
CBDT issues Draft Guiding Principles for determination of Place of Effective Management ('POEM')

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The Central Board of Direct Taxes ('CBDT') has issued detailed Draft Guiding Principles for determination of the Place of Effective Management ('POEM') of companies. Comments and suggestions have been invited from stakeholders and the general public in respect of the draft guidelines.

The key highlights of the Draft Guiding Principles are set out below:

Active Business outside India

It is proposed that the process of determination of POEM will primarily be based on whether the company is engaged in *active business* outside India.

Under the guidelines, a company can be said to be engaged in *active business outside India* if the following cumulative conditions are satisfied:

- Its passive income (income by way of royalty, dividend, capital gains, interest, rents and income from purchase/sale of goods from/to associated enterprises) is not more than 50% of its total income;
- Less than 50% of its total assets are situated in India;
- Less than 50% of its total number of employees are situated in India or are resident in India; and
- Payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

In making the above determination, the average of the data for the previous year and the two preceding years is to be taken into account. If the company has been in existence for a shorter period, data for the shorter period is to be taken.

Guidelines for determining POEM for companies engaged in Active Business outside India

It is provided that in the case of companies engaged in active business outside India (under the above parameters), the POEM shall be presumed to be outside India if the majority of the meetings of the Board of Directors of the company are held outside India.

Mindful that the POEM concept is stated to be one of substance over form, it is provided that if the facts and circumstances establish that if the Board of Directors are standing aside and not exercising their powers, and that such powers are being exercised by either the holding company or any other person resident in India, the POEM shall be considered to be in India.

Guidelines for determining POEM for companies that are not engaged in Active Business outside India

The Guiding Principles envisages a two stage process for determination of POEM for companies that are not engaged in an active business outside India:

- Stage 1 involves the identification of the persons who actually make the key management and commercial decisions for the conduct of the company's business as a whole;
- Stage 2 involves determination of the place where the decisions are in fact being made

The proposed principles for determining the POEM in such situations are as under:

Decisions v. Implementation

The place where management decisions are taken will be more important than the place where the decisions are implemented.

Location of Board of Directors

The location where the Board of Directors regularly meets may be the POEM provided-

- The Board retains and exercises its authority to govern the company
- The Board, does, in substance, makes the key management and commercial decisions necessary for the conduct of the company's business as a whole

The mere formal holding of the Board Meetings at a place will not by itself be conclusive for determination of POEM. If key decisions by the directors are being taken at any other place, such place would be relevant for POEM.

If the Board has delegated the authority to make key management and commercial decisions to the senior management or any other person, and does nothing more than ratify their decisions, the POEM will ordinarily be where such senior managers or other persons make those decisions.

In cases where the Board has (*de facto* or *de jure*) delegated some or all of its authority to one or more committees, the location where key members of the committee are based and where the committee develops and formulates key strategies for the formal approval of the Board will be the POEM.

Location of the Head Office

The draft Guiding Principles provide that the location of the head office will be an important factor in the determination of POEM and provides for parameters that are relevant in determining the location of a company's head office.

Where the company's senior management and their support staff are based in a single location which is held out as the company's principal place of business or headquarters, such place will be the place where the head office is located.

Where a company is decentralised, the head office will be where the senior management:

- Are primarily or predominantly based
- Normally returns, following travel to other locations; or

- Meet when formulating or deciding key strategies and policies for the company as a whole

Where members of senior management operate from different locations and participate in meetings via telephone or video conferencing, the head office will be the place where the highest level of management and their direct support staff are based.

However, it is provided that where it is not possible to determine the company's head office with a reasonable degree of certainty, the location of the head office will not be of much relevance in determining POEM.

Other factors

It is clarified that routine operational decisions taken by junior and middle management will not be relevant for the purpose of determining POEM.

The draft also notes that the physical location of meetings may not be where the key decisions are in substance made (on account of participation in meetings through use of technology). In such cases, it is stated that the place where the persons taking the decisions or a majority of them usually reside may also be a relevant factor.

Where the factors referred to above do not lead to a clear identification of POEM, then the following secondary factors are provided for consideration:

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

Factors that are not determinative of POEM

It is sought to be emphasised in the draft that POEM is not to be determined on the basis of isolated facts that by itself do not establish effective management. Some illustrative factors that will not be conclusive

evidence that the conditions for establishing POEM in India are satisfied are provided. These are:

- The fact that a foreign company is wholly owned by an Indian company
- The fact that one or some of the directors of a foreign company reside in India
- The fact that local management is situated in India in respect of activities carried out by a foreign company in India
- The existence in India of support functions that are preparatory and auxiliary in character

Procedural aspects and Safeguards

The draft guidelines note that the principles set out therein are for guidance only and that no single principle will be decisive in itself.

It is also stated that the principles are to be applied with reference to activities performed over a period of time during a previous year, and not by means of a 'snapshot' approach.

From an administrative standpoint, it is provided that if the Assessing Officer proposes to hold a company incorporated outside India as a resident of India based on POEM, such a finding can be made only after seeking prior approval of the Principal Commissioner/ Commissioner. It is also provided that the Principal Commissioner/Commissioner will provide an opportunity of being heard to the company before deciding the matter.

Dhruva Comments

The draft guidelines seek to provide a fairly detailed set of factors that will be considered for determination of POEM. While the consultative process is certainly a welcome step, there may be a need for providing more objective parameters for determining POEM so as to eliminate uncertainties faced by taxpayers. Given that this is a far reaching measure that could have a significant bearing on how businesses operate, this may need to be appropriately addressed in the final guidelines.

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