

Place of Effective Management [PoEM]

Test of tax residency for foreign companies

Edition 2017

Contents:

- Introduction
- Residential status for companies- change in definition
- Likely trigger of PoEM
- Implications of PoEM
- Draft PoEM guidelines
- Challenges ahead
- How NBC can assist?



Introduction

Under Section 6 of the Income-tax Act, 1961 (the Act), a company is considered to be an Indian resident company, only if it is incorporated in India or the control and management of its affairs is situated wholly in India.

The Finance Act 2015 had proposed to amend the test of residence for foreign companies to provide that a company would be treated as resident in India if its place of effective management in the previous year is in India.

As per the amendment, a company shall be considered an Indian resident company if:

• It is incorporated in India; or

• Place of effective management, in that year, is in India.

"Place of effective management" 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.

In the recent budget 2017 announced on February 01, 2017, Government said it aims to target the shell companies that are created to evade taxes through the place of effective management (POEM) rules, but excluded firms with an annual turnover of less than Rs 500 million from its purview. The Central Board of Direct Taxes (CBDT) made public the longpending "guiding principles" to determine place of effective management of a company, which have been effective April 1, 2016. The PoEM rules with an aim to assess the tax liability was to come into effect in the current fiscal. The final guidelines have now been issued.

The main objective of introducing PoEM, was to ensure that the companies incorporated outside India, but controlled and managed from India do not escape taxation in India. It also brings in the concept of residency of corporates in line with internationallyaccepted principles.

"The final guidelines on POEM contain some unique features. Active Business Outside India (ABOI) test has been provided so as not to cover companies outside India which are engaged in active business," CBDT said in a statement.

The guidelines prescribed to determine PoEM of a non-resident is indeed welcome as it ushers in certainty for foreign investors in terms of applicability and the procedure to be followed by the revenue authorities. The final guidelines address some of the issues highlighted by the stakeholders, such as determination of PoEM in case of backoffice/support services, existence of PE, meaning of certain terms, methods used in the active/passive business tests, shareholders activity, etc.

Residential status for companies – change in definition

Existing provisions under the Income Tax Act, 1961 (sec 6)	Proposed provisions under Finance Act 2015
A company is said to be resident in India if:	A company is said to be resident in India if:
• It is an Indian company; or	• It is an Indian company; or
 During that year, the control and management of its affairs is situated wholly in India 	 Its place of effective management in that year is in India



Likely trigger of PoEM

Tax payers likely to be affected by PoEM	Activities likely to trigger PoEM	Ambiguity in PoEM
Foreign companies having Indian branches	Board meeting in India	Any decision in India?
Foreign subsidiaries of Indian parents	Decisions taken by a Director, Executive Committee, Key Management Personnel in India Delegation of authority from India	Place where functions are performed vs. place where decisions are taken?
Foreign company having global reporting structure with an India connection	Regional roles e.g. Group CEOs / CFOs sitting in India and approving decisions for foreign affiliates	Actions to be taken by the entity as a whole are determined?
Regional headquarters	Functions carried on in India e.g. Global Procurement Cell of foreign companies	Can presence in another country be used to demonstrate absence of PoEM in India?

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Worldwide income of foreign subsidiaries/ JVs liable to tax in Transaction of foreign Foreign companies subsidiary with could be liable to related foreign parties comply with WHT may be subject to obligation in India Indian transfer pricing Implications of PoEM Other provisions like Foreign subsidiaries/ MAT etc. could also JVs liable for all tax compliances in India apply

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Draft PoEM guidelines

The place of effective management of a company conducting active business outside India shall be considered to be outside if majority of board of directors meetings of the company are held outside India or it its assets, employees, income, and employee expenses are from outside India. For a company whose directors are not involved in decision making and such decision making powers are exercised by a holding company or a person resident of India, then the company is considered as a resident under the place of effective management rules.

- For determining whether a company is active outside India, the average of past 3 years data are taken into consideration.
- In case if a company's board delegates its powers to a committee, then the location where the members of the committee formulating the key decisions is considered as the place of effective management of the company.

In case of use of technology such as telephone or video conferencing by the board members in conducting meetings, the location of head-office is considered as place of effective management. It is not necessary for the person taking decisions to be physically present at a particular location.

Further, Support function is an important part of the business, but is not the decisive part of the conduct of business and hence presence of support function in India shall not tantamount to effective management in India. Also, the concept of separate legal entity shall prevail and the corporate veil shall not be lifted. A permanent establishment (PE) of a foreign company is a separate legal entity and shall not be considered as place of effective management of the foreign company in India.

It is imperative to note that having a PE in India is vastly different from having PoEM in India, since having a PE shall mean the income related to the PE is taxable in India; however having PoEM in India means that the worldwide income of the foreign company is taxable in India.

Challenges Ahead

Overseas-incorporated entities held to have PoEM in India would face some of the following challenges:

- Tax rate to be applied on computed income
- Applicability of minimum alternate tax (MAT) provisions, given foreign companies are outside the ambit of MAT (in the absence of Permanent Establishment in India)
- Applicability of Dividend Distribution Tax on payments made by such companies to overseas group entities
- Set-off of claims for foreign taxes paid by such companies
- Applicability of transfer pricing provisions versus specified domestic transactions
- Consequential withholding tax implications



How NBC can assist?

- Collect data and relevant information for review which includes understanding the group structure, nature of business of the companies, the authority matrix for managerial and commercial decisions, the composition of the BoD, etc.
- Evaluation of the information and assessing potential impact
- Discuss our findings with the management and provide Recommendations
- Assist in the implementation of viable solutions
- Reviewing authority matrix, SOPs etc to be put in place from the tax perspective
- Review the effective implementation on an on-going basis

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We are prominent Chartered Accountants in India. We offer services of accounts outsourcing, auditing, company formation in India, Business taxation, corporate compliance, starting business in India, registration of foreign companies, transfer pricing, tax due diligence, taxation of expatriates etc.

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9

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