
POEM – Concept, Challenges & Audit

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The SAAR of POEM - Overview

- **Promulgation:** The Finance Bill 2015 introduced POEM w.e.f. AY 2016-17 - At the enactment Stage, the words 'at any time' were dropped to eliminate any unintended consequences (e.g. single Board meeting of FCo in India = POEM)
- **Draft Guidelines:** The CBDT issued draft POEM Guidelines on 23 Dec 2015
- **Operationalization:** The Finance Act 2016 defers POEM to AY 2017-18 & introduces New Chapter XII-BC (Section 115JH) - modified scheme of taxation of FCo having POEM in India
- **Final Guidelines:** The CBDT issued final POEM Guidelines vide Circular No. 6 dt. 24 Jan 17 + PR of even date with threshold of Rs. 50 Crores for applicability of POEM
- **POEM Threshold:** The CBDT issues Circular No. 8 dt. 23 Feb 2017- POEM not applicable to FCo having turnover or gross receipts of Rs. 50 crores or less in a financial year.
- **POEM clarification:** The CBDT issues Circular No. 25 dt. 23 Oct 2017 – POEM clarification for multinational companies having regional structure
- **POEM Notification:** No. 3039(E) dt. 22 Jun 2018 - Taxation scheme under Section 115JH (*certification that no person is adversely impacted by retrospective effect to this notification*)
- **International developments** - POEM's Tie Breaker cases are treaty abuse and to be resolved through MAP - OECD AP 6 & MLI & Amendments to MC – OECD, UN & US

*For DTAA benefits, POEM needs to be demonstrated in the State of Incorporation & Residence and merely demonstrating POEM outside India not sufficient. **Obligation is distinct and over and above other obligations e.g. LOB, beneficial ownership of income, GAAR and Principle Purpose Test.***

POEM – Statutory Framework

▪ Section 6(3) of the Income-tax Act 1961 w.e.f. AY 2017-18

“A company is said to be a 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. #***

*Explanation.—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 business of an entity as a whole** are, **in substance made.**”*

▪ General guiding principles

- POEM to be examined every year per facts / circumstances and substance over Form
- There can be many places of control / management but only one POEM
- POEM not intended to tax global income of FCo merely because of their PE or business connection
- POEM targets shell companies & companies incorporated outside India for retaining income outside India but controlled and managed from India

Till AY 206-17 - During that year, the control and management of its affairs is situated wholly in India

Key elements of POEM

- *the Place where*
- *Key management and commercial decisions*
- *That are necessary for conduct of business of an entity as a whole*
- *Are in substance made*

POEM Guidelines – Active v. Non-Active / Passive

▪ FCo engaged in Active Business Outside India (ABOI) if:

- Passive income not more than 50% of total income; and
- Less than 50% of its total asset are situated in India; and
- Less than 50% of its total employees are situated in India or Resident in India; and
- Payroll of such employees as above is less than 50% of its total payroll expenditure

▪ Computation of ABOI

- As per Average of the data of the previous year and the prior two years (or shorter period for newly incorporated FCo) (accounting year data if different from previous year)
- Income - Tax computation as per laws of country of incorporation or as per books of accounts if no computation
- Passive income - (i) Income from 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.
- Depreciable Asset – Average of beginning and end of the year (Block / Individual Assets); Other Assets – as per books of account
- Employees -Average of beginning and end of the year (include persons performing similar tasks as employees)
- Payroll – cost of salaries, wages, bonus and all other employee compensation included pension / social costs

▪ Fco not ABOI is OABOI (Other than those engaged in ABOI)

POEM Guidelines – FCo engaged in ABOI

▪ POEM of FCo which is engaged in ABOI

- POEM is **presumed** to be outside India if the majority meetings of the Board of Directors (BoD) of FCo are held outside India
- POEM in India if BoD is **standing aside** and control / management powers are exercised by Hold Co in India or persons resident in India
- Cases where BoD is **not** considered as **standing aside**:
 - BoD follows general and objective of global policy of the group laid down by the Parent entity (in India)
 - Such policies are in the field of Payroll, Accounting, HR, IT infrastructure and Network Platforms, Supply Chain, Routine Banking Operational Procedures, and not being specific to any entity per se
 - CBDT Circular No. 25 dt. 23 October 2017 extends above principles to Regional HQ activities in India with a rider that GAAR would be applied if this relaxation was applied for aggressive / abusive tax planning

Place of management decisions v. Place where such decisions are implemented

Standing aside v. Standing by the side (better still Standing Tall...)

The expression "control and management" means de facto control and management and not merely the right or power to control and manage. Nandlal Gandalal [1960] 40 ITR 1(SC)

POEM Guidelines – FCo engaged in OABOI

POEM for FCo other than those engaged in ABOI:

- First Stage - Identify / ascertain person(s) who actually make the management and commercial decisions for the conduct of the Company's business as a whole
- Second Stage - Determine place where the decisions are made

▪ Areas to be examined through fact finding exercise

- Location of regular BoD meeting and decisions therein
- Delegation by BoD of its authorities
- Role of Head Office and Senior Management
- Modern Technology impact
- Circular Resolution / Round Robin Voting
- Shareholders decisions and matters reserved for them
- Routine operational decisions taken by junior management

▪ If above not conclusive then POEM is at the:

- Place where substantial activity of FCo is carried out; or
- Place where the accounting records are kept

POEM Guidelines – OABOI - BoD & Delegation

▪ Questions / Challenges

- Where is the Location of BoD Meetings?
- Whether BoD retains and exercises authority to govern the company in the said meeting?
- Whether in the meeting, the BoD makes in substance the key management and commercial decision for the company's business as a whole? Are such decisions made elsewhere?
- Whether BoD has board delegated its authority *de facto* to shareholders, promoter, strategic or legal or financial advisor? Whether BoD routinely ratifies the decision that have been made? Where are such persons based and where are such decisions made?
- Whether BoD has delegated its authority to one or more committee consisting of senior management?
- Whether such delegation is *de jure*? Where are such persons based?

▪ Key checklist

- TRC and POEM provisions in the Other State
- Constitution of BoD / Committee – their numbers, locations, Indian / Foreign, Residential status, etc.
- Director's qualification, experience, capability, Independence, terms of appointment, remuneration and other roles / responsibilities.
- How many meetings held? where? Who sets Agenda? Who are drivers?
- Notice / Debates & Minutes / Quorum / Meeting Mode / Email ids -Signatures / Secretarial framework
- MoA / AoA / Agreements with & role of shareholders and consultants
- Information in Internal and Public Domain (Website, Linked in, News item, press release, corporate announcements, etc.)

POEM Guidelines - HO

- **Questions / Challenges**

- Where is the HO – the location where the company’s Senior Management (SM) and their support staff are based? Is there any location that is held out to the public as the company’s principal place of business or headquarters?
- If the company’s HO is decentralized then at which locations are the SM team members based? Where are the MD / CEO / FD - CFO / COO or Heads of Department based? (Sales, marketing, technology)
- Where do these SM team normally return to after travelling to other locations?
- Where do SM meet when formulating or deciding key strategies and policies for the company as a whole?

- **Key checklist**

- Registered office and other places of business as per corporate records
- Capacity and size of the offices
- SM qualification, terms and place of employment, roles / responsibilities
- Incentives to SM and their basis (e.g. ESOPs)
- Travel details and reasons of travel
- Third party evidences such as tickets, hotel stay, etc.
- Secretarial records / minutes of such meetings and operations.
- Public profile of SM (Linked-in)
- Tone of internal / external communication

POEM Guidelines – Modern Technology

- **Questions / Challenges**

- What are the local rules for attending BoD meetings by video / audio conference?
- How many directors or committee members or senior management team attend the meeting physically and how many of them were on video or audio call?
- Where were the majority members with respect to any decision taken in the meeting?
- Was the decision taken in any other mode or who is the person or persons who took that decision and where were they located?

- **Key checklist**

- What Technology is used for video / audio conference? Whether Recordings available?
- What details are captured when the Director / SM is not attending the meeting physically?
- Is there a trend of attendance from a particular place?
- How has the decision been concluded in the meeting? Is it through majority or left to one / selected person ? Where is such person located?

POEM Guidelines – Activities / Accounting Records

- **Questions / Challenges**

- Which are the places where substantial activity of FCo is carried out?
- Which are the place where the accounting records are kept?

- **Key checklist**

- List of places of business with activities and applicable statutory registrations
- Business Website, description of activities and places of business mentioned therein
- Who has the authority to bind the Fco and where is that person located?
- Bank account address, authority and operation
- Nature and terms of transaction with Related Parties – at Arm’s Length? Management cross-charges?
- Place where accounting records are kept?
- Who is responsible for accounting and auditing of the financial statements?
- Places where operational costs of business are incurred and method of funding?

POEM - Other relevant factors

Clarifications by CBDT:

- Illustrative list of factors, which per se, would **not** lead to the conclusion that POEM of an entity is in India:
 - Overseas entity is completely owned by an Indian entity;
 - Overseas entity has a Permanent Establishment in India;
 - One or some of the directors of the overseas entity resides in India;
 - Local management of the overseas entity is situated in India in respect of the activities of the overseas entity in India;
 - Existence of support functions in India, that are preparatory or auxiliary in character

Procedure to be adopted by AO:

- Tax Officer to obtain a prior approval of the Commissioner before initiating any inquiry on POEM;
- Prior approval of a Collegium of three Commissioners before holding a overseas entity's POEM to be in India; and
- Opportunity of being heard to be granted by Collegium to the company before issuing any directions

If FCo has POEM in and outside India

- **POEM shall be presumed to be in India** if it has been mainly / predominantly in India.

Section 115JH - CBDT Notification

(A) Framework

- FCo treated as NR and taxed at NR rate on income chargeable basis POEM with no impact on income otherwise taxable in India. DDT not applicable.
- Fco subjected to TDS as if it is a NR – S. 195 applicable
- Foreign Tax Credits eligible on same proportion as income offered / assessed to tax
- Exchange Rate – Rule 115
- Transactions with R not altered – TP applicable
- Provisions applicable to Foreign Company and Residents to apply to FCo having POEM in India
- Most complicated provisions
 - Preparation of P&L and B/Sh where accounting year is different from financial year
 - C/f of unabsorbed depreciation and Losses – proportionate computation

(B) Computation of Depreciation:

- Tax WDV on 1 day of previous year
 - If assessed in Foreign Country - as per Tax records post depreciation allowed / allowable
 - If not assessed to Tax – as per Books

(C) Unabsorbed Depreciation / Losses

- As on 1 day of previous year
 - If assessed to Tax - as per Tax Records of Foreign Country
 - If not assessed to Tax – as per Books
- C/f as per the Act for the remaining years taking the year of incurrence as first year
- They can be set-off only against income taxable of FCo due to becoming Resident
- To be revised in India if revised overseas including due to reassessment

POEM – Model Commentary & MLI

▪ **OECD MC 2017 – New Article 4(3) pursuant to OECD BEPS AP 6 (2015)**

- Dual Resident Entities (DREs) cases to be examined case by case as could involve tax avoidance.
- Tie Breaker Rule for POEM done away
- DREs – case to be decided by Competing Authorities (CAs) of Contracting State
- Relief / exemption as per agreement between CAs and none in absence thereof
- Factors that are to be considered by CAs – continue to be POEM based (para 24.1)
- Contracting States can agree to retain erstwhile model article – tie breaker rule based on POEM

Note: India's Reservation to OECD MC 2014 were on similar lines – DRE to be resolved through MAP and POEM reference similar to enacted in Section 6(3) by FA 2015

- **UN MC 2017** – Article 4(3) reproduces the OECD MC 2017

▪ **US MC 2016 – Article 4(4)/ (5)**

- Dual Resident Company shall not be resident of either of the contracting state for purpose of relief under the convention
- Dual Resident Person other than an individual or a company, the CAs of the Contracting State to determine the mode of applicability of the Convention

• **Article 4 of MLI**

- Incorporate revised Article 4(3) of OECD MC 2017 to earlier tax treaties which would be CTAs
- Art 4(2) of MLI – “in place of or in absence of” (widest opt-in rule)

Selected Judicial Precedents – India & International

- **AB Mauritius II (2018) (AAR) (not directly on POEM) - Favorable**
 - **Relevant** - TRC, Investments in India long term through Banking channels, MD of Holding Company is Director in Mauritius Company and made 11 trips to India / Mauritius, Shares held in Mauritius company name – Legal & Beneficial Owner (No Benami), Mauritius Authorities Certificate on Place of Business in Mauritius, Directors were qualified and Independent, Board meetings took place in Mauritius, etc.
 - **Not Relevant** - Persuasive influence of US ultimate Parent, movement of Directors in and out of Mauritius, Participating physically every time is not relevant and participation through electronic / video are valid means. Investment companies do not require huge offices and staff. Outsourcing of secretarial function.
 - **AB Holding II (2018) (AAR) – Against - Negative factors:** Board merely reiterated Holding Company decisions, SPA not signed by Directors but Representative of Ultimate US Parent, SPA did impose no obligation on Mauritius Company, consideration paid by Ultimate US Parent, etc.
 - **SMR Investment (2010) (Del AT) -** Order for sale and purchase of shares for the Mauritius Company given by Indian Resident Shareholder from Phone then effective place of management is in India
 - **Bay Lines (2018) (Mum AT) -** UAE Directors attended BoD only on calls, Mauritius directors were only to satisfy Mauritius Law, BoD transacted no other business except Mauritius Law compliances, even items like letter to AO signed by UAE parent representative – POEM was not in Mauritius
-
- **Bywater (Australian Full Court) –** Person appointed in AOA and not BoD which controlled the Company and BoD powers were usurped – POEM was where the Person was located and not where BoD meetings held
 - **Development Securities (UK Tribunal) –** Jersey Company’s BoD agreed to implement tax planning scheme of UK Parent and all decisions made / supervised by UK Parent even if unlawful / unauthorized and local Directors resigned after the Scheme – POEM in UK and not Jersey (*see also UK HC in Smallwood case which shot down tax planning through Trustees in similar manner*)

POEM - Things to Watch Out!

Further updates / clarification on POEM Guidelines and method of tax computation

Possible recourse to non-discrimination clause on method of taxation of Fco if POEM in India

Principles and mechanism to resolve DRE cases by CAs under MAP in a time bound manner - whether will or can relate to method of computation of income? Need to take up computation aspects additionally?

Other Contracting State adopting POEM in domestic law and consequential conflicts with Indian POEM Guidelines

Q&A



Questions

&



Answers

THANK YOU ALL FOR YOUR ATTENTION !

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