

TAX TRENDS

Volume 1 Issue 3 | Oct-Dec 2015

We are happy to present the third edition of Tax Trends, SKP's Direct Tax Newsletter. This issue covers developments from October to December 2015. The dynamism in the Indian tax environment brought about by the new government continued in this quarter.

The Finance Act, 2015 provided that a company will be considered as tax resident in India if it is registered in India or its Place of Effective Management (POEM) is in India. This amendment was aimed at imposing tax on companies incorporated outside India but which are effectively managed from India. Towards the very end of this quarter, the government announced a proposed set of rules to determine the POEM of a company. *Spotlight* discusses the finer aspects of these rules.

The introduction of Income Computation and Disclosure Standards (ICDS) with effect from 1 April 2015 gave rise to a series of complexities regarding their application and the enormous compliance burden imposed by them. The government has officially sought feedback from the taxpayers about the difficulties involved in adopting ICDS. It is expected that the government will soon issue clarifications on certain matters relating to ICDS.

In furtherance of its initiative to ease compliance for taxpayers, the government has launched electronic Revenue Audits. Under this initiative, the majority of the Revenue Audit proceedings shall be conducted through electronic means; thus, visits to the tax office shall significantly reduce. This initiative is being launched as a pilot project for a select 100 cases of individual taxpayers and thereafter, it is likely to be extended to corporate taxpayers. It has been equally heartening to see that certain decisions of the High Courts have been accepted by the government by issuing express clarifications to that effect.

To reduce the difficulties faced by taxpayers during a Revenue Audit, the government also issued an instruction to its officers to ensure that the information requirements for Revenue Audits are customised to a specific taxpayer rather than sending a generic information requirement list as a standard procedure.

The Union Budget 2016-17 shall be presented at the end of February 2016. It is expected that a series of significant policy measures shall be announced by the government then, including a reduction in corporate tax rates. We will be publishing our Budget analysis in March 2016 covering the Budget proposals.

We hope you find this newsletter useful and we look forward to your feedback. You can write to us at skptax@skpgroup.com.

Warm regards,

The SKP Tax Team

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SPOTLIGHT

Determining Place of Effective Management – An overview of the draft guiding principles

The Finance Act, 2015 has amended the criteria for companies to be qualified as 'resident in India'. According to the amended definition, a company would be a 'resident in India' if it is an Indian company or its 'place of effective management' (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.

Furthermore, the Memorandum Explaining the Provisions in The Finance Bill, 2015 had mentioned that the Central Board of Direct Taxes (CBDT) would release a set of guiding principles to determine the POEM, which would benefit taxpayers and the tax administration. These guidelines provide the following guiding principles:

- The concept of POEM is one of substance over form.
- The entity may have more than one place of management but it can have only one POEM at any point of time.
- Since the 'resident' status has to be determined every year, the POEM has to be determined each year.

- The process of determining the POEM would primarily be based on whether a company is engaged in 'active business' outside India or otherwise.

For this purpose, a company would be said to be engaged in 'active business' outside India if:

- its passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of the total number of employees are situated in India or are residents in India; and
- the payroll expense incurred on such employees is less than 50% of its total payroll expenditure.

For this purpose, an average of the data of the current financial year and two years prior shall be taken into account.

Passive income of a company shall be considered to be the aggregate of:

- income from transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- income by way of royalty, dividend, capital gains, interest or rental income.

Considering that transactions between associated enterprises are governed by transfer pricing provisions, it may not be fair to consider the income/ expenses from associated enterprise as passive income.

POEM guidelines for companies engaged in active business outside India

The POEM of a company engaged in active business outside India shall be presumed to be outside India if the majority of meetings of the company's Board of Directors are held outside India. Thus, the fact that an isolated board meeting is held in India will not make the company a tax resident of India. This is a welcome clarification.

However, in case the Board of Directors is not exercising its powers to make decisions and such decisions are taken by the holding company or by any other persons resident in India, the POEM would be considered to be in India. The POEM for such companies may still be considered to be in India even if the majority of board meetings are held outside India but no key decisions or strategic decisions are carried out in such board meetings.

POEM guidelines for companies other than those engaged in active business outside India

In such cases, the determination of POEM would be a two-stage process:

- Firstly, identifying/ascertaining persons making the key management and commercial decisions for conducting the company's business as a whole.
- Secondly, determining the place where these decisions are being made.

Thus, the place where management decisions are taken would be more important than the place where the decisions are implemented. Some guiding principles for implementing the above two tests are as follows:

- The location where the company's board regularly meets and makes decisions would be considered the POEM of the company. However, mere formal holding of board meetings would not be conclusive. **If key decisions are taken at a place which is different from the location of the board meetings, then such place would be considered.**
- In situations where a company has delegated (either through a board resolution or by conduct) some or all of the authority to an executive committee consisting of key senior management, the **location of the key members and the place where such committee members develop policies and plans will be the POEM.**
- The location of the head office will be very important in considering the POEM because it often reflects the place where key company decisions are taken. Companies would need to keep in mind the following scenarios which could lead to determination of the location of the head office:
 - The place of the company's senior management (which may include the Managing Director, CEO, CFO, COO, etc.) and support staff may be considered the company's principal place of business or headquarters.
 - If the company is decentralised, then its head office would be the location where these senior managers are predominantly

based or normally return to following travel to other locations, or meet when formulating or deciding key strategies and policies for the company as a whole.

- In cases where the senior management participates in meetings via telephone or video conferencing, the head office would be the location where the highest management and their direct support staff are located.
- In cases where the company is so decentralised that it is not possible to determine its head office, the same may not be considered for determining the POEM.
- Day-to-day routine operational decisions undertaken by junior/middle management would not be relevant for determining POEM.
- In the present age, where physical presence is no longer required for taking key management decisions, the place where the majority of the directors/persons taking the decisions usually reside would be considered the POEM.
- If the above guidelines do not lead to clear identification of POEM, then the place where the **main and substantial activity of the company is carried out** or the **place where accounting records of the company are kept** would be considered.

The CBDT has also clarified that POEM would be a fact-based exercise. It has also provided an illustrative list wherein it has mentioned that certain isolated instances would not necessarily lead to POEM. The illustrations are as follows:

- The instance of a foreign company being completely owned by an Indian company would not necessarily lead to POEM in India.
- If one or some of the directors of a foreign company reside in India, it would not necessarily lead to POEM in India.
- Even if the local management of the foreign company is situated in India, that would not be conclusive evidence for establishing the POEM in India.
- Mere existence in India of support functions in the nature of preparatory or auxiliary functions

would not be conclusive evidence for establishing POEM in India.

The CBDT also clarified that these principles are only guidelines and no single principle will be decisive in itself.

The determination of POEM has to be a fact-based exercise. A 'snapshot' approach cannot be adopted and the activities of the companies are to be seen over a period of time and not at a particular time.

Furthermore, the CBDT has also pointed out that in case the POEM of a company is in India as well as outside India, then the POEM **shall be presumed to be in India** if it is mainly/predominantly in India. However, 'mainly/predominantly' being very subjective could lead to litigation in India as the CBDT has not provided any basis for determining the POEM based on '*mainly/predominantly*'. One of the key takeaways from these draft guiding principles is the requirement of prior approval of higher tax authorities by the tax officer in case he proposes to hold a foreign company as a resident in India on the basis of its POEM. Furthermore, an opportunity of being heard would also be given to the taxpayer before the matter is concluded by the higher tax authorities.

Conclusion

These guidelines are a welcome change and would provide much-needed clarity. However, Indian groups with presence outside India or proposing to establish their presence outside India would have to consider these guidelines very carefully as they provide for stringent conditions. Collective reading of the definitions of active business and passive income may result in many foreign subsidiaries falling under POEM.

These guidelines could also largely affect Indian groups who want to set up/have already set up trading companies outside India that mainly deal with related parties. Board meetings, the composition of the Board of Directors, the place where effective decisions are being taken, and head office location are very important factors in determining the POEM of a company and, if due care is not exercised, may lead to several complications.



LEGAL UPDATES

As per the protocol to the India-Netherlands tax treaty, benefit of the make available clause as provided in India-USA tax treaty can be applied, holds Ahmedabad Tribunal

Shell Global Solutions International BV vs ITO ([ITA No. 1283/AHD/2010](#))

The taxpayer was a tax resident of the Netherlands. It provided certain 'basic refinery package services' (which included providing physical deliverables, commercial services and technical services) and other optional services to an Indian company. The tax authorities taxed the entire consideration as fees for technical services (FTS) stating that even though the most favoured nation (MFN) clause is applicable, the definition of make available cannot be imported from the India-USA Tax Treaty.

The Tribunal observed that as per the MFN clause of the India-Netherlands tax treaty, in case India extends any benefits to another OECD country, by reducing the rate or the scope of FTS, such reduced rate or restricted scope would also apply to the India-Netherlands tax treaty.

Recharge of salary cost of seconded employees of a foreign company with high level managerial/executive positions under a secondment agreement would be considered as FTS, holds Bangalore Tribunal

Food World Supermarkets Ltd vs DDIT (Bangalore) ([ITA No. 1356 & 1357\(BANG.\)/2013](#))

The taxpayer, an Indian company, entered into an agreement with a foreign company engaged in a similar line of business to provide certain personnel for assistance. It was agreed that the foreign company would pay the salary to the assigned personnel and that the taxpayer would reimburse the specified amounts to M/s Dairy Farm Company Ltd (DFCL). The taxpayer discharged the withholding tax liability under section 192 on the salary paid to employees. The taxpayer had not withheld taxes at the time of reimbursing the salary costs. The tax officer held that the remittance towards salary cost constituted FTS as per the Indian tax laws and tax should have been withheld on it.

The Tribunal observed that the employees are under the control of DFCL and that the employees had the right to claim their salary from DFCL. In addition, there was no agreement between the taxpayer and the seconded employees. Accordingly,

the seconded employees have provided services on behalf of DFCL.

The Tribunal held that the concept of income includes positive or negative or nil income. Accordingly, the absence of a profit element is not relevant. Therefore, the payment of salary cost to the foreign company, though a reimbursement, was in the nature of FTS and would attract tax withholding.

Credit of foreign taxes is allowed against taxes paid as per the provisions of section 115JB (i.e. MAT), holds Bangalore Tribunal.

DCIT vs Subex Technology Ltd ([ITA No. 913/BANG./2013](#))

The taxpayer had computed its income under the provisions of Minimum Alternate Tax (MAT) and claimed credit for taxes paid in a foreign country as per section 90 of the Act. The tax authorities denied this credit.

The Tax Tribunal held that even though the taxable income is determined as per the normal provisions of the Act or section 115JB, the subsequent scheme of computing tax and granting credit must be done as per the normal provisions of the Act. Therefore, the taxpayer must be given the credit for taxes paid abroad even though the income is computed under MAT provisions.

Government issues proposed plan for phasing out direct tax exemptions and deductions

In line with its earlier announcement of reducing the corporate tax rate from 30% to 25% over the next four years, the government has issued a proposed action plan explaining the following road map for phasing out the various types of direct tax exemptions/deductions:

- Profit-linked, investment-linked and area-based deductions will be phased out.
- Sunset date of exemptions/deductions will not be advanced or extended.
- For exemptions/deductions without any sunset date, a sunset date of 31 March 2017 will be provided either for commencement of activity or for claim of benefit (depending upon the structure of the relevant provisions of the Act).
- No weighted deductions will be permitted from 1 April 2017.

The road map is proposed to be implemented from 1 April 2017. The government has invited comments from the public by 31 December 2015 on the proposed road map.

Government calls for inputs on implementation issues for Income Computation and Disclosure Standards (ICDS)

Following up on our earlier update regarding the possibility of ICDS (applicable for computing taxable income for financial year 2015-16 and onwards) resulting in the advancement of taxable income or bringing certain additional items to tax, the government has referred the issues in implementation of ICDS to an Expert Committee.

CBDT addresses the issue of defect notices to foreign companies, but only for FIIs/FPIs

Foreign companies and Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs), have been receiving defect notices from the tax authorities stating that the details of their balance sheet and profit and loss account were not filled in their tax return forms. These companies contended that these details were not required as they do not have any presence/permanent establishment (PE) in India and are not required to maintain books of accounts in India.

To address this issue, in line with its decision of not seeking to levy book profit tax on FIIs/FPIs, the Central

Board of Direct Taxes (CBDT) on 10 December 2015 issued a clarification stating that tax returns filed by FIIs/FPIs will not be treated as defective even if their balance sheet and profit and loss account are not filled, provided the concerned FII/FPI:

- is registered with the Securities Exchange Board of India (SEBI);
- has no PE/place of business in India;
- has provided the basic information required in case of any business income in India.

Furthermore, the CBDT has stated that wherever SEBI registration numbers were provided by FIIs/FPIs in their tax returns for the assessment year 2015-16, on similar lines, the same will not be treated as defective. The online response facility has been provided to FIIs/FPIs who continue to receive defect notices for previous assessment years. This clarification is only with respect to FIIs/FPIs and does not extend to other foreign companies.



TAX TALK

Government is open to out-of-court settlement for legacy tax issues, states Revenue Secretary.

[Excerpts from [The Economic Times, dated 27 December 2015](#)]

Revenue Secretary Hasmukh Adhia, stated that the Indian government is open to an out-of-court settlement of retrospective tax issues like the ones facing Vodafone and Cairn Energy.

Undisclosed income worth over INR 160 billion detected since March 2014

[Excerpts from [The Economic Times, dated 25 December 2015](#)]

Revenue Secretary Hasmukh Adhia has revealed that the government has detected undisclosed income worth over INR 160 billion since March 2014. He added that assets worth INR 12 billion have been seized and prosecution has been filed in 774 cases.

Government constitutes Expert Committee to simplify provisions of the Income Tax Act, 1961

[Excerpts from [CBDT Press Release, dated 27 October 2015](#)]

The government has constituted an Expert Committee with the objective of simplifying the provisions of the Income Tax Act, 1961. The committee has been asked to focus on provisions and phrases in the law that are leading to litigation and provisions impacting the ease of doing business.

Prime Minister Narendra Modi calls for making tax officers more accountable by making changes in their performance appraisal system

[Excerpts from [The Economic Times, dated 6 November 2015](#)]

Prime Minister Narendra Modi has asked the Ministry of Finance to change the performance appraisal system of tax officers to reflect whether their orders and assessments have been upheld on appeal. He stated that this will deter corruption and also motivate officers to pass correct orders.

Government examining proposals for tax waivers to start-ups

[Excerpts from [The Indian Express, dated 27 November 2015](#)]

It was reported that the government is examining certain proposals for tax benefits to start-ups. These benefits could include exemption from Minimum Alternate Tax, providing exemption for royalty income generated by the intellectual property rights (IPRs) developed by start-ups and certain other benefits for their research and development activities.

Compliance Calendar (January–March 2016)

Month	Due Date	Compliances
January	7	TDS payment for TDS deducted in December 2015
January	15	TDS statements for the quarter of October to December 2015
January	30	Issuance of TDS certificates for the quarter of October to December 2015
February	7	TDS payment for TDS deducted in January 2016
March	7	TDS payment for TDS deducted in February 2016
March	15	Advance tax for fourth instalment for corporate taxpayers (100% of estimated tax liability to be deposited on cumulative basis)
March	15	Advance tax for third instalment for non-corporate taxpayers (100% of estimated tax liability to be deposited on cumulative basis)
March	31	Revision of tax return for year ending 31 March 2014 with extension of time limit for issuance of notice for Revenue Audit
March	31	Revision of tax return for year ending 31 March 2015 without extension of time limit for issuance of notice for Revenue Audit

Corporate Tax Myth

If any claim of deduction of expenditure or allowance is not made in the return of income and the time limit for revision of the return of income has passed, the claim is lost forever.

If you would like us to help you understand the implications, please write to skptax@skpgroup.com.

About SKP

SKP is a long established and rapidly growing professional services group located in six major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1,200 active clients including multinationals, companies listed on exchanges, privately held and family-owned businesses from more than 45 countries.

From consulting on entry strategies to implementing business set-up and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, right across the business lifecycle.

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