Key international rulings on concept of POEM

Finance Act, 2015 introduced a concept of Place of Effective Management (POEM) to determine the residential status of companies u/s 6 of the Income-tax Act, 1961 and the new provisions are applicable from AY 2017-18. CBDT issued final POEM guidelines in January 2017. CBDT press release in this respect clarified that the intent is not to target Indian Multi Nationals which are engaged in business activity outside India, but **to target shell companies and companies which are created for retaining income outside India although real control and management of affairs is located in India**. Though the concept of POEM is yet to be tested on judicial canons in India, it is not new for courts across the world. In this compilation, we discuss the important principles emerging from key international rulings which can be relevant even in Indian context.

1) De Beers Consolidated Mines Ltd v. Howe[1]

South African company held resident of UK as London office controlled key management decisions

The taxpayer, De Beers Consolidated Mines Limited was registered in South Africa. The head office was at Kimberley and the general meetings had always been held there. Also the profits was made out of diamonds raised in South Africa and sold under annual contracts to a syndicate for delivery in South Africa upon terms of division of profits realized on resale between the company and the syndicate. Further, some of the directors and life governors lived in South Africa, and there were directors' meetings at Kimberley as well as in London.

The House of Lords noted that the tax authorities clearly established that the majority of directors and life governors lived in England, that the directors' meetings in London were the meetings where the real control was always exercised in practically all the important business of the company except the mining operations. London controlled the negotiation of the contracts with the diamond syndicates, determined policy in the disposal of diamonds and other assets, the working and development of mines, the application of profits, and the appointment of directors. London also always controlled matters that required to be determined by the majority or all the directors, which included all questions of expenditure except wages, materials, and some expenses at the mines.

The House of Lords held that company should be held to be resident for the purpose of income-tax where the real business is carried on. *"Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad."* Thus, House of Lords accepted Revenue's contention that trade and business of the taxpayer was carried out and exercised in United Kingdom at its London office. Further, the head and seat and directing power of the affairs of the company were at the office in London, from whence the chief operations of the company, both in the United Kingdom and elsewhere, were, in fact controlled, managed, and directed.

Thus, it was held that the company was resident of United Kingdom even though it was registered in South Africa.

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[1] [1906] A.C. 455 (H.L.) (Eng.)

2) The Oceanic Trust Co. Ltd N.O v Commissioner of South African Revenue services (Western Cape High Court of South Africa)[2]

South-African HC lays down principles for determination of POEM

The taxpayer was a company registered in Mauritius with its principle place of business at Port Louis Mauritius. It was the sole trustee of a trust, Specialized Insurance Solution (Mauritius)(SSIM) which was also established and registered in Mauritius. SSIM held category I Global Business License. It was also registered as trust under South African Trust Property Control Act. SSIM conducted business as captive reinsurer to mCubed Life Limited (a South African registered company). The tax authorities of South Africa alleged that SISM was resident of South Africa because it had place of effective management in South Africa. The tax authorities claimed that all the investments of SSIM were in South Africa and it generated entire income from business activities actually conducted in South Africa. mCubed Holdings Limited was a beneficiary of International Investment Trust which was itself a beneficiary of SSIM. Further, SSIM held a bank account in South Africa and it did not transfer money to Mauritius out of the bank account and vice versa.

The High Court relied on Commissioner of HM Revenue and Customs v Smallwood and another case (2010 EWCA civ 778) to lay down following principles relevant for determination of POEM:

1. The POEM is a place where key management and commercial decisions necessary for conduct of business are in substance made
2. The POEM would ordinarily be a place where most senior group of persons (e.g. bard of directors) makes decision where the action to be taken by entity as a whole are determined
3. However, no definite rule can be given and all relevant facts and circumstances must be examined to determine POEM of entity
4. There may be more than one place of management, but there can be only one POEM at a given time.
5. Smallwood decision was based on not only the general tests for POEM, but also specific provision under UK legislation which provided that trustees be treated as single and continuing body of persons who shall be treated as resident in UK unless general administration of trust is carried out outside UK and majority of trustees are not ordinarily resident of UK.
6. Painstaking analysis of facts was needed to be done to decide POEM as was done in Smallwood case.

Noting the facts stated above, the Court held that taxpayer has not made out a case for declaratory relief it prayed for i.e. declaring that SISM is resident of Mauritius. Further, the Court observed that at least some key managerial or commercial decisions were taken in South Africa. Noting that all the material facts required to determine POEM are not sufficiently clear for the Court to make decision on POEM, the Court held that it is unable to decide this issue. The Court observed that it does not have the power to make the required finding of facts and legislature has given such powers to the Tax Court.

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[2] Case number 2011/22556/09

3) Bywater Investments Ltd. & Ors. Vs. Commissioner of Taxation (Australian Federal Court)[3]

Australian Federal Court holds POEM as place where the board of directors makes its decisions

In case of appellant companies - Chemical Trustee, Derrin, Bywater, and HWB (out of which first 2 were incorporated in United Kingdom and remaining 2 were incorporated in Bahamas and Samoa respectively), the issue of determining their residential status for the period 2001-2007 had come up before the Federal Court of Australia. The Court noted that though the shares of these companies were held by JA Investments & MH Investments (a Cayman Island based groups) and Mr. Borgas and family were directors and shareholders on record, but ultimately the affairs of appellant companies were controlled by Mr. Gould from Sydney. HC observed that Mr. Borgas and family (only recorded directors and shareholder) just mechanically carried out Mr. Gould's decisions, thus place of central management and control was Sydney from where Mr. Gould made substantive decisions.

Referring to the POEM definition in relevant DTAAs, Court noted that the place of effective management may "ordinarily" be the place where the board of directors makes its decisions, "all relevant facts and circumstances must be examined to determine [where] the place of effective management" of a company is located. Court concluded that as the key management and commercial decisions were made by Mr Gould in Australia, it was the "place of effective management".

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4) Richard Lee and Nigel Bunter vs. Commissioner of HMRC (UK Tribunal)[4]

UK Tribunal rules on POEM determination on sale of Vodafone shares

The appellants, Mr. Richard Lee and Mr. Nigel Bunter, established trusts in Guernsey: the N S Bunter 1997 Settlement and the R A Lee 1997 Settlement (together "the Settlements"). In February 2001 Spread Trustee Company Limited ("STC"), as trustee of the Settlements, entered into call option arrangements with Vodafone UK Limited ("Vodafone") for the possible sale to Vodafone of the entire shareholdings in LeBunt and FB Holdings.

While the deeds of Settlements provided that the settlors—Mr Lee and Mr Bunter respectively—had the power to appoint a new trustee, on 28 March 2002 , STC resigned and appointed DTOS Limited ("DTOS"), the Mauritian trust corporation. DTOS was owned by the Mauritius office of Deloitte & Touche. On the same day a novation agreement transferred STC's rights and obligations under the option agreements with Vodafone to DTOS. In March, 2003, Vodafone exercised its call option and paid the consideration of about £55 million. Immediately after this, at the appellants' instigation, DTOS retired as trustee of each of the Settlements, and the appellants appointed two new UK corporate trustees: Island Trustees Limited ("Island") and Walbrook Trustees Limited ("Walbrook"), also companies within the control of Deloitte & Touche, though in London.

[3] [2016] HCA 45

[4] [2017] UKFTT 279

For the year 2002-03, The UK Tribunal rejected appellant's stand that because the place of residence of the trustees at the moment of disposal of shares was Mauritius, the DTC conferred the right to tax the gain on Mauritius alone. Tribunal remarks that "…such tax liability cannot be determined by reference only to one moment". Though the trustees were initially in Guernsey, followed by a new trustee in Mauritius and finally in UK in the same year, but the key decisions relating to the sale were taken in UK, and not by the Mauritian trustee, and that Mauritius based Trustee was appointed only to take benefit of Treaty and was not involved in effective management of the Trusts. Tribunal ruled that the POEM of appellants' trust was in UK, at the time of sale of shares vide the call option. In light of above, UK Tribunal held that, the appellants were liable for UK Capital Gains Tax ('CGT') on the gains arising on the disposal of the shares notwithstanding the overseas residence of their respective Settlements.

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5) R.A. Hewitt & Sons Ltd. v. The Queen (Canadian Tax Court)[5]

Canadian Tax Court rules that POEM of taxpayer's Bahamian subsidiary lies in Canada where real business runs

The taxpayer/appellant, R.A. Hewitt & Sons Ltd., is a corporation incorporated under the laws of the Ontario (a province in Canada). At all material times its directors were Robert A. Hewitt and Yvonne M. Hewitt, with Robert A. Hewitt (a Canadian resident) as its controlling shareholder. Further, A. Hewitt and Sons (Bahamas) Limited ('the subsidiary') was incorporated in the Commonwealth of the Bahamas having three directors, Robert A. Hewitt, his wife, Yvonne J.M. Hewitt and their son David R. Hewitt (all residents of Canada.). The subsidiary had 5,000 issued shares of which (A) 3,000 were registered in the name of Abaco Grower Limited ("Abaco") which is a corporation incorporated under the laws of the Commonwealth of the Bahamas and (B) 2,000 were registered in the name of the Appellant.

Because 60% of its issued shares were registered in the name of Abaco, the subsidiary took the position when dealing with the Bahamian government that it was beneficially owned as to a minimum of 60% by persons of Bahamian nationality. However, the Tax Court of Canada ruled that the subsidiary was a resident corporation of Canada during the years in question i.e. 1994,1995 and 1996, because -
(1) Its directors were always Canadian residents. Almost all directors meetings occurred in Woodstock. The corporate seal and the minute book of the subsidiary were in Woodstock, Ontario. There is no evidence of a share registry outside of the minute book.
(2) Subsidiary's corporate decisions were done by Robert and Yvonne Hewitt at their residence in Woodstock, Ontario. Further, the corporate returns and filings were made from Woodstock by Robert Hewitt. It also had a bank account in the Bahamas.
(3) Subsidiary operated an unsuccessful farm in the Bahamas which Robert Hewitt and Yvonne Hewitt managed respecting all major decisions including kinds of crops, changes of crops, exporting, capital purchases and government dealings in the Bahamas.

Thus, Court concluded that subsidiary's real business was carried on at Woodstock and its central management and control abided at Woodstock, Ontario.

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[5] 2000 DTC 2441 (TCC)

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