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30<sup>th</sup> December 2015

To,

**The Director**

**Tax Policy & Legislation – I,**

**Central Board of Direct Taxes,**

Room No 147-D, North Block,

New Delhi 110001.

Dear Sir,

## **Comments and Suggestions on Draft Guiding Principles for Determination of Place of Effective Management (POEM) of a Company**

On 23<sup>rd</sup> December 2015, the Central Board of Direct Taxes has released the draft Guiding Principles for Determination of Place of Effective Management of a Company for public comments and suggestions.

We give below our representation on, and suggestions in respect of the draft.

### **General**

1. In principle, we welcome the issuance of guidelines, to bring further clarity on what constitutes a POEM in India, and which will help to reduce the subjectivity. This will help to reduce possible litigation in this regard.
2. While the purpose of the guidelines is to reduce the subjectivity as to what constitutes POEM in India, and to have greater certainty as to the existence or non-existence of a POEM in India, we believe that the draft guidelines are too subjective in nature, and leave too much room for interpretation by the assessing authorities. The guidelines, if issued in the present draft form, will therefore not serve the purpose behind the issue of such guidelines. We set out below some of the reasons as to why we believe the guidelines are too subjective. We suggest that, at least in the initial stages, the guidelines should be more objective, to prevent misuse of discretion by assessing officers.

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### **Definition of “Passive Income”**

3. The definition of “passive income” includes income by way of royalty, dividends, capital gains, interest or rental income. There are often instances where such incomes could be active incomes. For example, royalty for a research and development company or for a company providing value added services to a telecommunications company, interest for a bank or financial services company, rental income for a mall, etc., are incomes arising out of active business activity, and cannot be regarded as passive incomes. Such incomes of such types of companies need to be classified as active incomes.

### **Companies Carrying on Active Business**

4. In case of companies carrying on active business outside India, in paragraph 7, it has rightly been laid down that the POEM shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India. This is an objective test. However, paragraph 7.1 completely negates such objective test laid down under paragraph 7, by stating that if, on the basis of facts and circumstances, it is established that the board of directors are standing aside and not exercising their powers, which powers are being exercised by either the holding company or any other person resident in India, the POEM should be regarded as being in India.

This paragraph fails to appreciate the commercial reality that every company exists for the benefit of its shareholders. Therefore, it is inevitable that every holding company always exercises some amount of control over its subsidiaries, and that certain crucial decisions are always taken in principle by the holding company, particularly in case of wholly owned subsidiaries. The board of directors, which takes the final detailed decisions, is very often guided by the views expressed by and the needs of the holding company, though they may also have their independent views in relation to the relevant matter, and do consider the impact of their decisions on the subsidiary.

Further, though directors may be resident in India, it is not necessary that by virtue of their residence, decisions are being taken in India, since very often the directors would be visiting the country where the subsidiary is carrying on operations, and taking decisions during the course of such visits, in consultation with the local management of the subsidiary.

Paragraph 7.1, which is supposed to be an exception, rather than the norm, is likely to be taken as the norm by assessing officers, rather than the exception, rendering the provisions of paragraph 7 redundant. A view will likely be taken by most assessing officers, where even a couple of or a few decisions are taken by the holding company, which are confirmed by the board of the subsidiary outside India, or where a majority of the directors are resident in India, that the POEM is in India. This will lead to unwarranted litigation.

We therefore strongly recommend that paragraph 7.1 be deleted altogether.

### Companies Carrying on Passive Business

5. The guiding principles laid down in paragraph 8.2 are many, and it is not clear as to in which order of precedence they are to be considered. It is possible that some guiding principles may indicate existence of POEM, while others may indicate non-existence of POEM. In such cases, invariably the assessing officer may take the view in favour of existence of POEM, while the assessee is of the view that there is no POEM, given the subjectivity of the guiding principles, leading to avoidable litigation.

It is therefore suggested that the guiding principles should be given in order of precedence, step by step, similar to the tie-breaker test contained in Double Taxation Avoidance Agreements for determination of residence. This will bring clarity and objectivity to the tests. This is important, at least in the initial years of the introduction of the concept of POEM.

### Approval of CIT

6. Paragraph 11 provides that in case the assessing officer proposes to hold a company, on the basis of its POEM, as being resident in India, then he needs to seek the prior approval of the Principal Commissioner or Commissioner.

In order to prevent unnecessary harassment of foreign companies, it is suggested that even in cases where an assessing officer wishes to investigate the existence of POEM in India of a foreign company, he should seek such prior approval, giving his reasons for such investigation. Besides, instead of approval by the Commissioner/Principal Commissioner, the approval required both for investigation, as well as for holding a foreign company as resident in India on the basis of existence of its POEM in India, should be that of the Chief Commissioner/Principal Chief Commissioner.

### Other Suggestions

7. It is suggested that it should be clarified that in case a foreign company is regarded as being resident in India, based on its POEM being in India, it should yet to be entitled to all treaty benefits under the treaty of India with the country in which the foreign company is located.
8. Since the guidelines would be issued only in January 2016, it is suggested that the concept of POEM should be introduced only with effect from assessment year 2017-18. An amendment should be made to the Income Tax Act, 1961 through the Finance Act 2016, making the amendment in section 6(3) applicable with effect from assessment year 2017-18, instead of with effect from assessment year 2016-17.

### For Bombay Chartered Accountants' Society



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