



## TAX RESIDENCY OF COMPANIES IN INDIA

The concept of Place of Effective Management (POEM) for deciding the residential status of a company was introduced by Finance Act 2015. CBDT has issued guiding principles for determination of POEM of a company. The main objective of introducing POEM, is to ensure that the companies incorporated outside India, but controlled and managed from India do not escape taxation in India. It is effective from 01.04.2016 and accordingly shall **apply from AY 2017-18 onwards. The POEM guidelines shall not apply to Companies having gross turnover or Gross Receipts of INR 500 Million or less in a financial year.**

A company is said to be resident in India in any previous Year if:

- it is an Indian company or
- its place of effective management is in India

"Place of effective management" is defined in the Act 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.

### The Key Aspects of POEM

- The POEM concept is one of Substance over Form
- An entity may have more than one place of management but it can have only one place of effective management
- POEM will be determined on year to year basis

### Identification of POEM

CBDT has issued following guidelines for determination of POEM:

#### 1. Guidance for Companies having Active Business outside India

A company shall be engaged in "Active Business outside India" if fulfills all the conditions laid down below:

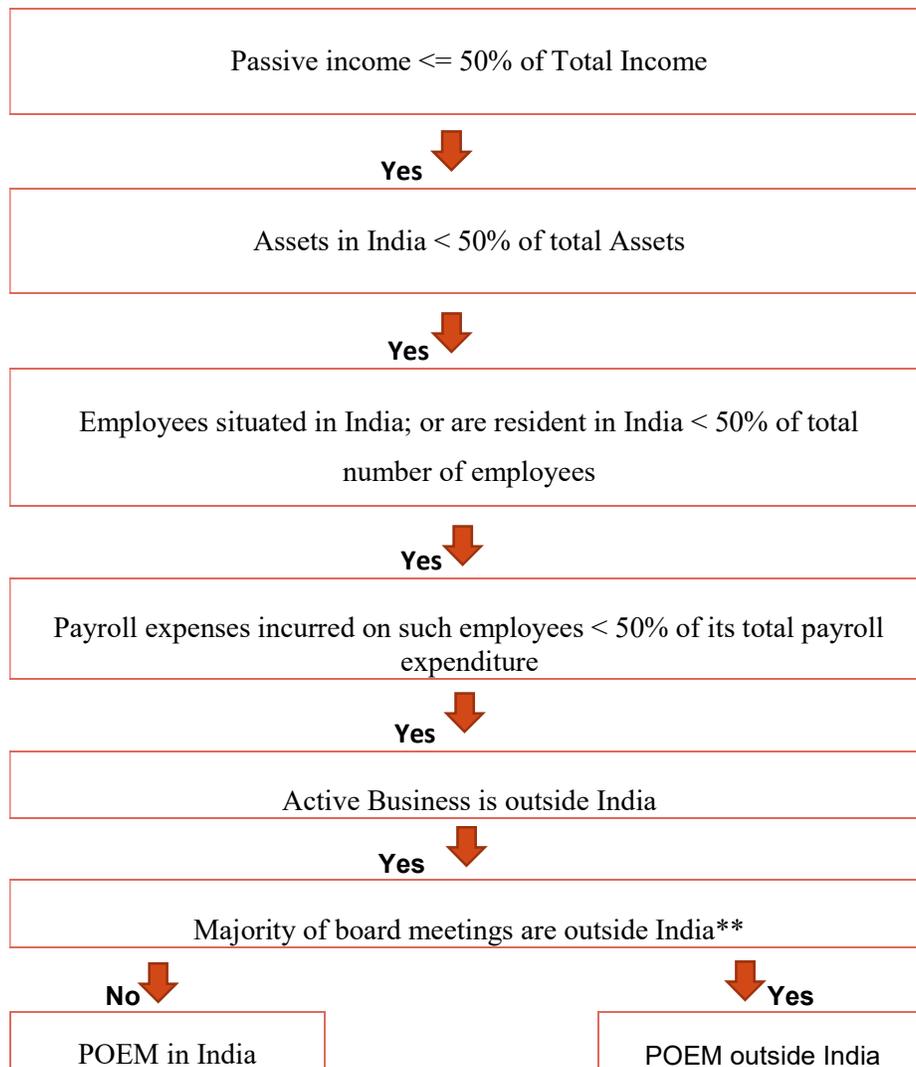
- Passive income is not More than 50% of total income, and
- less than 50% of its total assets are situated in India; and

- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

The POEM 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.

However, 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 resident in India, then the POEM shall be considered to be in India. This is summarized below:

### Active Business outside India

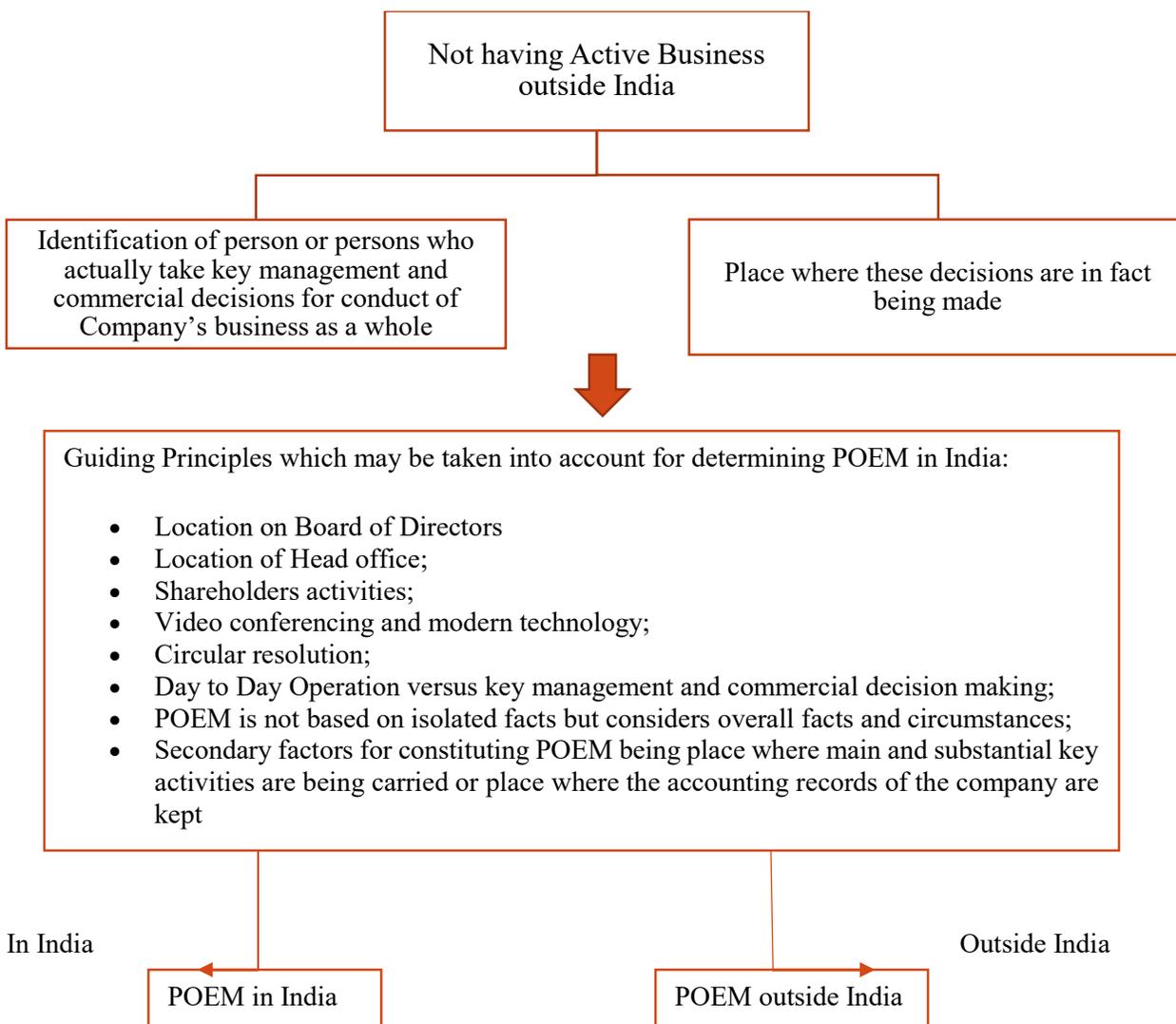


\*\* If it is established that decisions are not taken by BOD outside India then POEM for such an entity shall be determined a per the guiding principles similar to applicable to those entities Not having active Business in India.

For determining the active business outside India, the average of the data of the previous Year and two years prior to that shall be taken into account.

2. Guidance for companies not having active business outside India

For the companies not having active business outside India guiding principles for determination of POEM is summarized below:



## **Impact of POEM**

- If the place of effective management of a foreign company is established in India, then it becomes tax resident as per domestic laws. Accordingly, the global income of such companies shall be taxable in India.
- Foreign subsidiaries/JV may become liable for all tax compliances in India. This imposes a cost in the form of tax compliance. Income of these foreign company may be taxable at 40% in India if they have not made arrangement of declaration and payment of dividend in India.
- Other provisions like MAT etc. could also apply as being Resident they will be subject to Indian taxes.
- Transaction of foreign subsidiary with related foreign parties may be subject to Indian Transfer Pricing regulations.
- Foreign Companies who become resident of India as per POEM guidelines would be resident of the other jurisdiction as per the local tax laws. The residential status of these companies would be determined by the tie-breaker rule as per the Article 4 of the respective DTAA of this jurisdiction with India and would most likely be decided by Mutual Agreement Procedure. Thus resulting in delays and uncertainty pertaining to place and quantum of Taxation.
- The guidelines would ensure that Directors, Board of Directors meeting and offices of foreign companies would be moved out of India.