

F. No. 142/11/2015-TPL
Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

Dated: 23rd December, 2015

Subject: - Draft Guiding Principles for determination of Place of Effective Management (POEM) of a Company.

Section 6(3) of the Income-tax Act, 1961, prior to its amendment by the Finance Act, 2015, 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. To address these concerns, the existing provisions of section 6(3) of the Income-tax Act, 1961 were amended vide Finance Act, 2015, with effect from 1st April, 2016 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 .

2. For the purposes of this clause, "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.

3. 'Place of effective management' (PoEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognize the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

4. The Explanatory Memorandum to the Finance Bill, 2015 has stated that a set of guiding principles to be followed in the determination of PoEM would be issued for the benefit of the taxpayers as well as the tax administration. Accordingly the guiding principles on the following lines are proposed to be issued.

5. For the purposes of these guidelines, -

- (a) A company shall be said to be engaged in "active business outside India" if the passive income is not more than 50% of its total income and ,-

- (i) less than 50% of its total assets are situated in India; and
- (ii) less than 50% of total number of employees are situated in India or are resident in India; and
- (iii) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure ;

(b) “Head Office” of a company would be 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;

(c) “ Passive income”of a company shall be 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;

(d) “Senior Management” in respect of a company 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).

6. Any determination of the PoEM will depend upon the facts and circumstances of a given case. The PoEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since “residence” is to be determined for each year, POEM will also be required to be determined on year to year basis. 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.

7. The place of effective management in case of a company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India.

7.1 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.

7.2 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.

8. In cases of companies other than those that are engaged in active business outside India referred to in para 7 the determination of POEM would be a two stage process , namely:-

(i) . First stage would be 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.

(ii) . Second stage would be determination of place where these decisions are in fact being made.

8.1 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.

8.2 Some of the guiding principles which may be taken into account for determining the PoEM are as follows:

(a) The location where a company's board regularly meets and makes 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. As an example this may be the case where the board meetings are

held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

(b) A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. 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.

The delegation of authority may be either *de jure* (by means of a formal resolution or Shareholder Agreement) or *de facto* (based upon the actual conduct of the board and the executive committee).

(c) 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:-

- If the company's 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.
- If the company is more decentralized (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company's head office would be the location where these senior managers,-

(i) are primarily or predominantly based; or

(ii) normally return to following travel to other locations; or

(ii) meet when formulating or deciding key strategies and policies for the company as a whole.

- Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.
- 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.

(d) 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.

(e) The use of modern technology impacts the place of effective management in many ways. 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 or meeting of senior management 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.

(f) 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.

9. It needs to be emphasized that the determination of PoEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following 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 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.
- iii. 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.
- iv. 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.

10. It is reiterated that the above principles for determining the PoEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered. In other words a “snapshot” approach is not to be adopted. Further, 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

11. Further, in case the Assessing officer proposes to hold a company incorporated outside India, on the basis of its PoEM, as being resident in India then any such finding shall be given by the Assessing officer 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.

12. The comments and suggestion of stakeholders and general public on the above draft guidance are invited. The comments and suggestions may be submitted by 02nd January, 2016 at the email address (dirtpl1@nic.in) or by post at the following address with “Comments on draft Guidance on POEM” written on the envelop.

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