

Tax Residency of Foreign Companies Controlled From India

“Place of Effective Management”



Determination of Residence of a Foreign Company



RESIDENCY & TAXABILITY OF A FOREIGN COMPANY CONTROLLED FROM INDIA

- A domestic company is taxed on all its global income i.e., both Indian & foreign sourced.
- A foreign company that is a non-resident is taxed on income that has its source in India i.e., the income is received or deemed to be received in India, or it accrues or arises or is deemed to accrue or arise in India.
- Normally, companies incorporated outside India are tax non-resident in India.
- However, if a foreign company is deemed to be a tax resident of India, it will be subject to tax on its global income

Section 6(3) of the Income-tax Act, 1961

- A company is said to be a resident in India in any previous year, if—
 - (i) it is an Indian company; or
 - (ii) its place of effective management, in that year, is 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 business of an entity as a whole are, in substance made.

- Therefore, the tax residence of a foreign company is dependent on the location of its place of effective management, i.e. its **“POEM”**

What is POEM?

- A company's POEM is the place where key commercial decisions necessary to manage and operate that company are taken.
- The POEM is used to determine the residential status of a foreign company, especially in cases where its operations and management take place largely from and in India.
- A foreign company would be at risk of having its POEM situated in India, if the management decision making is exercised from and in India.
- The tax department has issued guidelines for determination of POEM of a company.
- The process of determination of POEM would be primarily based on the facts as to whether or not the company is engaged in active business outside India.

Circulars on POEM

- The CBDT issued Circular No. 6/2017 on 24th January 2017 to provide guiding principles for determining the POEM of a company (“POEM Guidelines”). Available at: [circular06_2017.pdf](#)
- The POEM Guidelines clarify that the POEM provisions are intended to apply only to companies which have turnover/gross receipts exceeding INR 50 crore in a financial year.
- Emphasize **substance over form** and focus on decision-making
- Provides a two-stage test for determining POEM, including other guidelines and clarifications on various POEM related matters
- Clarifies that mere formal holding of board meetings in a foreign country is not sufficient to establish POEM outside India

Active Business Outside India (“ABOI”)

- The POEM Guidelines contain 4 criteria, all of which must be simultaneously satisfied to be considered to be engaged in ABOI:
 - (i) Passive income (i.e. dividend, rent, interest, royalty, etc.) must be less than or equal to 50% of total income
 - (ii) Less than 50% of total assets should be situated in India
 - (iii) Less than 50% of total employees should be situated in or resident in India
 - (iv) Less than 50% of total payroll expenditure towards employees situated in/ resident in India
- A company engaged in ABOI shall be presumed to have POEM outside India if majority of its Board’s meetings are held outside India, i.e. decisions are taken outside India

POEM in Other cases

- In the event the company does not meet the ABOI criteria, it is considered not to have active business outside India. The POEM Guidelines prescribe that determination of POEM would then be a two-stage process, namely:
 - (i) First stage would be identifying or ascertaining the person(s) who actually make the key management and commercial decision for conduct of the company's business as a whole
 - (ii) Second stage would be determining the place where these decisions are in fact being made
- The place where management decisions are taken would be more important than the place where such decisions are implemented
- For determination of POEM, substance would be conclusive rather than the form.



Points to Note

Mitigation of POEM risk

Best Practices to ensure POEM remains in the country where the company is incorporated

- The ABOI criteria prescribed by the POEM Guidelines should be fulfilled
- The company must have sufficient substance outside India and be managed and controlled by qualified person or persons located outside India. Such persons should have both, the legal authority to take management & control decisions, and must actually be exercising their authority (de facto and de jure control).
- The local management must be capable and qualified to be able make decisions and manage the specific type of business being undertaken
- Having a local director/manager in charge of day-to-day administrative, management and control functions would help substantiate local control

Mitigation of POEM risk

Best Practices to ensure POEM remains in the country where the company is incorporated

- All meetings of the Board of Directors should be held in the foreign country & proper records of the minutes of such meetings ought to be duly maintained
- Directors who are resident in India should preferably travel to the foreign country to participate in the management of the foreign company and should not undertake the same while in India.
- Indian resident directors may participate virtually/electronically in the Board meetings but should also physically attend few board meetings overseas each year

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