

Place of Effective Management (POEM)

Section 6 of the Income Tax Act, 1961 has been amended vide Finance Act, 2015. Clause 3 of Section 6 has been amended to include the concept of POEM. The amendment would be operational w.e.f April 1, 2016 i.e AY 2016 – 17.

Amended Clause 3 to Section 6	Present Clause 3 to Section 6
A company is said to be resident in India in any previous year, if—	A company is said to be resident in India in any previous year, if—
(i) it is an Indian company; or	(i) it is an Indian company; or
(ii) its place of effective management , in that year, is in India *	(ii) during that year, the control and management of its affairs is situated wholly 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 the business of an entity as a whole, are in substance made.

Now, in order to consider, a company resident in India, following conditions must be satisfied:

- place where key management and commercial decisions,
- necessary for conduct of business,
- in substance are made.

Rationale for amendment

The definition of 'place of effective management' has been amended to bring it in line with definition in OECD, which is internationally well accepted concept. Further, the previous definition of resident company was virtually irrelevant due to the condition that control and management should wholly be in India. This clause was easily defeasible. Company only needs to hold a board meeting outside India and the condition of control and management in India is beaten. This facilitates creation of shell companies which are incorporated outside but controlled from India.

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'Place of effective management' (POEM) is an internationally recognized concept for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognise the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation. Many countries prefer the POEM test to be appropriate test for determination of residence of a company.

The modification in the condition of residence in respect of company by including the concept of effective management would align the provisions of the Act with the Double Taxation Avoidance Agreements (DTAAs) entered into by India with other countries and would also be in line with international standards. It would also be a measure to deal with cases of creation of shell companies outside India but being controlled and managed from India.

What if the company's POEM is established in India

When a foreign company is treated as Indian Resident, it will have to comply with the Indian laws. To list a few of the compliances;

1. Obtaining PAN
2. Filing of income tax returns
3. Pay advance tax and self-assessment tax on its global income
4. Maintain and audit of books of accounts as per prevalent laws
5. Obtain TAN and comply with TDS obligations
6. All other laws applicable to Indian companies

Note: If a company is a resident of two nations, DTAA with that country would be applied, if applicable. Otherwise provisions of income tax act would be applicable and relief of double tax would be given.

How to establish that company's POEM is not in India

1. Keep management of company's affairs out of India, in actual.
2. Complete and proper documents to substantiate before the income tax authorities that management is situated out of India.
3. Have an office outside India which is physically present and is not just on papers.
4. Have non-resident directors on board who will actually manage the affairs of the company.
5. Meetings of the Board and Shareholders must be held outside India.
6. Comply with all local laws of the other country to open and operate the office in there.

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7. Books of accounts, Minutes, Vouchers, etc. must be maintained at that office.
8. Avoid telephonic and email communications or instructions.

Conclusion

To conclude, it can be said that POEM will be the factor to determine the residential status of the company. If the company is determined as resident in India, it will be treated at par with Indian companies. As an effect of this, Indian companies with overseas units have to work out the mechanism to ensure their units are truly independent of the parent and therefore out of the tax net of India.

Note: Guidelines on the applicability of POEM are awaited which will make the picture clear for the assessee.

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