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A Comparative Analysis of the Corporate Tax Residency:A Case Study Between India The UK and Tanzania

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ABSTRACT

While most advanced countries use the place of effective management, sometimes along with the place of incorporation, as the criterion for defining the residence of a company, the United States uses the place of incorporation as the sole criterion. This formalistic and objective criterion provides taxpayers with predictability.However, in interacting with different criteria in other countries this criterion also permits manipulation, including the creation of companies that technically are not resident anywhere. Using the place of effective management (POEM) criterion can also lead to dual residenceas opposed to no residence which was the only problem that was considered when the rules of international taxation were originally created. This was then to be dealt with under bilateral treaties and tiebreaking rules, with the OECD Model Treaty for example, expecting that dual residence issues would be solved by means of mutual agreement procedures on a case- by- case basis. It can be helpful, if not dispositive, for tax authorities to provide guidance on how the place of effective management criterion will apply.The aim of this paper is to analyses the tests that are used to determine corporate tax residency and whether they succeed in giving clarity and predictability to taxpayer and business. The other part of this paper aimed at examines how this test may end up being used as a loophole for tax avoidance.

***Keywords**: Corporate, Tax, Residency, Tax Law, International Taxation OECD Tax*

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INTRODUCTION

History shows that taxation has always been a topic of much public controversy. Issues of taxation has not only been the concern of the Governments but also the concern of the International Organizations. It is true that globalization has brought many benefits to the World economy but people and Governments realized that there is a lot of tax avoidance and evasion due to loopholes in International Taxation.Rules also allows multinationals corporations to legally shifts their profits to low or no tax jurisdictions. International Co-operation was vital to introduce some regulations to Globalization through the G20 and OECD.Countries work together to build robust international standards, organized tax co-operation and to restore trust in tax system leading to success in inclusive multilateralism. The Global Forum of Transparency and Exchange of information for tax purposes was established to step up the fights against tax avoidance and evasion.

OECD and G20 countries come together and develop OECD/G20 15 actions to tackle Base Erosion and Profit Shifting (BEPS).[2] Over 140 countries are working together on the implementations of these measures on equal footing in order to ensure multinationals are paying taxes. Many tax avoidance mechanisms have been neutralized.[3] A multilateral convention signed by over 90 countries. After all those efforts and great progress to regulate globalization, the job is not yet accomplished today. The pressing issue is to address tax challenges arising from digitalization. OECD admitted that new rules are urgently needed to ensure fairness and equity in tax systems and to adopt the international tax architecture to new and changing business market,

[2]Jackson Magoge & s Hashimy, *Base Erosion and Profit Shifting in Taxation: A Deep Dive into the Two-Pillar Solution in Tanzania*, 6 889 (2023).
[3]OECD, ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY (2014), https://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en (last visited Dec 4, 2023).

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without global understanding and sense solutions risks of furtheruncoordinated unilateral measures and trade sanctions is real and growing by the days.The OECDis inclusive framework failure will lead to tax laws turning into trade wars at the time when the situation of global economy is already suffering anomaly. India is the part of OECD-MT,[4] so it takes part towards these international fights against tax avoidance and evasion. While Tanzania on the other hand, is not part of the OECD-MT, the effect of which will be discussed in this paper.

TAXATION CONCEPTUAL FRAMEWORK

Corporate Taxation

A person may ask why do we tax corporation? The answer is that a corporation is taxable because it has its own rights independently of its shareholders. This is because of the company law principle of corporate personality, that a company is a legal personal separate from and capable of surviving beyond the lives of, its members.[5] This principle applied even in taxation issues, company's profit is subject to corporation taxation in a proposed tax rate. The corporation taxable income is that net surplus of revenue over expenses based on accrual accounting. Taxable profits are usually determined by reference to the respective national general accepted accounting principles subjects to specific tax adjustments.

Arm's Length Principle

The principle of *arm's-length pricing* (ALP), by which transactions between entities within anMNE are to be valued for tax purposes at prices to which independent parties engaging in

[4]Sanjay Kumar Mishra, *Impact of the OECD Tax Co-Operation with India*.
[5]Salomon v Salomon & Co 1895

thesame transaction in similar circumstances would agree.The dealing at arm's length principle is the corner stone of international profit allocation.[6]

Net Income from business activities of a corporation is allocated first to the "source"country in which it is generated, with a residual right to tax in the country of residence of thecompany. Generally, with a credit for taxes paid in the source country to relieve double taxation.The right to tax "passive income",e.g., interest, royalties, dividendsis generally allocated tothe country of residence of the recipient company, it having been thought harder to locate the"source" of such income.

Permanent Establishment

Taxation of business profits by the source country, however, requires that there be "nexus" in the form of a *permanent establishment* (PE), which requires a substantial degree of physicalpresence in a country.A permanent establishment is a fixed place of business through which the business is carried on. The country where the permanent establishment is located is entitled to tax the profits attributed to the permanent establishment.[7]

Controlled Foreign Corporation (CFC) rules

Corporate taxation of foreign income is deferred until repatriation to the resident company, with*Controlled Foreign Corporation (CFC) rules* often adopted in order to bring into tax in theresidence country that income, especially passive income, and sometimes low-taxed otherincome, earned by foreign subsidiaries of the resident company abroad.

Double Tax Agreement

[6] Ulrich Schreiber, (2013) International Company Taxation an Introduction to the Legal and Economic Principles,
[7] Art. 7 Para. 2 OECD-MT

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Double Tax Agreements (DTAs), generally bilateral, aim to allocate the tax base acrosscountries consistent with the broad principles. While avoiding overlapping claims to tax incomethey now also recognize risks of 'double non-taxation'. The treaty network has expandedmassively in the last 25 years or so, there now being more than 3000 DTAs, and the network hasgrown toencompass relations between developing countries (generally 'source only" and capital importing) and advanced economies.

OECD Model Treaty

OECD Model Treaty the OECD-MT is not a legally binging.[8] Its main purpose is to give guidance to tax treaty negotiations when concluding their own treaties. There are two fundamental principles that govern the OECD-MT which is the taxing right of the source country is acknowledged, but may be restricted. The taxing right of the source country is confirmed, nut is conditional on the obligation to eliminate possible double taxation.

Source Country

Concerning the source country, three categories can be distinguished with respect to the extent of the taxing right. The source country's taxing right can be unlimited, restricted, or non-existent.Unlimited taxing rights of the source country is granted under Article 6[9] that, *"Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State"*. Also, all profits of permanent establishments located in the source country as provide under Article 5 of the OECD-MT.

[8]Alberto Vega, *International Governance Through Soft Law: The Case of the OECD Transfer Pricing Guidelines*, (2012), https://papers.ssrn.com/abstract=2100341 (last visited Dec 4, 2023).
[9] OECD-MT

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Restricted taxing rights of the source country is as provide under Article 10 of the OECD-MT that:

> *"Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend); b) 15 per cent of the gross amount of the dividends in all other cases". Also, Article 11 of the OECD-MT restricts the source country´s taxing right for interest paid by a resident company to non-residents. The source country has no taxing right for royalties paid to non-residents and capital gains on shareholdings of non-residents in resident corporations.*[10]

Residence Country

The residence country has the right to tax worldwide income of resident taxpayers who are liable to tax by reason of domicile, residence, place of management, or similar criteria. If the taxpayer is the residence of two countries the provision of Article 4(3) of OECD-MT come into play which states that:

> *"a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the*

[10] Article 12 & 13 of OECD-MT

purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States".

CORPORATE TAXATION LEGAL FRAMEWORK

U.K. Corporate Taxation Residency

Apart from companies incorporated in the UK, a company registered outside UK will be considered as tax resident in the UK if its place of *"central management and control"* is in UK subject to limited exception.[11] For more than 28 years UK statutory laws has largely remained constant in this area. However, case laws have developed during that period such that considerable care must be taken to prevent a company registered outside UK from becoming UK tax resident.[12]

Since 1986 when the statutory provision was introduced, a company registered outside UK can be regarded as tax resident in the UK if its place of central management and control is in the UK. what is considered is the highest level of decision making, normally the place where directors meet and make key decision of the company. The principle has been developed in a number of leading UK tax cases.

In the case of De Beers Consolidation Mines Ltd v. Homes[13] Lord Loreburn in establish the central management and control test he said "A company resides where its real business is

[11]Proposed tax residency changes now in limbo, https://www.wolterskluwer.com/en-au/expert-insights/proposed-tax-residency-changes-now-in-limbo (last visited Dec 4, 2023).
[12]Tax on foreign income, GOV.UK, https://www.gov.uk/tax-foreign-income/residence (last visited Dec 4, 2023).
[13](1906) AC 455

carried on and the real business is carried on where the central management and control actually abides" in this case the mining company, De Beers, was incorporated in South Africa and its main trading operations were in South Africa. However, the majority of its directors lived in the UK and in practice the board exercised its powers in the UK, so the company was held to be UK resident for tax purposes. This case confirmed that determining the place of management and control is primarily a question of fact.

Victory of Taxpayer in UK

After that landmark decision by the House of Lords, most of the Worldwide companies try to avoid UK residence by arrange of director's meeting on to be held outside the UK. In the case of *Wood v. Holden,*[14] the case examined whether a company's management and control could be exercised by a shareholder. Mr and Mrs Wood owned shares in Greetings Cards Holdings Limited (Greetings), which they sold to a Dutch company, Eulalia Holdings BV (Eulalia). Mr Wood owned all the shares in Eulalia but had appointed a Dutch trust company to act as its sole managing director. Eulalia was a special purpose vehicle (SPV), whose only significant business decision was to sell the shareholding in Greetings. HMRC argued that the decision to sell had not been given proper consideration by the managing Dutch trust company but rather had been agreed to at the instigation of Mr and Mrs Wood, who were UK residents and that Eulalia was therefore resident in the UK at the time of the disposal. This was rejected by the Court of Appeal which held that although the managing company's directors had been advised and influenced, they not been by passed nor stood aside.

Victory for the Revenue Authority

[14] (2006) EWCA Civ 26

In the case of *Laerstate BV v HM Revenue & Customs*[15] Laerstate was a company incorporated in the Netherlands, and so resident there under Dutch law. It had two directors during the period in dispute – a Mr Bock and a Mr Trapman. Mr Bock acquired all the shares in the company in December 1992. At the time he was arranging finance from a German bank to fund the acquisition of £150M of Lonrho shares, by way of subscription (the subscription shares) and an option to acquire £50M of shares from a company controlled by Tiny Rowland (the option shares). The subscription shares were acquired by Laerstate using the funding organised by Mr Bock and in February 1993 he took up a role as joint managing director and CEO of Lonrho. In early 1996 Anglo American Corporation of South Africa Limited (Anglo) offered to buy Laerstate's option shares. Laerstate exercised its rights to buy the option shares and sold them on to Anglo in November 1996, Mr Bock having resigned as a director in August of that year. The UK Revenue issued assessments of Advance Corporation Tax and Corporation Tax on chargeable gains against Laerstate in November 1997, having concluded that it was resident in the UK by reason of its management and control.

The Tribunal considered that Mr Bock's activities in relation to Laerstate while in the UK did not amount to "ministerial matters or good housekeeping", as contended by the company. On the facts, Mr Bock's activities went much further and amounted to strategic decision-making on the company's behalf. During the lead-up to the exercise of the option to "put" the Lonrho shares by way of sale to Anglo, Mr Bock made an unfortunate reference to "my shares" and the Tribunal concluded that Mr Bock told Mr Trapman to exercise the option and Mr Trapman did so without giving the matter any particular consideration. In contrast with *Wood v Holden*, Laerstate was not

[15] [2009] UKFTT 209 (TC)

able to claim that the board was in possession of even an absolute minimum of information upon which it could base a decision, and then made one (even if mistaken or ill informed).

TANZANIA PERSPECTIVE

Section 4 of The Income Tax Act[16]as amended from time to time is the charging provision in Tanzania. In a nutshell the provision states that income shall be charged and is payable for each year of income by every person, who has permanent establishment (PE) that has repatriated income. The expression every person in Tanzania in so far as taxation is involved has been defined under Section 3 of the Income Tax Act[17] to means individual or an entity. The burden of tax which fall on any entity largely depend on the residence of that entity in Tanzania, if it is found to be a resident of the Tanzania the global income of that entity is taxable in Tanzania, if however, the entity is found to be a non-resident only the income which are source to Tanzania can be taxable.

According to Section 53 (1) of the Income Tax Act[18] a corporation shall be liable to tax separately from its shareholders. Residence of the corporation is the main basis of the income taxation in Tanzania. Section 66 (4) of the Income Tax Act[19] in a nutshell provides that*a corporation is a resident corporation for a year of income if it is incorporated or formed under the laws of the United Republic* or *at any time during the year of income the management and control of the affairs of the corporation are exercised in the United Republic*. So, from the provision we see there are two tests that has been enshrined therein, the *Place of incorporation test* (POI) and the *control and management of the affairs test* (C&M).

[16]Income Tax Act (CAP 332 R:E 2019)
[17]Ibid
[18]Ibid
[19]Ibid

The leading Case in Tanzania

African Barrick Gold Plc v Commissioner General & Tanzania Revenue Authority[20] the appellant is the company incorporated in UK and holing share of three mining entities in Tanzania. The question before the apex court of Tanzania CAT was whether certificate of compliance issued under Section 435 of the Companies Act, Cap 212 amount to the appellant company becoming formed in Tanzania for the purpose of income taxation under Section 66 (4) (a) of ITA 2004. At the Tax Revenue Appeals Tribunal, it was decided that in terms of section 66 (4) (a) (b) of ITA 2004 the appellant company was a resident company in Tanzania for taxation purposes and it was required to pay the withholding taxes on dividend payment amounting to UDS 81,843,127, being aggrieved with the decision of the tribunal the appellant appeal to the CAT.

The arguments by the appellant were that being a holing company dully incorporated in UK, it wa neither a resident company in Tanzania, nor did it conduct any business in Tanzania to attract income tax which the respondent demanded. The respondent on the other side keeps on insisting that as long as the appellant has its regional offices in Dar es Salaam, and had a Certificate of Compliance issued by the Registrar of Companies of Tanzania, and given that the appellant is also listed on the Dar es Salaam Stock Exchange; the appellant is as much a resident company doing business in Tanzania as any other company incorporated under the Companies Act of Tanzania. Further, the respondent also pleaded that the appellant is also a resident company in so far as it conducts its business in Tanzania through its gold mining entities of Bulyanhulu Gold Mine Limited, North Mara Gold Mine Limited, Tulawaka Gold Mine and the Buzwagi Gold Mine.

[20]Civil Appeal No. 144 of 2018, Decided on 31st August 2020

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The court apply the purposive method of interpretation, and concluded that the word “formed” in Section 66(4) (a) of ITA can be construed to include the registration of company under the Companies Act, that means the issuance of the certificate of compliance under section 453 of the Companies Act, would be included. Hence even though it does not amount to incorporation or re incorporation for that matter of the company in Tanzania, it is correct to conclude that registration amounted to the company’s formation in Tanzania as a foreign company. The Court of Appeal went further to hold that *"...any company or body corporate established... under any law in force in the United Republic or elsewhere..."* in the definition section 3 of the ITA, 2004 has cast the net so wide that it includes as tax residents, any foreign company that is issued with a Certificate of Compliance under section 435 of the Companies Act, 2002. The plain meaning of the words "or elsewhere" under section 3 of the ITA 2004 envisage the likes of the appellant company, which, though incorporated in the United Kingdom, as long as the Registrar of Companies had issued them with Certificates of Compliance, these foreign registered companies attain statutory footholds to establish places of business in Tanzania thereby attracting income tax liability. And concluded that after obtaining a Certificate of Compliance, the appellant's its income tax obligations can only cease when it gives notice in writing to the Registrar of Companies about closing of its place of business in Tanzania under section 441 (1) of the Companies Act.

INDIA PERSPECTIVE

The provisions for determineresidency of the company in Tanzania is more or less similar to India. In India tax incidence on an assessed depends on his residential status. For instance, whether an income, accrued to an assessed outside India, is taxable in India depends upon the residential status of an assessed in India. Similarly, whether an income earned by the foreign assessed in India or outside India is taxable in India, depends on the residential status of the

assessed. Therefore, the determination of the residential status of an assessed is very crucial in order to find out his tax liability. There are two types of taxpayers in India, resident in India and non-resident in India. Indian income is taxable in India whether the person earning income is resident or no-resident. Conversely, foreign income of a person is taxable in India only if such person is resident in India or has a permanent establishment (PE) in India. Foreign income of a non-resident is not taxable in India.

There are different taxable entities for the purpose of determining residential status, but for the purpose of our paper only residential status of a company will be considered. In India residential status of a company is determined as per the provision of Section 6(3) of the Income Tax Act[21]this has undergone tremendous changes and of course it has been a going concerning. Prior to the amendment by the Finance Act, 2015, Section 6(3) of the Income Tax Act[22] provides that *a company is said to be resident in India in any Previous year, if it is an Indian compony* or *if during that year the control and management (C&M) of its affairs is situated wholly in India.*So, the provision provides two tests to determine residence *the place of incorporation* (POI) and *Control and Management* (C&M).

Place of Incorporation (POI) The Differences Between India And Tanzania

An Indian Company is always resident in India. Even if it is controlled from a place located outside India or even if the shareholders of an Indian company controlling more than 51% voting

[21]Income-tax Act, 1961.
[22]Ibid

power are non-resident and or located outside India, the Indian company is a resident in India.[23] An Indian company can never be non-resident. This position is somehow different toTanzania,*while section 66 (4) (a) of the Tanzania Income Tax Act says a corporation is a resident corporation for a year of income if it is incorporated or formed under the laws of URT, section 6(3) (i) of the India Income Tax Act says that a company is said to be a resident in any previous year if it is an Indian company.* So, in Tanzania the corporation can be regarded as residence in Tanzania if it is dully incorporated in Tanzania or formed in Tanzania as clearly explained in African Barrick Gold Plc v Commissioner General & Tanzania Revenue Authority, *supra*in Indiait is only incorporation which is considered if it is not incorporated in India, it cannot be said that is an Indian company.

Place of Incorporation in United States of America and Pitfalls

The United States uses a formal test for corporate residence determination the place of incorporation. In US tax system, corporation that are considered domestic for tax purpose are generally taxed on their worldwide income from whatever source derived.[24]But foreign company are taxed in United States only to the extent they earn income that is sourced within United States.[25]Therefore, in US they tax corporation according to source-basedsystem, only income generated from source is to be taxed and all income sourced outside US is generally excluded form tax liability.[26]This test is easy to manipulate.What the companies do is to shift their income outside the source country by manipulating the source of income for tax purposes by having

[23]Taxmann, *Residential Status of a Company and Tax Incidence under Income Tax Act*, TAXMANN BLOG (2022), https://www.taxmann.com/post/blog/residential-status-of-company-and-tax-incidence-under-income-tax-act/ (last visited Dec 4, 2023).
[24]United States - Corporate - Taxes on corporate income, https://taxsummaries.pwc.com/united-states/corporate/taxes-on-corporate-income (last visited Dec 4, 2023).
[25]Molly F Sherlock & Donald J Marples, (2020),*Overview of the Federal Tax System.*
[26]Peter Schwarz, *Tax-Avoidance Strategies of American Multinationals: An Empirical Analysis*, 30 MANAG. DECIS. ECON. 539 (2009).

income that has been generated in high-rate country reported as generated in a low tax rate country. So, what they do is incorporate the subsidiaries in tax haven and shift income towards those subsidiaries. The US incorporated corporations can freely operate around the world and generates a huge foreign source of income.[27] There is evidence that US incorporated corporations collects most of their profits not directly, but indirectly through subsidiaries incorporated in low to no tax countries.[28]It is easy and practically costless to incorporate a subsidiary in a tax heaven, in order to avoid the US taxing power altogether. According to the analysis above the POI test is dysfunctional in the today's economic development and digital economy.

Control and Management of the Affairs

There is no statutory definition of the Control and Management but it has been judiciary interpreted in different cases. In *Narottam and Pereira Ltd. vs Commissioner of Income-Tax,*[29]the question that arises in this case was whether the assessed company is a resident company in assessment years 1944-45 and 1945-46 respectively. The company is a subsidiary company of the Scindia Steam Navigation Co. Ltd. and its business is stevedoring in Ceylon. It is registered in Bombay and its registered office is also in Bombay. The meetings of the board of directors are held in Bombay and also the meetings of the shareholders. In the 1922 Income Tax Act, in order that the company should be resident it is necessary that the control and management of its affairs should be situated wholly in the taxable territories. In order that a company's income should be subjected to tax as a resident, it has got to be established that the control and management of its affairs is situated wholly in the taxable territories. As we shall presently point out, "control and management" is a compendious expression which has acquired a definite

[27]Alan J. Auerbach, *The Future of Fundamental Tax Reform*, 87 AM. ECON. REV. 143 (1997).
[28]Donald J Marples & Jane G Gravelle, *Tax Cuts on Repatriation Earnings as Economic Stimulus: An Economic Analysis*, 15.
[29](1953)

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significance and connotation.[30] It is also necessary that the control and management of the affairs of the company should be situated wholly in the taxable territories.

Therefore, if any part of the control and management is outside the taxable territories then the company would not be resident. In this particular case considerable emphasis is placed upon the fact that the whole of the business of the company is done in Ceylon and the whole of the income which is liable to tax had been earned in Ceylon. But that is not a factor which the Legislature has emphasized. It is entirely irrelevant where the business is done and where the income has been earned. What is relevant is, from which place has that business been controlled and managed. The control and management contemplated by this sub-section is not the carrying on of day-to-day business by servants, employees, or agents. The real test to be applied is, where is the controlling and directing power, or rather, where does the controlling and directing power function or to put it in a different language there is always a seat of power or the head and brain, and what has got to be ascertained is, where is this seat of power, or the head and brain. The court when refusing to accept the arguments by the assessed that the control and management was under two managers under two powers-of-attorney look after all the affairs of the assessed company in Ceylon it says, a company may have a dozen local branches at different places outside India, it may send out agents fully armed with authority to deal with and carry on business at these branches, and yet it may retain the central management and control in Bombay and manage and control all the affairs of these branches from Bombay and at Bombay. It would be impossible to contend that because there are authorized agents doing the business of the company at six different places outside India, therefore, the company is resident not only in Bombay but at all these six different places.

[30] Eckhard Janeba & Wolfgang Peters, *Tax Evasion, Tax Competition and the Gains from Nondiscrimination: The Case of Interest Taxation in Europe*, 109 ECON. J. 93 (1999).

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The failure of Control and management Test in India

Despite the victory of the tax authorities in that case, the provision become an escapeway for the assessedin some cases.[31] The provision proved to be inadequate in recent era by live loopholes for tax avoidance for companies to artificially escape the residential status under those provision by shifting insignificant or isolated events related with control and management outside India.[32]In *Vodafone International Holding v. Union of India,*[33]Vodafone International Holding (VIH) and Hutchison telecommunication international limited or HTIL are two non-resident companies. These companies entered into transaction by which HTIL transferred the share capital of its subsidiary company based in Cayman Island, CGP to VIH. VIH by virtue of this transaction acquired a controlling, interest of 67 percent in Hutch is on Essar Limited or HEL that was an India joint venture company between Hutchinson and Essar because CGP was holding the above 67 percent interest prior to the above deal.

The Indian Revenue authorities issued a show cause notice to VIH as to why it should not be considered as “assessed in default” and thereby sought an explanation as to why the tax was not deducted on the sale consideration of this transaction.[34]The Indian revenue authorities thereby through this sought to tax capital gain arising from sale of share capital of CGP on the ground that CGP had underlying Indian Assets. VIH decided to petition to High Court challenging the jurisdiction of Indian revenue authorities. This writ petition was dismissed by the High Court and VIH appealed to the Supreme Court which sent the matter to Revenue authorities to decide

[31]Ashrita Prasad Kotha, *Place of Effective Management Test in The Income Tax Act, 1961: Is It the Right Way Forward? – NUJS Law Review*, http://nujslawreview.org/2016/11/06/place-of-effective-management-test-in-the-income-tax-act-1961-is-it-the-right-way-forward/ (last visited Dec 4, 2023).
[32]CIRCULAR NO.6 OF 2017 [F.NO.142/11/2015-TPL], DATED 24-1-2017
[33](2012) 204 Taxman 408 SC
[34]Sijbren Cnossen, *Key Questions in Considering a Value-Added Tax for Central and Eastern European Countries*, 1992 IMF STAFF PAP. (1992), https://www.elibrary.imf.org/view/journals/024/1992/002/article-A001-en.xml (last visited Dec 4, 2023).

whether the revenue had the jurisdiction over the matter. The revenue authorities decided that it had the jurisdiction over the matter and then matter went to High Court which was also decided in favour of Revenue and then finally Special Leave petition was filed in the Supreme Court. It was held that revenue authorities do not have jurisdiction to impose tax on an offshore transaction between two non-residents companies where in controlling interest in a Indian resident company is acquired by the non-resident company in the transaction.

In *Radha Rani Holding (P) Ltd v. Additional Director of Income Tax*[35] Facts in brief are that the assessed company incorporated under the laws of Republic of Singapore filed its return of income on 21st Oct., 2002 showing interest income of Rs. 12,28,770. The return was filed in the status of a non-resident company. The AO noticed that the paid-up capital of the company consisted of 100 shares out of which Mrs. Geeta Soni held 99 shares and Mrs. Juliana Kassim, a resident of Singapore, held one share. Mrs. Geeta Soni is a resident of India and is an income-tax assessed in India. The AO examined the issue of residential status of the assessed company under Section 6(3) of the IT Act as well as under Article 4 of the DTAA between India and Singapore.[36] The company was assessed as the Indian by the argument that the majority shareholder is a resident in India so its control and management was wholly in India. The assessed appealed to the Tribunal on the arguments inter alia that unless and until control and management of the affairs of a foreign company is situated wholly in India, it could not be treated as a resident of India. Therefore, the mere fact that one of the directors of the company was of Indian origin was of little significance unless it was shown that control and management of its affairs was situated wholly in India. It was also submitted that the board meetings in which the key decisions were taken were held in Singapore and not in India. It was submitted that in the

[35][2007] 110 TTJ 920.
[36]Yukon Huang, *Distribution of the Tax Burden in Tanzania*, 86 ECON. J. 73 (1976).

light of the provisions of Section 6(3)(ii) even if a part of the control was outside India the company could not be treated as a resident in India. The Delhi bench of the Income Tax Appellate Tribunal (ITAT) held inter alia that, even if one of two directors of a company is present in India, the test of control and management being *"wholly situated"* in India would not be satisfied, since board meetings were conducted outside India. It went further by saying that Under Section 6(3)(ii), a company can be said to be a resident in India if during that year, the control and management of its affairs is situated wholly in India. Therefore, in the case of a foreign company, even if a slightest control and management is exercised from outside India it would not fall within the ambit of Section 6(3)(ii) of the Act and the company would be treated as a non-resident.

After failure and loopholes evidenced in the Control and Management of the affair test, there was a room for companies active in India to move part of their management abroad, to prevent India from taxing their worldwide income. The Indian government decided to come up with the Place of Effective management (POEM).

THE WAY FORWARD BY THE TAX AUTHORITIES

Establishment of Place of Effective Management test (POEM)

The above discussed provision of Section 6 (3)[37]was amended by the Finance Act[38]to the extent that the company would be resident in India in any previous year if it is an Indian company, or its Place of Effective Management (POEM) in that year is in India.[39] The POEM is defined in the Act to mean the place where key management and commercial decisions that are necessary for

[37]Income-tax Act, 1961.

[38] 2015

[39]PoEM: Place of Effective Management, https://taxguru.in/income-tax/poem-place-effective-management.html (last visited Dec 4, 2023).

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conduct of the business of an entity as a whole are in substance made.[40]India is not the first country to include POEM in the Tax laws, it has been used by various countries, for example China, South Africa also it is well recognized by OECD.[41]The guiding principles of POEM implementation under Circular No. 6 of 2017 are not decisive but in nature of guiding only.[42] The said guidelines as provided by the CBDT are unclear as regards to a number of terms mentioned therein. Thus, the lack of any definite established legal factors for the purpose of determination of POEM would lead to several tax disputes and the existence of POEM in India would be a subject matter of litigation in various cases. It sometimes seen to be an ineffective test in the situation where effective management exist in more than one country at per without being dominant in one country. In this situation, it fails to provide a clear residence to one country. It is also difficult to use POEM in the situation where mobile places of effective management technique is used. A bord of directors may arrange meeting to ta take place in different places throughout the year. Lastly, in the situation of videoconferencing senior managers adopt conferencing through the internet, as a key medium for making management and commercial decisions and those managers are located throughout the world.It may be difficult to determine a place of effective management. In such cases, a place of management might be regarded as existing in each jurisdiction where a manager is located at the time of making decisions, but it may be difficult (if not impossible) to point to any particular location as being one place of effective management.

CONCLUSION

[40]Article 4 OECD & Section 6 (3) (ii)
[41]Will it be Indian income tax v/s Indian PSUs for PoEM compliance? - The Economic Times, https://economictimes.indiatimes.com/news/economy/policy/will-it-be-indian-income-tax-v/s-indian-psus-for-poem-compliance/articleshow/57413199.cms (last visited Dec 4, 2023).
[42]Place of Effective Management in India - A Detailed Analysis, https://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=8480 (last visited Dec 4, 2023).

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Despite its shortfalls POEM is considered to be the best test to determine residency of Companies among other tests, its function is of two-fold, from domestic viewpoint laws it is used as a test to determine residency of a foreign company, while at the same time from international viewpoint POEM is used as a tiebreaker test restricting the dual residency to one nation. In *Union of India and Anr vs Azadi Bachao Andolan and Anr*[43]in relation to POEM the Supreme Court said that "The DTAC requires the test of 'place of effective management' to be applied only for the purposes of the tie-breaker clause in article 4(3) which could be applied only when it is found that a person other than an individual is a resident both of India and Mauritius. We see no purpose or justification in the DTAC for application of this test in any other situation". The question come do Tanzania respectively needs POEM and tax treaties.Most of the African countries have been brainwashed that into thinking that they need tax treaties. But the truth is that they do not. Tax treaties they always tend to set limits on when and in some cases at what rates signatories can tax across border economic activity, many of the tax legal scholars they concentrate on the benefits only but I chose to comment negatively, coming to POEM.

[43]Appeal (civil) 8161-8162 of 2003