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A COMPARATIVE ANALYSIS OF CORPORATE TAX RESIDENCY: A CASE STUDY BETWEEN INDIA, UK AND TANZANIA

*NYAMWERO BWIRE NYAMWERO**
&
*SAYED QUDRAT HASHIMY***

ABSTRACT

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

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giving clarity and predictability to taxpayer and business. The paper also examines how the test may end up being used as a loophole for tax avoidance.

KEYWORDS:

Corporate tax, Residency, Tax law, International taxation, OECD tax.

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 allow multinational corporations to legally shift profits to low or no tax jurisdictions. International co-operation is vital to introduce regulations to globalization through the G 20 and OECD.

Countries work together to build robust international standards, organized tax cooperation and to restore trust in the tax system leading to success in inclusive multilateralism.

The Global Forum of Transparency and Exchange of Information for tax purposes was established to counter tax avoidance and evasion.

OECD and G20 countries came together and developed OECD/G20 15 actions to tackle Base Erosion and Profit Shifting.[1] Over one hundred and forty countries are working together to implement these measures on equal footing in order to ensure multinationals are paying taxes. Many tax avoidance mechanisms have been neutralized.[2] A multilateral convention was signed by over ninety countries. Afterall the efforts to regulate globalization, the job is not yet accomplished. The pressing issue is to address

1. Jackson Magoge &S. Hashimy, *Base Erosion and Profit Shifting in Taxation: A Deep Dive into the Two-Pillar Solution in Tanzania*, Vol. 6, IJLMH 889 (2023).

2. OECD, *Addressing The Tax Challenges Of The Digital Economy* (2014), available at, https://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en..

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 structure to new and changing business market, without global understanding and solution risks of further uncoordinated unilateral measures and trade sanctions is real and growing. The OECD is inclusive framework and 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,[3] so it takes part in the international fights against tax avoidance and evasion. While Tanzania on the other hand, is not part of the OECD-MT, and the effect of which will be discussed in the paper.

Corporate taxation

A person may ask why do States tax corporation? The answer is that a corporation is taxable because it has its own rights independently of the shareholders. This is because of the company law principle of corporate personality, a company is a legal personal separate from and capable of surviving beyond the lives of, its members.[4] The principle applies to taxation issues, and company's profit is subject to corporation taxation. The corporation's taxable income is the 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 subject to specific tax adjustments.

The principle of arm's-length pricing, by which transactions between entities within an MNE are to be valued for tax purposes at prices to which independent parties engaging in the same transaction in similar circumstances would agree. The dealing at arm's length principle is the corner stone of international profit allocation.[5]

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3. The OECD Model Tax Convention on Income and on Capital is a model for the negotiation, interpretation and application of bilateral tax Conventions.

4. Salomon v. Salomon & Co., Ltd, [1897] AC 22.

5. *See*, ULRICH SCHREIBER, INTERNATIONAL COMPANY TAXATION AN INTRODUCTION TO THE LEGAL AND ECONOMIC PRINCIPLES (2013).

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 the company, generally, with a credit for taxes paid in the source country to relieve double taxation. The right to tax passive income e.g., interest, royalty, dividend etc. is generally allocated to the country of residence of the company, it having been thought harder to locate the source of such income.

Taxation of business profits by the source country, however, requires that there be nexus in the form of a permanent establishment, which requires a substantial degree of physical presence in the 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 establishment.[6]

Controlled Foreign Corporation Rules

Corporate taxation of foreign income is deferred until repatriation to the resident company, with Controlled Foreign Corporation Rules adopted in order to bring into tax in the residence country that income, especially passive income, and sometimes low-taxed other income, earned by foreign subsidiaries of the resident company abroad.

Double Tax Agreement

Double Tax Agreement [hereinafter DTA] generally bilateral, aims to allocate the tax base across countries consistent with the broad principles. While avoiding overlapping claims to tax income they now also recognize risks of double non-taxation. The treaty network has expanded massively in the last twenty years or so, there now being more than 3000 DTAs, and the network has grown to encompass relations between developing countries (generally 'source only' and capital importing) and advanced economies.

6. Article 7, Para. 2 OECD-MT.

OECD Model Treaty

The OECD-MT is not a legally binding.[7] Its main purpose is to give guidance to tax treaty negotiations when treaties. There are two fundamental principles governing the OECD-MT, one is the taxing right of the source country is acknowledged, but may be restricted. The taxing right of the source country is confirmed, but is conditional on the obligation to eliminate possible double taxation.

Source country

Concerning the source country, three categories may be distinguished with respect to the extent of the taxing right. The source country's taxing right may be unlimited, restricted, or non-existent. Unlimited taxing right of the source country is granted under article 6[8] which reads thus: "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.

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

> 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

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7. Alberto Vega, *International Governance Through Soft Law: The Case of the OECD Transfer Pricing Guidelines*(2012), available at, https://papers.ssrn.com/abstract=2100341.

8. OECD-MT.

> 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 percent of the gross amount of the dividends in all other cases". *See also*, Article 11, OECD-MT, which restricts the source country´s taxing power on interest paid by a resident company to non-residents. The source country has no taxing power over royalties paid to non-residents and capital gains of shareholdings of non-residents in resident corporations.[9]

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 resident of two countries the provision of article 4(3), OECD-MT comes into play. The article reads thus:

> 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 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

Apart from companies incorporated in the UK, any company registered outside UK will be considered to be tax resident in the

9. Articles 12 & 13, OECD-MT.

UK if its place of central management and controlis in UK subject to limited exception.[10] For more than twenty- eight years, UK has largely remained constant in the area. However, case law has developed during the period such that, considerable care must be taken to prevent a company registered outside UK from becoming UK tax resident.[11]

Since 1986, when the statutory provision was introduced, a company registered outside UK may be regarded as tax resident in the UK, if its place of central management and control is within the UK. What is taken into consideration is the highest level of decision -making, normally the place where directors meet and take key decisions of the company.

In *De Beers Consolidation Mines Ltd*. v. *Homes*[12] Lord Loreburn propounded the central management and control test thus: "A company resides where its real business is carried on and the real business is carried on where the central management and control actually abides." The facts show that De Beers mining company 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 powers from the UK. It was held that the company was resident in the UK for tax purposes. The decision affirmed that determining the place of management and control was primarily a question of fact.

Victory of taxpayer in UK

After that landmark decision by the House of Lords, most of the worldwide companies tried to avoid UK residence by arranging director meetings to be held outside the UK. In *Wood* v. *Holden*[13] the court examined whether management and control of the company could be exercised by a shareholder. The facts go to show

10. Proposed Tax Residency Changes Now InLimbo, available at, https://www.wolterskluwer.com/en-au/expert-insights/proposed-tax-residency-changes-now-in-limbo.

11. *TAX ON FOREIGN INCOME, GOV.UK*, https://www.gov.uk/tax-foreign-income/residence.

12. [1906] AC 455.

13. (2006) EWCA Civ. 26.

that Mr. and Mrs. Wood owned shares in Greetings Cards Holdings Ltd. (Greetings).They sold the shares to 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 hence Eulalia was resident in the UK at the time of the disposal. This was rejected by the Court of Appeal holding that although the managing company's directors had been advised and influenced, they had not been by passed or stood aside.

Victory for the revenue authority

In *Laerstate B.V.*v*. H.M. Revenue & Customs,*[14] the company was incorporated in Netherlands, and so was resident there under the Dutch law. It had two directors during the period of dispute. Bock and Trapman. Bock had acquired all the shares in the company in December 1992 by 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 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 to Anglo in November 1996, 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 Bock's activities in relation to Laerstate, while in the UK, did not amount to 'ministerial matters or

14. [2009] UKFTT 209 (TC).

good housekeeping', as contended by the company. On the facts, 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, Bock made an unfortunate reference to 'my shares' and the Tribunal concluded that Bock told Trapman to exercise the option and Trapman did so without giving the matter any particular consideration. In contrast with *Wood* v.*Holden*, Laerstate was not 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.

Section 4 of The Income Tax Act[15] 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 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[16] to mean individual or an entity. The burden of tax which falls on any entity largely depends 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 arise in Tanzania can be taxable.

According to section 53 (1) of the Income Tax Act[17] a corporation shall be liable to tax separately from its shareholders. Residence of the corporation is the main basis of the taxation in Tanzania. Section 66 (4) of the Income Tax Act[18] 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 one can see that there are two tests that have been enshrined therein, the Place of incorporation test (POI) and the control and management of the affairs test (C&M).

15. Income Tax Act (CAP 332 R.E. 2019).

16. *Id.*

17. *Supra* note 15.

18. *Id.*

The leading Case in Tanzania is *African Barrick Gold Plc* v. *Commissioner General & Tanzania Revenue Authority,*[19] where the appellant was the company incorporated in UK and holding shares of three mining entities in Tanzania. The question before the apex courts CAT was whether certificate of compliance issued under section 435 of the Companies Act, Cap 212 amounted to the appellant company becoming formed in Tanzania for the purpose of income taxation under section 66 (4) (a) of ITAct. The Tax Revenue Appeals Tribunal held that in terms of section 66 (4) (a) (b), 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.

The appellant appealed to the CAT. It was argued by the appellant that being a holding company duly incorporated in UK, it was neither a resident company in Tanzania, nor did it conduct any business in Tanzania to attract the tax liability. The respondent pointed out that as long as the appellant had its regional offices in Dar es Salaam, and had the 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 was as much a resident company doing business in Tanzania as any other company incorporated under the Companies Act of Tanzania. Further, the respondent pleaded that the appellant was also a resident company insofar as it conducted business in Tanzania through its gold mining entities of Bulyanhulu Gold Mine Ltd., North Mara Gold Mine Ltd., Tulawaka Gold Mine and Buzwagi Gold Mine.

The Court applied the purposive method of interpretation, and concluded that the word 'formed' in section 66(4) (a), ITA could be construed to include the registration of company under the Companies Act.That meant that issuance of the certificate of compliance under section 453 of the Companies Act, would be included. Hence though it did not amount to incorporation or re-incorporation for that matter of the company in Tanzania, it was correct to conclude that registration amounted to the company's formation in Tanzania as a foreign company. The Court of Appeal

19. Civil Appeal No. 144 of 2018. Decided on 31 August 2020.

went further to hold that '...any company or body corporate established... under any law in force in the United Republic or elsewhere' in section 3 of the IT Act had cast the net so wide that it included as residents, any foreign company that was issued with a certificate of compliance under section 435 of the Companies Act, 2002.

The plain meaning of the words 'or elsewhere' in section 3 of the IT Act 2004 envisages the appellant company.Though incorporated in the United Kingdom, as long as the Registrar of Companies had issued them with certificates of compliance, the foreign registered companies attain statutory footholds to establish places of business in Tanzania thereby attracting income tax liability. The conclusion was that after obtaining the certificate of compliance, the appellant's income tax obligations can only cease when it gives notice in writing to the Registrar of Companies about closing the place of business in Tanzania under section 441 (1) of the Companies Act.

India perspective

The provisions to determine residency of the company in Tanzania are more or less similar to what is followed in India. In India tax incidence on a person depends on the residential status. For instance, whether income, accrued outside India, is taxable in India depends upon the residential status of the assessed person in India. Similarly, whether income earned by the foreigner is to be assessed in India or outside India, depends on the residential status of the assessed person. Therefore, the determination of the residential status of an assessed person is very crucial in order to find out the tax liability. There may be two types of taxpayers in India, resident in India and non-resident in India. Income earned in India 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 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 present purpose only residential status of 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.[20] The section has undergone several changes. Prior to the amendment by the Finance Act, 2015, section 6(3) of the Income Tax Act[21] provided that a company was said to be resident in India in any Previous year, if it was an Indian company or if during that year the control and management of its affairs was situated wholly in India.So, the provision provided two tests to determine residence, the place of incorporation and control and management.

Place of incorporation; Differences in law 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 the company controlling more than 51% voting power are non-residents or located outside India, the company is a resident in India.[22] An Indian company can never be non-resident. The position is somehow different in Tanzania. While section 66 (4) (a) of the Tanzania Income Tax Act provided that a corporation was a resident corporation for a year of income if it was incorporated or formed under the laws of URT, section 6(3) (i) of the India Income Tax Act provided that a company was said to be a resident in any previous year if it was an Indian company. So, in Tanzania the corporation could be regarded as resident in Tanzania if it was duly incorporated in Tanzania or formed in Tanzania as clearly explained in *African Barrick Gold* Plc v. *Commissioner General & Tanzania Revenue Authority,* in India it was only incorporation which was considered, if it was not incorporated in India, it could not be said to be an Indian company.

Place of incorporation in United States of America and pitfalls

The U S uses a formal test for corporate residence determination the place of incorporation. In US tax system,

20. Income Tax Act, 1961.

21. *Id.*

22. 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/..

corporation that are considered domestic for tax purpose are generally taxed on their worldwide income from whatever source derived.[23] But foreign company is taxed in United States only to the extent they earn income sourced within United States.[24] Therefor US taxes corporations according to source-based system, only income generated from source is to be taxed and all income sourced outside US being excluded form tax liability.[25] The test is easy to manipulate. What the companies do is to shift the income outside the source country by manipulating the source of income for tax purposes, by having 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 the subsidiaries.

The US incorporated corporations can freely operate around the world and generate huge foreign sourced income.[26] There is evidence that US incorporated corporations collected most of the profits not directly, but indirectly through subsidiaries incorporated in other countries.[27] It is easy and practically costless to incorporate a subsidiary in any tax heaven to avoid the taxation by U S. According to the analysis above the POI test is dysfunctional in the current economic development and digital economy.

Control and management of the affairs

There is no statutory definition of control and management, being an innovation by the judiciary. In *Narottam and Pereira Ltd.*v. *Commissioner of Income-Tax,*[28] the question arose whether the assessed company was a resident company during assessment

23. United States- Corporate- Taxes on corporate income, available at, https://taxsummaries.pwc.com/united-states/corporate/taxes-on-corporate-income.

24. *See*,MOLLY F. SHERLOCK & DONALD J MARPLES, OVERVIEW OF THE FEDERAL TAX SYSTEM (2020).

25. Peter Schwarz, *Tax-Avoidance Strategies of American Multinationals: An Empirical Analysis*, 30 MGMT. DECISION ECON. 539 (2009).

26. Alan J. Auerbach, *The Future of Fundamental Tax Reform*, 87 AM. ECON.. REV. 143 (1997).

27. Donald J Marples & Jane G. Gravelle, *Tax Cuts On Repatriation Earnings As Economic Stimulus:An Economic Analysis*, CONGRESSIONAL RESEARCH SERVICE 15 (2011).

28. [1953]23 ITR 454 (BOM).

years 1944-45 and 1945-46 respectively. The company was a subsidiary of the Scindia Steam Navigation Co. Ltd. and its business was stevedoring in Ceylon. It was registered in Bombay, and the registered office was in Bombay. The meetings of the board of directors and that of the shareholders were held in Bombay. The Income Tax Act, 1922 had provided that for a company to be resident, it was necessary that the control and management of its affairs should be situated wholly inside the taxable territory. In order that a company's income should be subjected to tax as resident, it had to be established that the control and management of its affairs was situated wholly inside the taxable territory. But 'control and management' is a compendious expression which has acquired a definite significance and connotation.[29] It is also necessary that the control and management of the affairs of the company should be situated wholly with in the taxable territory.

Therefore, if any part of the control and management was situated outside the taxable territory, then the company could not be resident. In this particular case considerable emphasis was placed upon the fact that the whole of the business of the company was done in Ceylon, and the whole of the income which was liable to tax had been earned in Ceylon. But that was not a factor which the Legislature had emphasized. It was entirely irrelevant where the business was done and where the income had been earned. What was relevant was, from which place had that business been controlled and managed. The control and management contemplated by the sub-section was not the carrying on of day-to-day business by servants, employees, or agents. The real test to be applied was, where was the controlling and directing power, or rather, where did the controlling and directing power function or to put it in a different language there was always a seat of power or the head and brain, and what had got to be ascertained was, where was that seat of power, or the head and brain.

The court when refusing to accept the arguments by the assessed person that the control and management was under two

29. 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).

managers, acting under two powers-of-attorney look after all the affairs of the assessed company in Ceylon it said, a company could have a dozen local branches at different places outside India, it could send out agents fully armed with authority to deal with and carry on business at the branches, and yet it could retain the central management and control in Bombay and manage and control all the affairs of these branches from Bombay. It would be impossible to contend that because there were authorized agents doing the business of the company at six different places outside India, therefore, the company was resident not only in Bombay but at all the six different places.

The failure of control and management test in India

Despite the victory of the tax authorities in the case, the provision became an escape way for the assessed in some cases.[30] The provision proved to be inadequate in by loopholes for tax avoidance for companies to artificially escape the residential status under the provision by shifting insignificant or isolated events related with control and management outside India.[31] In *Vodafone International Holding* v*. Union of India,*[32] the Company and Hutchison Telecommunication International Ltd.[hereinafter HTIL] were two non-resident companies. They entered into transaction by which HTIL transferred the share capital of its subsidiary company CGP, based in Cayman Island, to VIH. VIH by virtue of the transaction acquired the controlling interest of 67 percent in Hutch on Essar Ltd. 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 showcause 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

30. Ashrita Prasad Kotha, *Place of Effective Management Test in The Income Tax Act, 1961: Is It the Right Way Forward? – N. U. J. S. L.*Rev., available at, http://nujslawreview.org/2016/11/06/place-of-effective-management-test-in-the-income-tax-act-1961-is-it-the-right-way-forward/.

31. Circular No..6 of 2017 [F.NO.142/11/2015-TPL], 24-1-2017

32. (2012) 204 Taxman 408 SC.

deducted on the sale consideration of the transaction.[33]The revenue authority thereby sought to tax capital gains arising from sale of share capital of CGP, on the ground that CGP had underlying Indian assets. VIH challenging the jurisdiction of Indian revenue authority in the High Court. The petition was dismissed by the High Court and VIH appealed to the Supreme Court which sent the matter to Revenue authority to decide whether the revenue had the jurisdiction over the matter. The revenue authority decided that it had the jurisdiction. Finally, the matter reached the Supreme Court. It was held that revenue authorities did not have jurisdiction to impose tax on an offshore transaction between two non-residents companies, where the controlling interest in an Indian resident company was acquired by non-resident company in the transaction.

In *Radha Rani Holding (P) Ltd.*v*. Additional Director of Income Tax,*[34] facts were that the assessed company incorporated under the laws of Republic of Singapore filed the return of income on 21 October 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 one hundred shares, out of which Geeta Soni held 99 shares and Juliana Kassim, a resident of Singapore, held one share. Geeta Soni was a resident of India and assessed in India. The AO examined the issue of residential status of the company under section 6(3) of the IT Act as well as under article 4 of the DTAA between India and Singapore.[35] The company was assessed as Indian as the majority shareholder was resident in India, so that the control and management was wholly situated in India.

In the appeal before the Tribunal, it was argued that only when the control and management of the affairs of a foreign company was situated wholly in India, it could not be treated as resident 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 light of section 6(3)(ii), even if a

33. Sijbren Cnossen, *Key Questions in Considering a Value-Added Tax for Central and Eastern European Countries*, 1992 IMF Staff Pap. (1992), available at, https://www.elibrary.imf.org/view/journals/024/1992/002/article-A001-en.xml.

34. [2007] 110 TTJ 920.

35. Yukon Huang, *Distribution of the Tax Burden in Tanzania*, 86 Econ. J. 73 (1976).

part of the control was outside India the company could not be treated as resident in India. The Appellate Tribunal held that, even if one of the two directors of a company was 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 was also held that under section 6(3)(ii), a company could be said to be a resident in India only if during that year, the control and management of its affairs was situated wholly in India. Therefore, in the case of a foreign company, even if a slightest control and management was exercised outside India, it would not fall within the ambit of section 6(3)(ii) of the Act and the company would be treated as non-resident.

After failure and loopholes evidenced in the control and management of the affair test, there was room for companies active in India to move part of the management abroad, to prevent India from taxing their worldwide income. The Government decided to come up with the place of effective management test.

THE WAY FORWARD BY THE TAX AUTHORITIES

Establishment of place of effective management test

Section 6 (3)[36] was amended by the Finance Act, 2015 providing that a company would be resident in India in any previous year if it was an Indian company, or its place of effective management [hereinafter POEM] in that year was in India.[37] The POEM was defined in the Act to mean the place where key management and commercial decisions that were necessary for conduct of the business of an entity as a whole were in substance made.[38] India is not the first country to include POEM in the Tax laws, it has been used by various countries, for example China and South Africa also it was well recognized by OECD.[39]

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36. Income-tax Act, 1961.

37. POEM: Place of Effective Management, https://taxguru.in/income-tax/poem-place-effective-management.html.

38. Article 4 OECD §ion 6 (3) (ii).

39. Sachin Dave, *Will it be Indian Income Tax v/s Indian PSUs for POEM Compliance?* - THE ECONOMIC TIMES (2017), available at, https://economictimes.indiatimes.com/news/economy/policy/will-it-be-indian-income-tax-v/s-indian-psus-for-poem-compliance/articleshow/57413199.cms.

The guiding principles of POEM implementation were not decisive, but in nature of guidance only.[40] The guidelines as provided by the CBDT were unclear, as regards to a number of terms mentioned therein. Thus, the lack of any definite established legal factor for the purpose of determining POEM would lead to tax disputes, and the existence of POEM in India would be a subject matter of litigation in various cases. It was sometimes seen to be an ineffective test in the situation, where effective management existed in more than one country, without being dominant in one country. In such situations, it failed to provide a clear residence in one country. It is also difficult to use POEM in a situation, where mobile places of effective management technique is used. The board of directors may arrange meetings to take place in different places throughout the year.

Lastly, in the situation of video-conferencing senior managers adopt conferencing through the internet, as a key medium to make management and commercial decisions, and the managers could be located throughout the world making it difficult to determine the 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

Despite the 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, it is used to determine residency of foreign company, while at the same time from international viewpoint, POEM is used as a tiebreaker test restricting dual residency. In *Union of* India v. *Azadi Bachao Andolan,*[41] in relation to POEM the Supreme Court observed that :

40. Sneha Lad, *Place of Effective Management in India - A Detailed Analysis*(2019), available at, https://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=8480.

41. AIR (2004) SC 1107.

> 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[42].

The question remains, does Tanzania needs POEM and tax treaties. Most of the African countries have been brain washed into think that they need tax treaties. But the truth is that they do not. Tax treaties they have always tend to set limits on when and in some cases at what rates signatories can tax across border economic activity.

42. *Id.* at 1126.