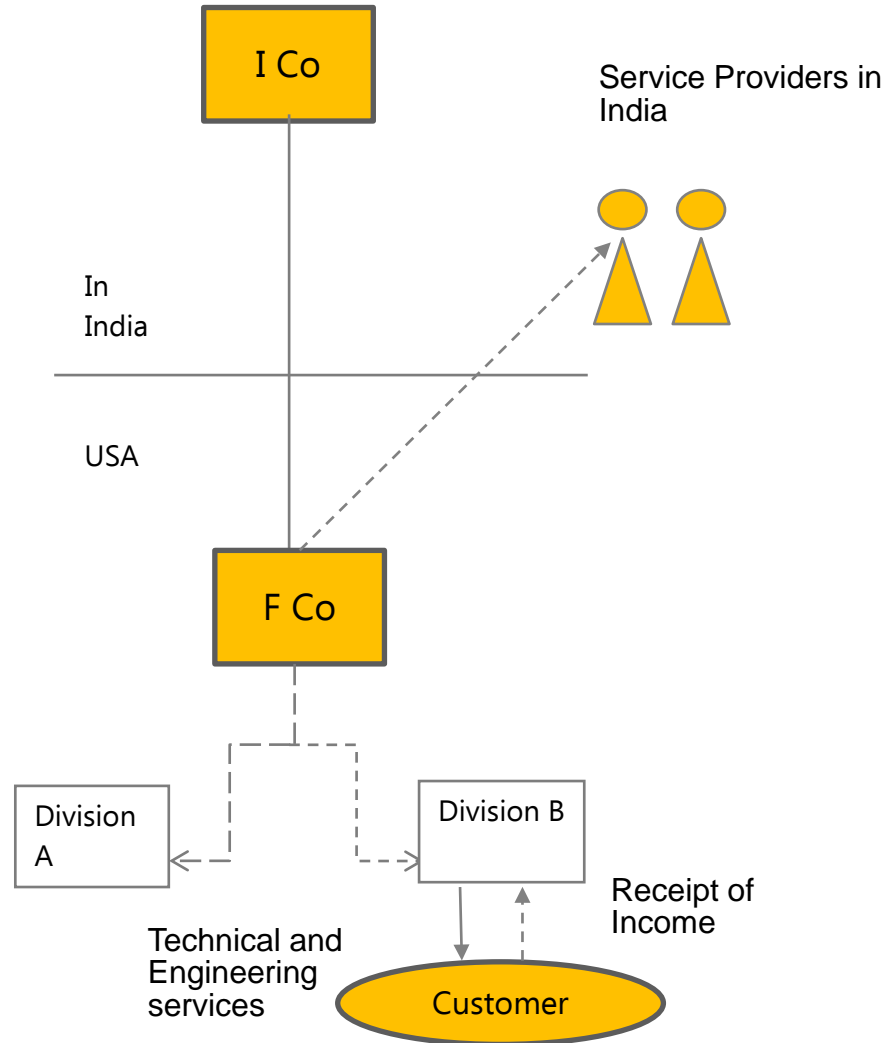


Case Study 1- Control and management on core business division by I Co and Consequences of POEM Trigger in India



Case Study 1- Control and management on core business division by I Co and Consequences of POEM Trigger in India

Facts:

- ▶ I Co has a WOS, F Co in USA having two divisions viz A (manufacturing segment) and B (service segment)
- ▶ CFO of ICo is also on the Board of FCo
- ▶ Other directors of F Co are resident of USA
- ▶ Manufacturing segment is of significance in terms of turnover, profitability and manpower
- ▶ Service division constitutes the non-core business of the subsidiary
- ▶ All the main decisions pertaining budget, capital expenditures, pricing, key appointments, marketing and other activities relating to division A are taken by CFO of I Co attending through video conferencing
- ▶ Decisions concerning division B are left to the local management
- ▶ The key personnel of division A are deputed/seconded from I Co and lower level staff are outsourced locally
- ▶ USCo paid tax at 50% on net operating profit (say \$20) by way of federal & state taxes.

P&L of USCo			
Cost	\$ 80	Revenue	\$ 100
Profit	\$ 20		
	\$ 100		\$ 100

Issues:

- ▶ What will be implication, if by invoking POEM FCo is treated as "Resident" as per Section 6(3) of the Act?
- ▶ Whether the FCo will be eligible to claim treaty benefit for its income in India or eligible to claim tax credit?

Case Study 1- Control and management on core business division by I Co and Consequences of POEM Trigger in India

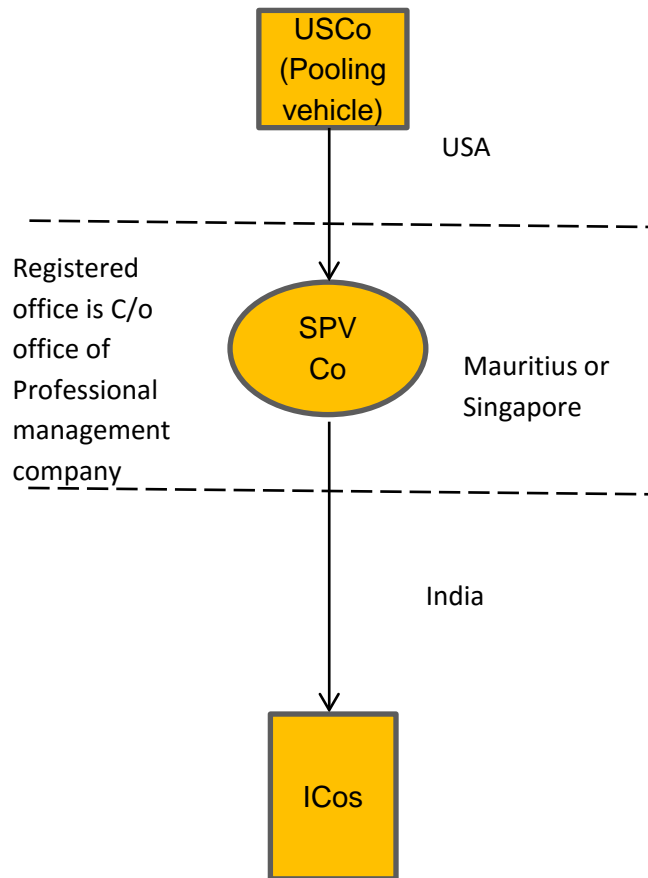
Working Notes

- ▶ There seems to be risk / exposure of POEM for F Co on the basis that key commercial and management decisions for F Co as a whole are taken by CFO in India
- ▶ CFO is only concerned with the decisions pertaining to division A – but Tax Authority may contend that division A comprises of the core business of subsidiary as a whole
- ▶ What is relevant is the situs of the authority making decisions as a whole which lies in India and not the place where actual board meetings are held, i.e., outside India
- ▶ Board of F Co has power to decide on the decisions of a small or insignificant aspect of its business
- ▶ Mere situs of Board meetings out of India may not avoid residency in India under the amended provisions of the Act.
- ▶ If CFO of I Co would have travelled to attend most BOD of F Co in his capacity as BOD member, and made key commercial and management decisions during the BOD meeting outside India, implications may be different

Case Study 1- Control and management on core business division by I Co and Consequences of POEM Trigger in India

- ▶ Dual residency and treaty benefit
 - ▶ US – Incorporation as test of residency whereas in India – Control & Management is relevant;
 - ▶ Treaty do-not recognise dual residency for companies
- ▶ Tax Credit to US Co if assessed in India
 - ▶ Karnataka HC in case of Wipro Ltd support that Section 91 is applicable if treaty is not able to resolve or cover tax credit issue;
 - ▶ S.91 is not applicability to be seen – not applicable with treaty countries
 - ▶ Assuming India –US treaty is applicable – Article 25(2)(a) restricts tax credit to US sourced income.
- ▶ Computation of income
 - ▶ US Co can claim depreciation as per Income-tax
 - ▶ Applicability of MAT provisions need to be evaluated – No PE then no MAT
- ▶ TDS provisions will be applicable for payment to Indian residents – If decision of tax residence is taken after end of year based on POEM, what will happen to TDS default?

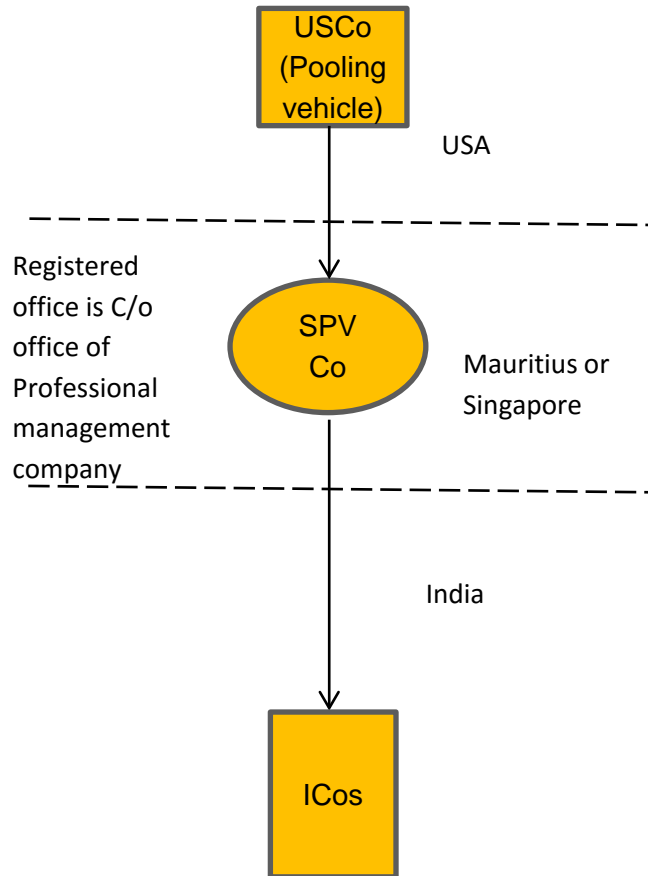
Case Study 2- Inbound- Private Equity



Facts:

- ▶ High networth individuals (HNI's) from USA have come together for making India centric investments. US Co is pooling vehicle formed by HNI's
- ▶ HNI's have identified professionals in India with experience to identify start-ups/ investment opportunity, decide terms of investment, advice on shareholder and other agreements, exit timing, etc.
- ▶ Such professionals work on partly fixed fee and partly success fee whereby remuneration is linked to performance of investment portfolio
- ▶ Investment advisors advised to set up SPV in Mauritius/ Singapore for making investments in India. The SPV was incorporated in Mauritius. The funds for investment has flown from US investors to SPV in Mauritius
- ▶ BOD of SPV comprises of 2 directors from USA and 2 from Mauritius (from professional management company) and 2 from India.
- ▶ 2 directors from USA are employees of US Co.
- ▶ 1 Indian directors is nominees of advisor from India. The employee/ nominee director will cease to be director on termination of service contract.

Case Study 2- Inbound- Private Equity



Facts (contd....):

- ▶ The 2nd Indian director is MD of Indian Cos of the group .
- ▶ 2 Mauritian directors are professionals either CAs/ CS representing professional management company (which is managing several companies)
- ▶ BOD at Mauritius has implemented in almost all cases – decisions of investment, exit and dividend extraction etc after taking advice of investment advisors
- ▶ The director (nominated by advisor) is permanent chairman at Board Meeting. In his absence, designated nominee of advisor chairs the meeting. Chariman has no casting vote
- ▶ During the year 6 Board Meetings were held
 - ▶ 3 in Mauritius;
 - ▶ 1 each in India and US and 1 via Video Conferencing
- ▶ Agenda/ Papers/ proposals for Board meetings are prepared by professionals in India. The instructions pertaining to ICos are normally implemented by India MD and instructions pertaining to SPV are implemented by US Director.

Issue:

- ▶ Examine POEM implications

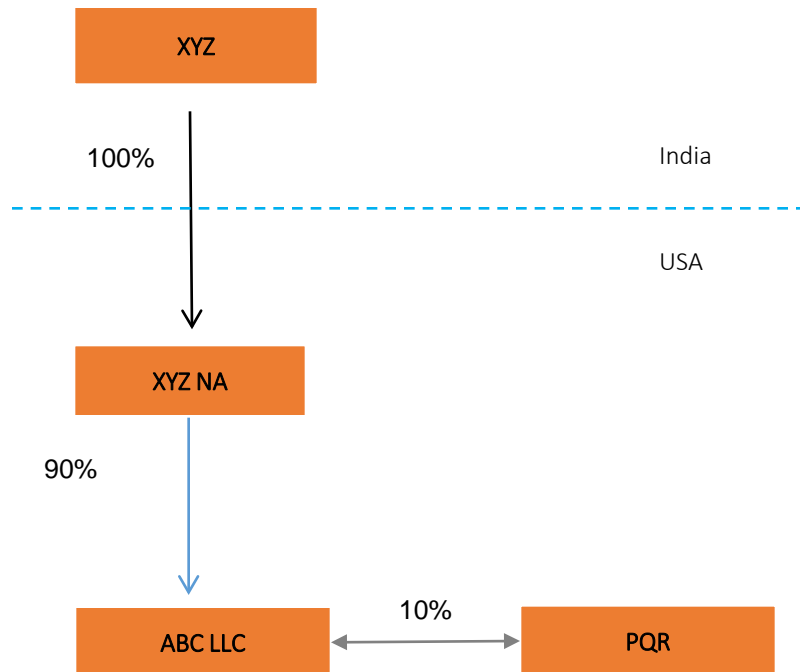
Case Study 2- Inbound- Private Equity

Working Notes:

- ▶ Mauritian treaty also has POEM as tie breaker rule
- ▶ Which are 'key management and commercial decisions that are necessary for the conduct of business of SPV as a whole' in context of private equity / investment
 - ▶ Identifying opportunities, making investment , deciding terms, devising agreements, exit timings , etc
- ▶ Who is making those decisions in the present case?
 - ▶ HNIs, BOD of SPV, or Investment committee, or investment advisors?
- ▶ Where are those decisions 'in substance' made? USA, Mauritius/ Singapore or India

If it can be demonstrated that investment advisors have acted merely in their professional capacity and 'final' decisions regarding making investments, deciding timing of exit etc are actually made outside India, then POEM is not in India

Case Study 3 – Active Business Outside India test (ABOI Test) for POEM analysis



Facts:

- ▶ XYZ North America, Inc ('XYZ NA') is a passive investment company in United State of America ('USA') and is tax resident of USA.
- ▶ XYZ NA is wholly owned subsidiary of XYZ Private Limited (Indian Company)
- ▶ XYZ NA has made investment in ABC LLC, a joint venture between XYZ NA (90%) and PQR (10%) [Non Associate Enterprise('AE')].
- ▶ ABC LLC is engaged in the business of trading goods where it purchases goods exclusively from XYZ (AE) and sale goods to third party in USA.
- ▶ ABC LLC is a pass through entity i.e. on profit earned by ABC LLC is taxed in the hands of XYZ NA and PQR.

Issue:

Whether profit received by XYZ NA from ABC LLC is considered as active income under Active Business Outside India ('ABOI') test for evaluating Place of Effective Management ('POEM').

Case Study 3- Active Business Outside India test (ABOI Test) for POEM analysis

Working Notes:

- ▶ The Draft Guidelines makes POEM determination primarily divided into two captions viz.
 - ▶ Foreign companies engaged in ABOI or
 - ▶ Foreign companies other than those engaged in ABOI.
- ▶ ABOI test is satisfied if :
 - ▶ Passive income is more than 50 per cent of the total income;
 - ▶ Less than 50 per cent of assets are situated in India;
 - ▶ Less than 50 per cent of total number of employees are situated or residents of India; and
 - ▶ Less than 50 percent of payroll expenses is incurred on such employees
- ▶ One of the condition for a company to fulfill the ABOI test is that 50 per cent or less than 50 per cent of total income is passive income (i.e. more than 50 per cent of total income has to be active income).

- ▶ The Draft Guidelines has defined the term passive income as under:

“Passive income’ of a company shall be aggregate of,

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

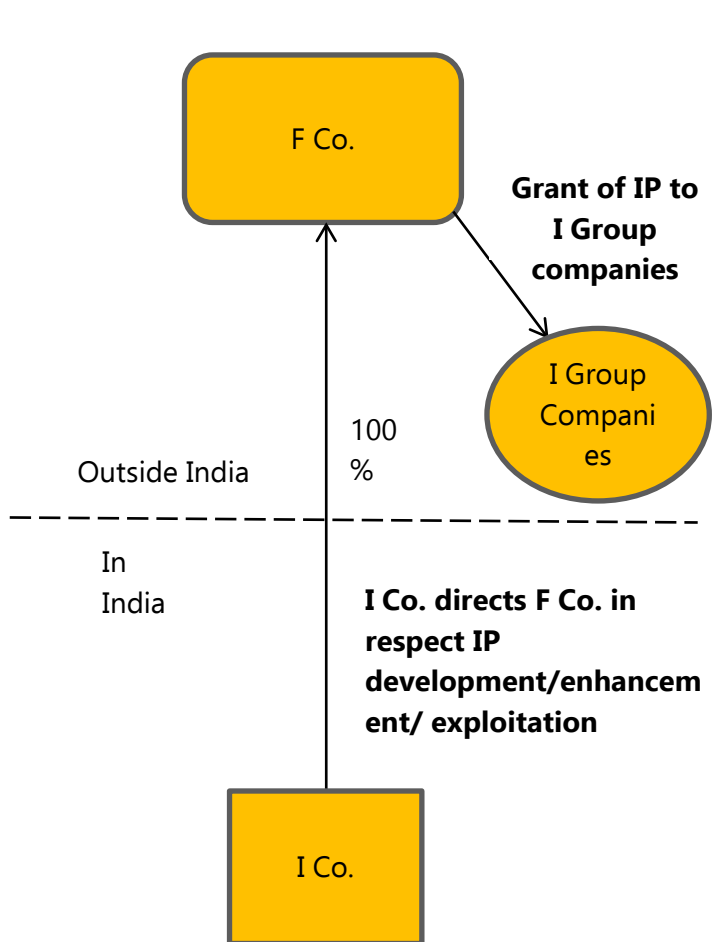
Income by way of royalty, dividend, capital gain, interest or rental income.”

- ▶ In case of ABC LLC, which is engaged in the business of trading goods where it purchases goods exclusively from XYZ (AE) and sale goods to third party in USA.

Therefore, income earned by ABC LLC under such trading activity could be term as active income.

- ▶ Further, XYZ NA’s only income for the year under consideration is profit from ABC LLC. As per the definition of passive income, profit/ loss from LLC/ partnership firm are not considered as passive income.

Case Study 4- Development and commercialisation of technology



Facts:

- ▶ I Co, an Indian company has a subsidiary F Co in a foreign jurisdiction which is engaged in research and development (R&D) of technology for I Group. The roles of both companies are as under:

F Co:

- ▶ Conducts R&D to develop technology and know-how, the rights of which are then given to I Group companies outside India
- ▶ Earns royalty income from the I Group companies
- ▶ Only undertakes IP development and licensing and further development/enhancement/ improvement of IP based on directions and instructions given by the I Co

I Co:

- ▶ Undertakes conceptualisation and preparing blue print of R&D
- ▶ Takes all decisions for development of R&D
- ▶ Directs and supervises the R&D activities conducted by F Co
- ▶ Does not retain any legal ownership right over the intellectual property ('IP') developed by F Co but directs the F Co over the manner of utilisation/exploitation of IP like to whom it should license the IP, how IP is to be protected etc

Issue:

- ▶ Whether income earned by F Co would be taxable in India considering that I Co takes all decisions relating to development and commercialisation of technology?

Case Study 4- Development and commercialisation of technology

Working notes:

- ▶ In the case under consideration, there is a risk that the tax authorities may contend that, as all the key commercial and business decisions in relation to functioning of F Co.'s namely areas wherein research and development is required to be undertaken, licensing of IP etc are taken by I Co and hence, royalty income derived by F Co. from licensing the know-how/technology to I Group entities is taxable in India.
- ▶ Even if F Co does not trigger POEM in India, there is a risk that because of TP provisions, income is fully or majorly imputed in hands of I Co, and / or I Co may be regarded as 'economic owner' of the IP
- ▶ Even PE implications for F Co in India needs examination