Place of Effective Management
Recommendations on Guidelines to be issued

September 2015
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The Indian regulatory landscape is undergoing a change and several new regulations are being enacted and implemented. GST, ICDS, IndAS and Place of Effective Management (PoEM) are some of the regulations that Indian companies would have to understand and apply over the next 12 to 18 months.

One of the most important changes introduced by the Finance Act, 2015 (FA 2015) is the concept of PoEM. PoEM is a new concept for determining the residency of a Company with effect from April 1, 2015. Under the erstwhile provisions, a Company would become resident in India if it was an Indian company; or during that year, the control and management of its affairs was situated wholly in India. As per the FA 2015, a company would become resident in India if its Place of Effective Management (PoEM) is in that year is in India. PoEM has been defined 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’.

Internationally, the concept of PoEM for determining residency of a company is not new. For instance, countries like Switzerland, Germany, China, South Africa, Italy, Russia etc. have PoEM as one of the criteria for determining residency of a company. The OECD and UN commentary have also provided clarification and definition on the concept of PoEM.

If a foreign company is found to have its PoEM in India, it will have its own set of tax complications. The amendment therefore assumes significance to foreign companies having nexus with India, especially Indian MNCs having outbound investments. It will be therefore important for Indian MNCs to take stock of the functioning of the group’s operations and evaluate impact on account of PoEM, if any, on its overseas entities.

The Memorandum to the Finance Bill has indicated that a set of guiding principles will be issued for the benefit of the taxpayers as well as, tax administration which will be useful in determination of PoEM. While we await the guidance on PoEM, this paper has been prepared, keeping in mind international perspective on PoEM and the intention of the Indian government in introducing the concept of PoEM.

Through this paper we wish to highlight some of the key considerations that must be taken into account by the Central Board of Direct Taxes prior to finalizing its guidelines. Hopefully, the guidelines will be in line with the internationally accepted principles. More importantly India Inc. would expect that the implementation of the new law does not open up doors for unnecessary litigation in India and abroad.

We hope this paper will help in the understanding of the concept of PoEM and the challenges thrown up by the application of the concept of PoEM. This paper summarizes the recommendations of CII and Deloitte, based on communication and feedback received from various members and Indian Multinationals over the last few months.

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Executive Summary

The Finance Act, 2015 has introduced the concept of ‘Place of Effective Management’ (PoEM) to determine the tax residency of foreign company in India. The term ‘PoEM’ has been defined 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”. Further, the Memorandum explaining the Bill also states that a set of guiding principles would be issued which can be followed while determining the PoEM of a company in India.

This paper attempts to provide recommendations which could be considered in the guidelines to be issued for interpreting and application of PoEM in determining the tax residence of a foreign company.

1. The entire year as a whole should be considered for determining the PoEM in India. The determination should look at where the key management and commercial decisions are regularly and predominantly made during the whole year.

2. The guidelines should clearly define some of the key terms like ‘Key’, ‘Effective’, ‘Key Management and Commercial Decisions’ and ‘Senior Management / Key Management Personnels’, in order to avoid any ambiguity with regards to their interpretation.

3. PoEM is a fact and circumstance specific concept and all relevant facts and circumstances must be examined on a case-by-case basis. The guidelines should clearly provide the factors which should be considered to determine PoEM in India. Illustrations should be provided for clarity.

Although it may not be possible to provide a detailed list of all the factors that must be considered, the following factors could be considered for determination of PoEM.

**Relevant Factors**

**Primary factors**
- Place of Senior Management and Key Management Personnels;
- Place of Board of Directors Meeting;
- Shareholders influence.

**Ancillary factors**
- Operational management / operational commercial decisions;

**Limited relevant factors / irrelevant factors**
- Place of incorporation and the governing law should of limited relevance;
- Place where accounting records are kept should of limited relevance;
- Location of global advisory committee in India providing non-binding advisory services should not be a relevant factor;
- Place from where the support services are provided should not be a relevant factor.
4. Safe harbor provisions may be prescribed to avoid unnecessary compliance burden with no corresponding tax collection in India.
   - PoEM should not be considered to be in India in cases where the foreign company is incorporated in a jurisdiction with a minimum base tax rate, say 20%, as India will in any case be required to grant foreign tax credit.
   - Operating companies having primary assets / employees located at a place outside India should be excluded from the ambit of PoEM.

5. PoEM provision should be resorted only in exceptional case. A process, similar to the process prescribed for GAAR should be prescribed for selecting cases for invoking PoEM.

6. If a foreign company is resident in India on account of PoEM in India then, it should be eligible to claim FTC in respect of taxes paid in foreign jurisdiction which is doubly taxed.

7. A mechanism should be provided to avoid double taxation of the same income in the hands of different companies creating PoEM in India in a multi-layer structure.

8. With regard to the transfer pricing regulations the following points should be considered:
   - The transactions between the associated enterprise (PoEM in India) and the Indian company should not be considered to be within the ambit of Specified Domestic Transactions under Indian transfer pricing regulations.
   - Transactions between the associated enterprise (PoEM in India) and its group companies outside India should also not be considered within the ambit of International Transactions under Indian transfer pricing regulations.

9. The tax compliances to be undertaken under the Income Tax Act, 1961 (the Act) should be applicable only once the foreign company is considered as having PoEM in India and the same is confirmed under the Mutual Agreement Procedures of the respective tax treaties.
Upto Financial Year 2014-15, a foreign company was treated as resident of India, if during the year, control and management of the affairs of that company was wholly situated in India. As per the amendment brought in by the Finance Act, 2015 a foreign company will be regarded as a tax resident of India, if it’s PoEM in that year is in India. PoEM has been defined 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”.

As per the Memorandum to the Finance Act, 2015, it is apparent that the law in India is amended to bring it in line with the international practice. Reference is also made to the Organization for Economic Cooperation and Development (OECD) Commentary for this purpose. Accordingly, interpretation with respect to PoEM may be derived considering the international principals. Further, the Memorandum explaining the Bill also states that a set of guiding principles would be issued which can be followed while determining the PoEM of a company in India.

This paper attempts to provide recommendations which could be considered in the guidelines to be issued for interpreting and application of PoEM in determining the tax residence of a foreign company.
Model Commentaries

The residence article in the OECD Model Convention provides a tie-breaker rule for determining residence where an entity is resident in two different countries. The residence of such a dual resident entity is determined to be in the country in which its PoEM is situated. OECD Commentary mentions that PoEM is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made. The definition of PoEM provided under the Act is in line with the OECD Commentary.

In relation to PoEM, the OECD Commentary further provides that,

- All relevant facts and circumstances must be examined to determine the place of effective management;
- An entity may have more than one place of management, but it can have only one place of effective management at any one time.

With respect to determining the PoEM of a company, OECD provides various factors to be considered:

- Place where meetings of the Board of Directors or equivalent body of the company are usually held;
- Place where the chief executive officer and other senior executives usually carry on their activities;
- Place where the senior day-to-day management of the person is carried on;
- Place where the person’s headquarters are located;
- Place of which country’s laws govern the legal status of the person;
- Place where its accounting records are kept.

It may be noted that India does not adhere to the OECD interpretation of PoEM. In its view the place where the main and substantial activity of the entity is carried on is also to be taken into account while determining PoEM.

The United Nation (UN) Model Convention also provides the tie breaker rule for determining residence of a dual resident company which is based on the PoEM of that company in a particular jurisdiction. As per the UN commentary, factors which may help in determining PoEM of a company are as under:

- Place where a company is actually managed and controlled,
- Place where the decision-making at the highest level on the important policies essential for the management of the company takes place,
- Place that plays a leading part in the management of a company from an economic and functional point of view, and
- Place where the most important accounting books are kept.

Though UN Model commentary does not provide meaning to the term PoEM, it provides illustrative list of factors which may establish a PoEM of a company in a particular country which is similar to the factors considered under the OECD Model Commentary.

1. Para 24 to Article 4 of Commentary to the OECD Model Convention
2. Para 24.1 to Article 4 of Commentary to the OECD Model Convention
3. Para 10 of Article 4 to the UN Commentary
According to renowned author Klaus Vogel:

- PoEM is the place where the management’s important policies are actually made;
- What is decisive is not the place where the management directives take effect but rather the place where they are given;
- The ‘Centre of management’ activities of a company generally is the place at which the person authorized to represent the Company carries on his business management activities;
- A place from where the business is merely supervised would not qualify;
- If the commercial and the non-commercial side of the business are managed at different places, the location of Commercial management is of significance;
- If the above criteria is inconclusive, then the top manager’s residence will regularly determine the residence of the Company.

PoEM around the world

PoEM as interpreted in some of the foreign countries have been summarised in Appendix 1.

Key International Jurisprudence

Reference may also be made to the international jurisprudence on tax residency including PoEM which provides as under:

- One has to look at the place from where the real top level of management or realistic, positive management of the taxpayer, a trust, was exercised.
- ‘Effective’ implies realistic, positive management. The PoEM is where the shots are called, to adopt a vivid transatlantic colloquialism.
- One needs to consider, whether a director acted on another person’s wishes or instructions without truly considering the merit of those wishes or instructions; or whether the director considered the wishes or instructions but still made the decision while in possession of the minimum information required to make a decision.
- The PoEM would be where the economic and effective center of a company is located. The decisive factor is thus the management of daily business activities within the company’s purpose; the place of board meetings or the general assembly is to be disregarded.

References:

4. Klaus Vogel on Double Taxation 3rd Edition Page 262
5. RFH RStBl. 804,805 (1936); BFH 5 HFR 136,137 (1965); BStBl. II 695,697 (1968); 759, 760 (1970); 68 (1972); 401,403 (1976); 57 Headline (1977); FG Hamburg, 33 RW 724 (1987); Birk, D., in : HubschmannHeppSpitaler, 10 AO, Anm. 14; KuhnKutterHoffmann, 10 AO, Anm. 3; TipkeKruse 10 AO, Anm. 1.
6. BFH 44 DB 1429 (1991)
7. Hey, F.E.F., 18 TPI September 1991, at 34
8. RFH RStBl. 779, 780 (1936)
10. Trevor Smallwood Trust - [2010] EWCA Civ 778 (UK)
11. Wensleydale’s Settlement Trustees V. Inland Revenue Commissioners - [1996] STC 241 (UK)
13. Switzerland Case - 2C-1086/2012, 2C-1087/2012
Key Recommendations on Interpretation of PoEM

Key terms to be defined

The guidelines should clearly define some of the key terms in order to avoid any ambiguity with regards to their interpretation. In issuing the guidelines, the following key terms and their interpretation may be considered:

Key

In terms of PoEM may be read as important, main, crucial, significant, vital, strategic decision.

Effective

Producing the results that is wanted or intended; in reality, although not officially intended. The term “effective” should be understood in the sense of the French “effective” which means “real”.

Key Management and Commercial decision

Key management and commercial decisions should mean decisions which are concerned with broader strategic and policy decisions and tend to be made by members of the Senior Management / Key Management personnels.

Senior Management / Key Management Personnel

Senior Management Personnels (SMPs) / Key Management Personnels (KMPs) means the top level executives / employees of a company who are generally responsible for taking the key Management and Commercial decisions for the Company. The SMPs / KMPs may include Managing Director, Chief Executive Officer, Chief Financial Officer, Financial Director, Chief Operating Officer, heads of various divisions or departments like Sales and marketing head, etc.

Period to be considered

The Finance Act, 2015 omitted the words ‘at any time’ which shall have effect that a company shall be resident in India if its PoEM is in India in the financial year under consideration. Nevertheless, a question may still arise that for a foreign company to be resident in India, is it necessary that the PoEM should be situated in India throughout the financial year under consideration or mainly in India. Currently, the provisions of the Act do not provide any clarity on this.

In case the key decisions with respect to conduct of a business of a company as a whole are taken only in one country, there would be no difficulty in determining the PoEM of that company. However, if such key decisions are taken in India during part of the year and in some other country at other times, can we say that the PoEM of that company is situated in India?

In this regard, we submit as under:

PoEM should be situated in India throughout the year under consideration

The basis of this recommendations is that since the words ‘at any time’ are deleted, the section then reads that PoEM of the company should be in India throughout the year under consideration for a foreign company to be considered to be resident in India.

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15. Wensleydale’s Settlement Trustees v. IRC - [1996] STC 241 (UK)
The Finance Minister while replying to the debate on the Finance Bill 2015 in Lok Sabha explained the reasons for omission of the words “at any time” from the substituted section 6(3) as under:

“…concerns have been raised with regard to the phrase ‘at any time’, which may lead to unintended consequences. Such as even one board meeting in India may make a foreign company a resident in India. The explanatory memorandum to the Finance Bill 2015 state that guidance note will be issued in this regard. However, taking into account the concerns raised, I propose to drop the phrase ‘at any time’ so that no ambiguity remains. Thus, a foreign company will be treated as a company resident in India for a previous year if its place of effective management is in India in that previous year …” (Emphasis supplied)

Based on the above, it is suggested that the entire year as a whole should be considered for determining the PoEM in India. Multiple facts and circumstances are to be taken into account, often involving multiple locations, and from those facts and locations it is necessary, to determine a single dominant place where effective management is located. The determination should look at where the key management and commercial decisions are regularly and predominantly made during the whole year.

Key factors to be considered

PoEM is a fact and circumstance specific concept and hence, all relevant facts and circumstances must be examined on a case-by-case basis. Following are some of the key factors which can be considered in determining PoEM in India.

Primary factors

i. Place of Board of Directors (BoD) Meeting

Where the BoD controls and manages the affairs of the Company and takes key management and commercial decisions necessary for the conduct of the company’s business as a whole, then the place of BoD meeting should be considered as the PoEM. If BoD meetings are held in different countries then the place where the BoD meets generally and take the key management and commercial decision may be considered as PoEM.

However, where the BoD has delegated the power for undertaking key management and commercial decisions to a management or executive committee and the BoD routinely ratifies the decisions taken by such committee, the place of meeting / location from which the key management and commercial decisions are taken by the management or executive committee should be relevant in determining PoEM.

16. South African Revenue Authorities (SARS) Draft Interpretation Note: No 6 (Issue 2) - also refers place of BoD meeting as one of the factors in determining PoEM.

The Russian Law No. 376-FZ also recognizes that a foreign company will be deemed to be resident of Russia if majority of the BoD meetings are held in Russia.
In the era of telecommunications and technology revolution and with the availability of advanced and evolving communications technology such as video conferencing or electronic mediums like group applications via the internet results in a situation where it is no longer necessary for people to be physically located or meet in one place to hold discussions and take decisions. If the BoD meetings are held through video conferencing or by any other electronic means, then the BoD meeting may be considered to be held in the country where the majority of the directors participate from. Alternatively, the place where the chairman or the senior most member of the Board attends the meeting can be considered as the place of the meeting.

Due regard may be given to the qualification and experience of the directors in considering the place of BoD meeting as the factors in determining PoEM.

### Analysis of place of BoD meeting as PoEM

<table>
<thead>
<tr>
<th>Place of BoD meeting relevant factor</th>
<th>Place of BoD meeting Not a relevant factor</th>
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<tbody>
<tr>
<td>The key management and commercial decisions necessary for the conduct of the company’s business as a whole are taken in the BoD meeting.</td>
<td>Holding occasional BoD meeting in India, especially when majority of the BoD meeting, where key management and commercial decisions are taken, are generally held at a place outside India.</td>
</tr>
<tr>
<td>The BoD meetings are held in different countries then the place where the BoD meets generally and take the key management and commercial decision may be considered as PoEM.</td>
<td>The BoD just acts as a rubber stamp or routinely ratify the decisions made by the shareholders or executive committee / KMPs. In such a case, the place where the shareholders or executive committee / KMPs meet and take decision should be of relevance.</td>
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<td></td>
<td>The directors constituting the BoD substantially lacks qualification and experience in relation to business / decisions taken by the foreign company.</td>
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Illustrative case 1:

XYZ Group operating through XYZ Pvt. Ltd (XYZ) is a closely held India based multinational group. It has overseas operating and intermediate holding companies (foreign companies) within the group. Majority of the directors in foreign subsidiaries generally reside in India.

The promoters and KMPs of XYZ generally based in India are on the Board of all foreign companies. Foreign companies take all key management and commercial decisions in its BoD meetings.

Analysis of the PoEM of foreign companies

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<tr>
<th>Scenarios</th>
<th>PoEM of foreign companies</th>
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<tr>
<td><strong>Scenario 1:</strong> The directors of foreign companies’ travels to foreign jurisdiction for attending all the BoD meetings of foreign companies in which key management and commercial decisions are made.</td>
<td><strong>PoEM not in India</strong> – Since majority of the BoD meetings of foreign companies are held outside India, the key management and commercial decisions are regularly and predominantly being made outside India.</td>
</tr>
<tr>
<td><strong>Scenario 2:</strong> 3 out of the 4 BoD Meetings of foreign companies are held in India.</td>
<td><strong>PoEM in India</strong> - If majority of directors participate in the BoD meeting, where key management and commercial decision are taken, from India. However, due regards should be given to the decisions taken at BoD meetings held in India and outside India. If all the key management and commercial decision for the conduct of business as a whole are in substance taken at the BoD meeting held outside India, then PoEM should be at a place outside India.</td>
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<tr>
<td><strong>Scenario 3:</strong> The directors of foreign companies at times attend the BoD meetings of the foreign companies via video conferencing from India.</td>
<td><strong>PoEM in India</strong> - If majority of directors participate in the BoD meetings, where key management and commercial decisions are taken, from India. Alternatively, the place where the chairman or the senior most member of the Board attends the meeting can be considered as the place of the meeting.</td>
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</table>
ii. Place of Senior Management and Key Management Personnels

The location of a company’s SMPs and KMPs is generally the place where the key management and commercial decisions of the company are made. If such facts exist then one may consider the location of SMPs and KMPs as the PoEM.

With changing dynamics of business environment, it may happen that SMPs and KMPs are constantly on the move. For instance, this situation may occur if the SMPs / KMPs of a company are frequently traveling and take decisions while on move. Also decisions may be taken by SMPs and KMPs through electronic means like video-conferencing, tele-conferencing, over emails, etc. If the SMPs and KMPs operate, from time to time, at various locations, then PoEM ideally should be the location where those SMPs and KMPs are primarily based or where they normally return to following travel to other location or meet when formulating or deciding key strategies and policies for the company as a whole.

Analysis of place of SMPs / KMPs as PoEM

<table>
<thead>
<tr>
<th>Place of SMPs / KMPs as relevant factor</th>
<th>Place of SMPs / KMPs Not a relevant factor</th>
</tr>
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<tbody>
<tr>
<td>The key management and commercial decisions necessary for the conduct of the company's business as a whole are taken by SMPs and KMPs.</td>
<td>The SMPs and KMPs operates on a highly decentralized basis where it would be difficult to determine the place of key management and commercial decisions.</td>
</tr>
<tr>
<td>The BoD has delegated the power to SMPs / KMPs to take key management and commercial decisions.</td>
<td>The SMPs and KMPs routinely follows the decisions taken by the shareholders / parent company.</td>
</tr>
<tr>
<td>The SMPs and KMPs are located in different countries or meet in different countries for taking key management and commercial decision, then the place where they generally meet or the location from which they generally take the key management and commercial decision.</td>
<td>The SMPs and KMPs substantially lacks qualification and experience in relation to business / decisions taken or to be taken by Company.</td>
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</table>

17. SARS Draft Interpretation Note: No 6 (Issue 2) - also refers to the place where a company’s senior management and their support staff are predominantly located, is generally a major factor in the determination of a company’s PoEM because it often represents the place where key company decisions are made.

China State Administration for Tax (SAT) Notice No. 82 considers the primary place where the senior management personnel responsible for the day-to-day production and operation of the Company and the place where the management duties are performed primarily as one of the factors in determining PoEM.

The Russian Law No. 376-FZ also recognizes that a foreign company will be deemed to be resident of Russia if executive body activities are regularly exercised in Russia or the top management functions are exercised by key organisation officials from Russia.
Illustrative Case 2

ABC Ltd (ABC) is an Indian Multi-National Company listed on NSE and BSE. It has its presence around the world through its foreign subsidiaries and joint venture companies (foreign companies). Global Heads viz. Global Finance Head, Global Sales Head, Global Human Resources Head etc., are appointed to look after the key functioning of ABC Group. Divisional heads are appointed for divisions/segments such as chemical division, textile division, etc., to look after the functioning of respective division/segment of the group. Majority of the Global heads as well as Divisional heads are based in India. The group level management committee advises on the key issues on a non-binding basis for the entire group.

Each of the foreign company has its own BoD with directors based in and outside India. The BoD of foreign companies includes some of the directors of ABC. The foreign companies have their own KMPs for undertaking their business in respective jurisdiction.

Analysis of PoEM of foreign companies

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<tr>
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<tr>
<td><strong>Scenario 1</strong>: The SMPs and KMPs of foreign company takes all the key management and commercial decision from a place outside India.</td>
<td><strong>PoEM not in India</strong> - The SMPs and KMPs of foreign company are taking all the key management and commercial decision from a place outside India. Further, the role of Group Heads and Divisional Heads is limited to supervising and overseeing operations for the entire group for reporting and consolidation purposes.</td>
</tr>
<tr>
<td>The role of Group Heads and Divisional Heads is restricted to supervise and oversee the operations for the entire group for reporting and consolidation purposes.</td>
<td></td>
</tr>
<tr>
<td><strong>Scenario 2</strong>: The SMPs and KMPs of foreign company takes all the key management and commercial decision from India.</td>
<td><strong>PoEM in India</strong> – Since all the key management and commercial decisions are being taken by SMPs and KMPs from India.</td>
</tr>
<tr>
<td><strong>Scenario 3</strong>: The Group Heads takes all key management and commercial decision for foreign companies from India. The SMPs and KMPs of foreign companies routinely follow the decisions taken by Global Heads in India. Further, the SMPs and KMPs of foreign companies substantially lacks qualification and experience in relation to business / decisions taken for their companies.</td>
<td><strong>PoEM in India</strong> – Since Global Heads takes all the key management and commercial decisions for foreign companies from India. Further, SMPs and KMPs of foreign companies substantially lacks qualification and experience in relation to business / decisions taken for their companies.</td>
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iii. Shareholders influence

Generally decisions which affect the fundamental existence of the Company itself or the rights of the shareholders are reserved to be taken in shareholders meetings and should not be relevant in determining PoEM. For instance, decisions on sale of all or substantially all of the company’s assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares, etc.

Further, influence exercised by shareholders by way of general guidance and recommendations should ordinarily be disregarded for the purpose of determining PoEM. A distinction has to be made between influence and undue influence. Influence ordinarily should not constitute effective management. The important point which has to be established is whether the BoD / KMP of the Company independently make their own decisions or they are merely implementing what the shareholder has already decided for the company and in that way does not actually make decisions.

The parent company may lay down the guidelines and policies for the group as a whole, to direct co-ordinate and monitor the activities. However, if the BoD / KMPs of the foreign company takes its own decision even though it may follow the guidelines and policies of the group, then the place of shareholders making guidelines and policies should not be relevant in determining PoEM.

Analysis of shareholders influence as PoEM

<table>
<thead>
<tr>
<th>Shareholders influence a relevant factor</th>
<th>Shareholders influence Not a relevant factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Shareholders directs and takes all the key management and commercial decisions from India.</td>
<td>The Shareholders takes all decisions which affect the fundamental existence of the Company itself or the rights of the shareholders, as shareholders.</td>
</tr>
<tr>
<td>The SMPs and KMPs of the foreign company routinely follows the key decisions taken by the shareholders for the foreign company.</td>
<td>The role of shareholder in key management and commercial decisions of the foreign company is limited to providing guidance on a non-binding basis.</td>
</tr>
<tr>
<td>Guidance provided by global advisory committee of the shareholder in India in the capacity of an advisor on non-binding basis, in formulating strategies, model rules and policies for consideration of BoD / KMPs of the foreign company.</td>
<td></td>
</tr>
<tr>
<td>The Presence of group heads / business heads / divisional heads of the shareholder in India, especially, when the foreign company is managed by their respective BoD / KMPs at a place outside India and the role of such heads is to supervise or to provide guidance and not direct or make decisions.</td>
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18. SARS Draft Interpretation Note: No 6 (Issue 2) - also refers Shareholders influence as one of the factors in determining PoEM.
SAT Notice No. 82 – also considers the place where the decisions relating to the enterprise’s financial and human resource matters are made or are subject to approval by organizations or personnel, as a factor in determining PoEM.
Analysis of PoEM of foreign companies considering facts discussed in Illustrative Case 2 above:

<table>
<thead>
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<tr>
<td><strong>Scenario 1:</strong> ABC (Indian Parent – through its BoD or management advisory committee) takes all key management and commercial decision for foreign companies from India. The BoD and KMPs of foreign companies routinely follow the decisions taken by ABC.</td>
<td><strong>PoEM in India</strong> - Since all the key management and commercial decisions are being taken by ABC in India.</td>
</tr>
<tr>
<td><strong>Scenario 2:</strong> The role of ABC is restricted to framing non-binding group level policies/guidance and providing non-binding advice on key management and commercial decisions of foreign company. The BoD of foreign company takes all the key management and commercial decision from a place outside India.</td>
<td><strong>PoEM not in India</strong> – The role of ABC is restricted to framing non-binding group level policies/guidelines and providing non-binding advice on key management and commercial decisions of foreign company. Further, the BoD of foreign company are taking all the key management and commercial decision from a place outside India. Further, the role of ABC is limited to providing non-binding advice on key management and commercial decisions for foreign company.</td>
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</table>

Ancillary factors

Regard may be placed to the ancillary factors if the primary factors discussed above are inconclusive.

i. **Operational management / operational commercial decisions**

Operational management / operational commercial decisions refer to the general management of the business operations and activities of the company. Ordinarily operational management should not be relevant in determining PoEM. In case the primary factors are inconclusive then the place of operational decisions i.e. the place of day-to-day management may also be considered for determining the PoEM.

In this regard, we would like to draw your attention to the Memorandum to the Finance Act, 2015 which provides that PoEM is objectively targeted towards shell companies which are incorporated outside but controlled from India.

“A company can easily avoid becoming a resident by simply holding a board meeting outside India. This facilitates creation of shell companies which are incorporated outside but controlled from India.”

By considering the operational management as one of the ancillary factors in determining PoEM, consideration would be given to the operational substance in the foreign companies.

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19. SARS Draft Interpretation Note: No 6 (Issue 2) – provides that what constitutes a key management or commercial decision as opposed to an operational management decision is critical as it is the former that is relevant in the context of establishing the place of effective management.
Limited relevant factors / irrelevant factors

i. **Place of incorporation and the governing law**

The place of incorporation, location of registered office along with the corporate law which governs the company may be of limited relevance in determining PoEM. This is on the fact that in an technology driven environment, the act of incorporating a company in a particular jurisdiction has become relatively simple. In fact, many jurisdictions allow online incorporation or establishment. As a result it is possible that the only tie an enterprise may have to the jurisdiction in which it is incorporated or established is a formal tie.

ii. **Place where Accounting records are kept**

Maintenance of accounting records by a foreign company in India should be disregarded, considering that the maintenance of accounting records in a particular location is of limited relevance in taking key management and commercial decisions.

iii. **Global management advisory board / committee in India**

Indian Multinational companies usually form a global management advisory board / committee in India to provide guidance to group entities incorporated in and outside India for the purpose of advising on taking key management and commercial decisions. If the advice provided by such a board / committee are usually for consideration of the SMPs / KMPs of the respective companies and are non-binding in nature, the same should not be relevant for the purpose of determining PoEM in India.

iv. **Support services**

India based multinational companies may house their support function like data management, human resource management, customer support and accounting functions, etc from a central location or may be undertaken through a shared services company in India. The place where such support functions are performed should not be relevant in determining PoEM, since the people in-charge of support services are often not involved in making key management and commercial decisions.

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20. However, it may be noted that Paragraph 24.1 of the OECD Commentary provides that the place where the person’s headquarters are located and the laws of the country which govern the legal status of the person are relevant factors in determining the PoEM.

21. Draft OECD Technical Advisory Group discussion paper on ‘the impact of the communications revolution on the application of “place of effective management” as a tie breaker rule’.

22. SAT Notice No. 82 – provides that the enterprise’s primary assets, accounting books and records, company seals, board and shareholder meeting resolutions are located or maintained in China, as one of the factors in determining PoEM.

23. SARS Draft Interpretation Note: No 6 (Issue 2) – provides that the location where such support services may be located is generally of limited relevance to the determination of a company’s place of effective management.
Other Recommendations

Applicability of PoEM should be resorted to only in exceptional cases.

The Memorandum to the Finance Bill, 2015 also provides that PoEM is objectively targeted towards shell companies which are incorporated outside but controlled from India. Therefore, resort to PoEM provision as an anti-avoidance tool should be resorted only in exceptional case.

Safe harbor

Safe harbor provisions may be prescribed. This is necessary to avoid unnecessary compliance burden with no corresponding tax collection in India.

- PoEM should not be considered to be in India in cases where the foreign company is incorporated in a jurisdiction with a minimum base tax rate, say 20%, as India will in any case be required to grant foreign tax credit.
- Operating companies having primary assets / employees located at a place outside India should be excluded from the ambit of PoEM.

Approval Panel

A process by way of reference by assessing officer to Commissioner of Income tax (CIT) and further reference by CIT to an Approval Panel should be made before invoking PoEM for foreign companies. The process could be made in line with the process prescribed for GAAR u/s 144BA of the Act. The foreign companies should be allowed to make its submission on its tax residency / PoEM before the CIT and the Approval Panel on references made by CIT and the assessing officer respectively.

Clarity on Foreign tax Credit

In terms of Section 90 (countries where double tax avoidance agreement exists) and Section 91 (countries where no agreement exits) of the Act, all residents are eligible to claim Foreign Tax Credit (FTC). Therefore, if a foreign company is resident in India on account of PoEM in India then, it should be eligible to claim FTC in respect of taxes paid in foreign jurisdiction which is doubly taxed.

However, in certain situations the claim of FTC may not be clear. For instance, FTC issues may arise in case of income received by a foreign company which has entered into a transaction with another foreign company having PoEM in India. This would be with regard to the tax treaty to be applied for claiming credit for taxes paid in foreign jurisdiction. Considering that the foreign company having PoEM in India would be considered as tax resident in India, the tax treaty between India and the tax resident of the other foreign company should apply.

The guidelines on PoEM should clearly provide a mechanism for claiming FTC in case a foreign company creates a PoEM in India.

Double taxation in a multi-layer structure

In a multi-layer structure the same income flows from one company within the group to another company. In a scenario, where the companies in such a multi-layer structure create a PoEM in India a situation may arise wherein the same income flowing from one company to another company may be taxed separately in the hands of the respective companies leading to multiple times taxation of the same income.

A mechanism should be provided to avoid double taxation of the same income in the hands of different companies creating PoEM in India in a multi-layer structure.

Clarity on Compliances

The tax compliances to be undertaken under the Act should be applicable only once the foreign company is considered as having PoEM in India and the same is confirmed under the Mutual Agreement Procedures (MAP) of the respective tax treaties.
As per the transfer pricing regulations in India, international transactions between an Indian company and its associated enterprise outside India are covered under the ambit of international transaction. Such transactions are required to be reported in form 3CEB and documented from an arm’s length perspective. However, if an associated enterprise is found to have a PoEM in India, it becomes a resident in India. Clarity would be required on whether the associated enterprise would be subject to Indian transfer pricing regulations by virtue of it becoming a Indian resident because of PoEM.

With regard to the transfer pricing regulations the following points should be considered:

• The transactions between the associated enterprise (PoEM in India) and the Indian company should not be considered to be within the ambit of Specified Domestic Transactions under Indian transfer pricing regulations.

• Transactions between the associated enterprise (PoEM in India) and its group companies outside India should also not be considered within the ambit of International Transactions under Indian transfer pricing regulations.

If the transactions of associated enterprise (that has a PoEM in India) and its group companies outside India, are considered to be within the ambit of Indian transfer pricing regulations, it would increase the compliance burden of taxpayers to a great extent.

In a scenario if the Transfer pricing compliances are to be undertaken under the ITA, it should be only once the associated enterprise is considered as having PoEM in India and the same is confirmed under the Mutual Agreement Procedures of the respective tax treaties.
PoEM has to be determined based on facts of each case after looking into the activities of the foreign company in India as a whole and in substance. The above discussion on definition and key factors may assist in determining the PoEM of a company but may not be comprehensive and all relevant facts and circumstances must be examined on a case-by-case basis. There are generally various facts that are required to be taken into account, often involving multiple locations, and from those facts and locations it is necessary to determine a single principal place where effective management is located.

Although it may not be possible to provide a detailed list of all the factors that must be considered, some of the key factors like Place of BoD Meetings, Place where the Senior Management / directors and KMPs reside, Shareholders influence in key management and commercial decision making, and day to day management, etc. must be examined as a guidance in determining a company’s PoEM.
Appendix 1

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<tr>
<th>Country</th>
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| Russia  | New law (Law No. 376-FZ) amends the definition of tax residency for foreign companies. The amendment provides that tax residency for foreign companies is to be based on the place of effective management of such companies. A foreign company will be deemed to be resident in Russia if any of the following requirements are met:-  
  • Majority of the board of directors’ meetings are held in Russia;  
  • Executive management of the company is regularly exercised in Russia; or  
  • the key corporate officials (i.e. the persons in charge of strategic planning, of management and of control of the foreign company) perform their actual daily management activities in Russia  
  
Auxiliary criteria apply by default when it is impossible to recognise a foreign company as a tax resident by using the key criteria above. The list of auxiliary criteria notably includes:  
  • Preparation of accounting and financial statements in Russia;  
  • Operational personnel management is conducted from Russia;  
  • Books and records are kept in Russia;  
  • Certain activities including budgeting, preparation of consolidated statements, and adoption of group standards and policies will not be considered sufficient to result in a Russian tax residency status, even if they are carried out in Russia. |
A person other than a natural person is a “resident” as defined in section 1(1) if such person – 

- is incorporated, established or formed in the Republic; or 
- has its place of effective management in the Republic.

PoEM has been defined 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.

As per the SARS Draft Interpretation Note: No. 6 (Issue 2), the following factors can be considered in determining PoEM:

(a) **Head Office:** The location of a company’s head office, being the place where a company’s senior management and their support staff are predominantly located, is generally a major factor in the determination of a company’s place of effective management because it often represents the place where key company decisions are made.

(b) **Delegation of Authority:** The location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for formal approval by the full board will often be considered the company’s place of effective management.

(c) **Board:** The location where a company’s board regularly meets and makes decisions may often be the company’s place of effective management provided the board retains and exercises its authority to govern the company and does, in substance, make the key management and commercial decisions necessary for the conduct of the company’s business as a whole.

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| **South Africa** | A person other than a natural person is a “resident” as defined in section 1(1) if such person –  
• is incorporated, established or formed in the Republic; or  
• has its place of effective management in the Republic.

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Modernisation and global travel: In the information technology age, it is important not to place an undue focus on the location where board meetings take place without considering the surrounding facts and circumstances of a particular case.

Shareholders: Shareholders influence does not constitute effective management but undue influence may. Fundamental decisions which typically affect the existence of the company itself or the rights of the shareholders as shareholders, rather than the conduct of the company’s business from a management or commercial perspective and hence such decisions are generally not relevant to the determination of a company’s PoEM.

Operational management versus broader top level management: Operational management decisions are generally of limited relevance in determining a company’s PoEM and must be distinguished from the key management and commercial decisions.

Legal factors: Legal factors such as a company’s place of incorporation, formation or establishment, the location of its registered office and the location of its public officer are generally not relevant in the determination of a company’s place of effective management.

Economic nexus: The extent of a company’s economic nexus with a country is generally not relevant in the determination of a company’s place of effective management. However, this factor may be considered circumstantial and given some weight in cases where other factors are inconclusive.

Support functions: The location where such support services may be located is generally of limited relevance to the determination of a company’s place of effective management.

Definitive rules cannot be laid down in determining the place of effective management and all relevant facts and circumstances must be examined on a case-by-case basis.
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| China   | An entity established, incorporated in China or their PoEM is in China will be resident in China. Effective management is factual and effective exercise of the entire management and control over production and business operations, human resources, financial and property aspects of the entity. State Administration for Tax (SAT) has issued Notice no. 82 which provides guidance on PoEM in China.  
  
  i) Article 1 defines a “Chinese-controlled offshore incorporated enterprise” as an enterprise that is incorporated under the laws of a foreign country or territory and has a domestic (i.e. a Chinese) enterprise or enterprise group as its primary controlling shareholder.  
  
  ii) Article 2 provides that a Chinese-controlled offshore incorporated enterprise will be regarded as a Chinese tax resident by virtue of having a place of effective management and control in China and it will be subject to EIT on its worldwide income if all of the following conditions are satisfied:  
  • The senior management personnel responsible for the day-to-day production and operation of the Company is located primarily inside China and their management duties are performed primarily inside China;  
  • Decisions relating to the enterprise’s financial and human resource matters are made or are subject to approval by organizations or personnel in China;  
  • The enterprise’s primary assets, accounting books and records, company seals, board and shareholder meeting resolutions are located or maintained in China; and  
  • 50% or more of voting board members or senior executives habitually reside in China.  
  
  iii) Article 3 further provides that the substance-over-form principle will be applied in determining the place of effective management and control. |
| Switzerland | Entities establishment, incorporation or having their PoEM in Switzerland.  
  
  • Effective management in Switzerland is acquired if the day to day management in accordance with the entity’s purpose is conducted in Switzerland. The place of BoD meetings or the place where administrative functions are performed (for instance the accounting functions) is to a lesser extent relevant in establishing the PoEM of a legal entity. |
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| Italy   | A company is considered resident if its registered office (or legal seat), PoEM or main business purpose is in Italy for the greater part of the fiscal year.  
• A non-resident company is presumed to have its place of management in Italy if it controls an Italian-resident company (i.e. may exercise relevant influence) and either of the two following conditions is met:  
  – the non-resident company is directly or indirectly controlled (subject to relevant influence) by an Italian resident person (company or individual); or  
  – the non-resident company’s board of directors (or other managing body) is mainly composed of Italian resident persons. |
| Spain   | Incorporated under Spanish laws or its legal seat is located in Spain or its PoEM is in Spain. An organisation is considered to have its effective head office in Spanish territory when the management and control of the sum of its activities are exercised from said territory.  
The Tax Administration presumes that an organisation located in a country or territory considered to be a tax haven has its residence in Spanish territory when its,  
• Main assets, directly or indirectly, consist of assets situated in or rights that it satisfies or exercises in Spanish territory, or  
• When its main activity is undertaken in Spain, except when it proves that its address and effective management take place in that country or territory, and also that its incorporation and operations correspond with valid economic motives and substantive business reasons that are distinct from the simple management of securities or other assets. |
| Colombia | Colombia’s Ministry of Finance and Public Credit has issued Decree 3028 (27 December 2013), regulating the concept of effective place of management for companies and foreign entities. Article 12-1 of the Tax Statute, incorporated in Colombia by Law 1607 of 2012, defines “effective place of management” as:  
• The place in which the company makes business and necessary management decisions to carry out the company’s activities as a whole.  
• To determine the effective place of management, all the relevant facts and circumstances should be taken into account, especially those related to the places in which the senior executives and administrators of the company or entity usually exercise their responsibilities and carry out the company or entity’s upper management daily activities. |
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<tbody>
<tr>
<td>United Kingdom</td>
<td>Entities incorporated in UK or Centrally Managed and Controlled in UK. As per ITH348,</td>
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<td></td>
<td>• PoEM is generally understood to be the place where the Head Office is: the Head Office in the sense of - not the registered office - but the central directing source. The place where one would expect to find the finance director, for example, the sales director and, if there is one, the managing director. The company records would normally be found there together with the senior administrative staff.</td>
</tr>
<tr>
<td></td>
<td>• Nevertheless it is not that easy to divorce effective management from central management and control and in the vast majority of cases they will be located in the same place.</td>
</tr>
<tr>
<td>Mexico</td>
<td>Principal administration of business or the PoEM is in Mexico</td>
</tr>
<tr>
<td>Germany</td>
<td>Registered office or Place of Management (PoM) is in Germany</td>
</tr>
<tr>
<td></td>
<td>• PoM is place where persons who have final authority make their decisions concerning the management of the business.</td>
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<tr>
<td>Australia</td>
<td>Incorporation or carries on business in Australia, central management and control or voting power in Australia</td>
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<td></td>
<td>• In case of Dual residency, the assesses are treated as resident in Australia. Government has announced that legislation will be introduced which will treat such companies as non-resident for domestic tax purposes</td>
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The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India’s development process. Founded in 1895, India’s premier business association has over 7600 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 250 national and regional sectoral industry bodies.

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Place of Effective Management

Recommendations on Guidelines to be issued
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