  - all the employees of F Co. are also in country X
  - the average income wise breakup of the company's total income for three years is, —
    - 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises
    - 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises
    - 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises
    - 10% of the income is by way of interest

**Interpretation:** In this case passive income is 40% of the total income of the company. The passive income consists of, - (i). 30% income from the transaction where both purchase and sale is from/to associated enterprises; and (ii). 10% income from interest. The F Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of F Co. are in India the other requirements of the test is also satisfied. Therefore, the company is engaged in active business outside India

# Case studies on place of effective management

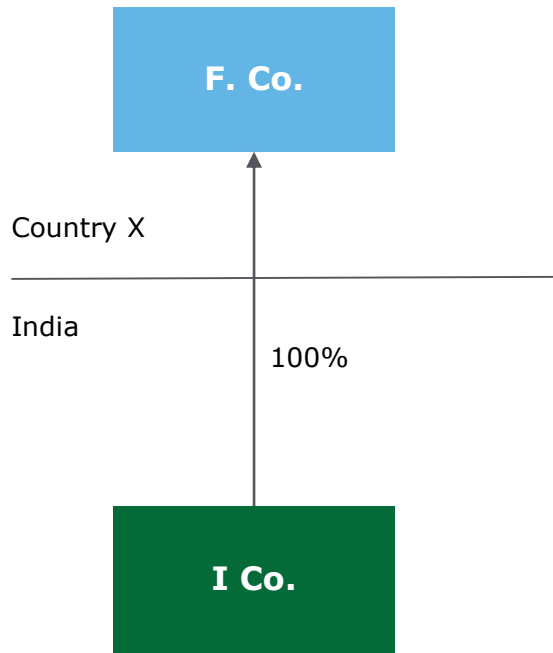


## Case Study - 2

- The other facts remain same as that in Case Study 1
- F Co. has a total of 50 employees
  - 47 employees are managing the warehouse, storekeeping and accounts of F Co. and they are located in country X
  - 3 employees who are Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India
- The total annual payroll expenditure in relation to these 50 employees is INR 50 million
  - The annual payroll expenditure in respect of MD, CEO and sales head is INR 30 million

**Interpretation:** Although the first limb of active business test is satisfied by F Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, F Co. is not engaged in active business outside India.

# Case studies on place of effective management

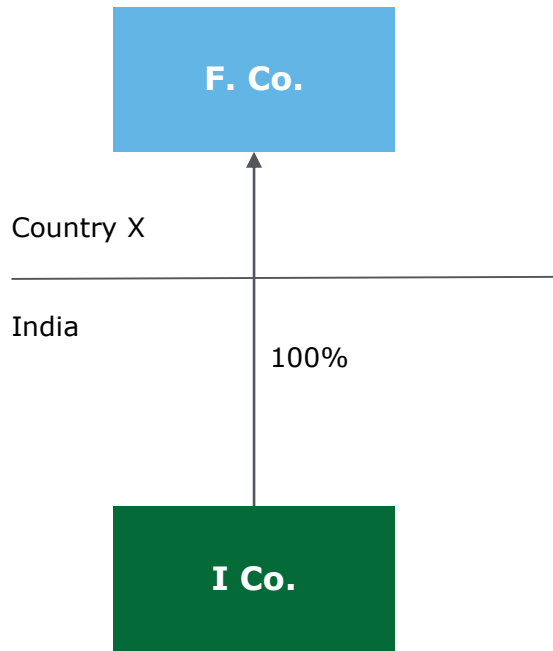


## Case Study - 3

- Indian company (I Co) has a wholly owned subsidiary (F Co.) outside India in country X
- F Co. is a sourcing entity for the Indian multinational group engaged in ABOI
  - All the directors of the F Co. are Indian residents
  - During the relevant previous year 5 meetings of the Board of Directors are held of which two were held in India and 3 outside India with two in country X and one in country Y

**Interpretation:** The F Co. is engaged in active business outside India - Since majority of board meetings have been held outside India, the POEM of F Co. shall be presumed to be outside India.

# Case studies on place of effective management

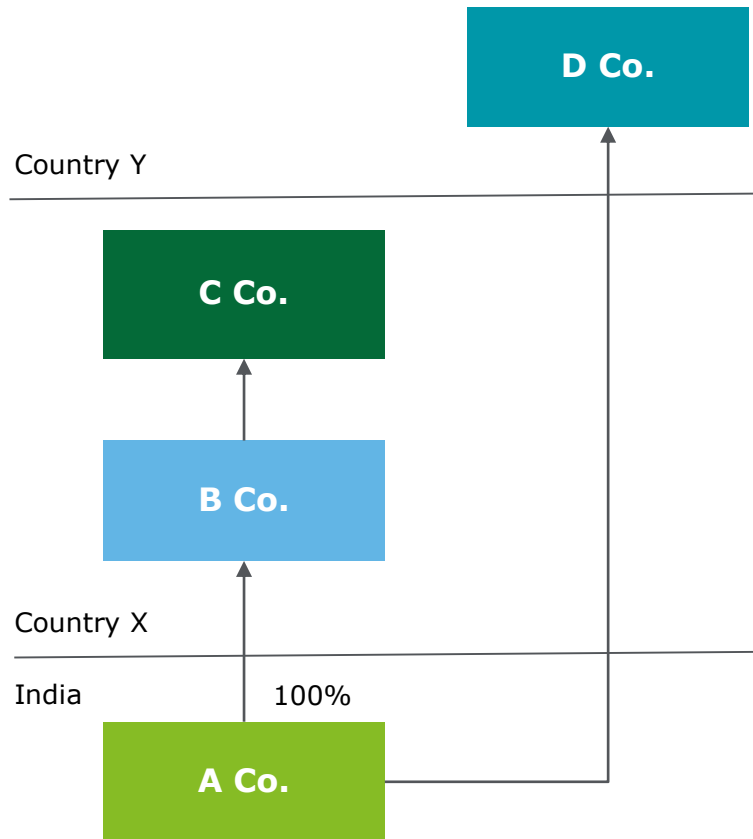


## Case Study - 4

- The other facts remain same as that in Case Study 3
- It is established by the Assessing Officer that although F Co.'s senior management team signs all the contracts, for all the contracts above INR 1 million the F Co. must submit its recommendation to I Co. and I Co. makes the decision whether or not the contract may be accepted
- It is also seen that during the previous year more than 99% of the contracts are above INR 1 million and over past years also the same trend in respect of value contribution of contracts above INR 1 million is seen

**Interpretation:** These facts suggest that the effective management of the F Co. may have been usurped by the parent company I Co. Therefore, POEM of F Co. may in such cases be not presumed to be outside India even though F Co. is engaged in active business outside India and majority of board meeting are held outside India.

# Case studies on place of effective management



## Case Study 5

- An Indian multinational group has a local holding company A Co. in country X
- The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y
- The A Co. has income only by way of dividend and interest from investments made in its subsidiaries
- The PoEM of A Co. is in India and is exercised by ultimate parent company of the group
- The subsidiaries B, C and D are engaged in active business outside India
- The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

**Interpretation:** Merely because the place of effective management of an intermediate holding company is in India the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since companies B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India



Thank you