

June 28, 2017

Draft Notification under section 115JH of the Act –Clarifications for foreign companies having POEM in India

Background:

- The concept of 'place of effective management' ('POEM') was introduced vide Finance Act, 2015, for determining the residential status of a foreign company in India. Section 6(3) of the Income Tax Act, 1961 ('the Act') was amended to provide that a company will be deemed to be resident in India if its POEM¹ in that year is in India. Finance Act, 2016 deferred the implementation of POEM by one year, making the same applicable from assessment year 2017-18 onwards (w.e.f. April 1, 2017). The Central Board of Direct Taxes ('CBDT') had vide Circular dated January 24, 2017, issued final guidelines for determination of POEM of a company in India.
- Further, section 115JH was inserted in the statute vide Finance Act, 2016 w.e.f. April 1, 2017, inter alia, providing that the Central Government (CG) may notify certain exceptions, or modifications as to the applicability of certain provisions of the Act relating to set off and carry forward of brought forward loss, unabsorbed depreciation, relief for taxes paid in the foreign country, deduction of tax at source, etc. on such foreign companies deemed to be resident in India due to POEM in India.
- In exercise of powers conferred under the aforesaid section, a draft notification² was issued by the CG on June 15, 2017, for public comments before June 23, 2017.

Draft Notification:

The draft notification provides for the following:

- Opening Written Down Value ('WDV') of depreciable assets

WDV as per the foreign tax records of the foreign company as on the 1st day of previous year shall be deemed to be the opening WDV of depreciable assets. However, if the foreign company is not assessed to tax in the foreign

1 Explanation to section 6(3) defines POEM as a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.

2 F No 370142/19/2017-TPL

jurisdiction, then WDV as appearing in the books of account maintained in accordance with the laws of that foreign jurisdiction shall be adopted as opening WDV.

- **Treatment of brought forward loss or unabsorbed depreciation ('BFL or UAD')**

BFL or UAD as on the 1st day of the first financial year as per the foreign tax records of the foreign company would be deemed to be the BFL or UAD on such date. However, if the foreign company is not assessed to tax in the foreign jurisdiction, BFL or UAD would be as per the books of account maintained in accordance with the laws of that foreign jurisdiction. The said BFL or UAD shall be allowed to be set off and carried forward in accordance with the relevant provisions of the Act.

- **Preparation of profit and loss account and balance sheet for the purpose of carry forward and set off of above losses**

In case the accounting year followed by the foreign company does not end on 31st March, the foreign company would be required to prepare its profit and loss account and balance sheet for a period starting from the date on which the accounting year immediately following the said accounting year begins to 31st March of the year immediately preceding the relevant previous year during which the foreign company turned resident in India on account of POEM.

It is further provided that for the purpose of carry forward of loss, if the period preceding the first financial year is six months or more, it would be treated as a separate accounting year. If such period is less than six months, then such short period would be added to the accounting year of the foreign company.

For example, if the accounting year of the foreign company is the calendar year ending on December 31, then, since, the period from January 1 to March 31, i.e., 3 months would be less than 6 months, the accounts of the foreign company shall be prepared for a period of 15 months, i.e., 12 months for the calendar year and 3 months for the enhanced period. If the accounting year of the foreign company ends on 30th June, then, accounting year immediately preceding the relevant previous year during which the foreign company is deemed to be resident in India, would of 9 months only i.e. from July 1 to March 31.

The foreign company shall also be required to prepare profit and loss account and balance sheet for succeeding periods of twelve months starting from the first financial year till the foreign company continues to be treated as a resident of India.

- **Provisions relating to deduction of tax**

Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as a resident as well as a foreign company, the provisions applicable to a foreign company shall apply. It implies that the provisions relating to deduction of tax at source ('TDS') from payment to resident contained in sections 194A, 194C, 194J, etc. shall not apply to payment made to such company; the payment to such company shall continue to remain subject to TDS under section 195 of the Act, being applicable to payment by a resident to foreign company. Further, the provisions contained in section 195(2) of the Act shall apply in such manner so as to include payment to the foreign company.

For example TDS from payment of royalty made to foreign company deemed to be resident in India on account of POEM shall be governed by section 195 and not section 194J of the Act.

- **Relief from double taxation**

The foreign company held to be resident in India on account of its POEM in India shall be entitled to relief for deduction of taxes paid outside India in accordance with the provisions of sections 90/91 of the Act.

- **Rate of income tax**

The rate of income tax as applicable to a foreign company shall apply, even though the tax status of the foreign company changes from non-resident to resident on account of POEM.

- **Exchange rate for conversion into rupees**

The rate of exchange for conversion of a value expressed in foreign currency into rupees shall be in accordance with Rule 115 of the Income Tax Rules, 1962³.

- The notification shall be deemed to have come into force from April 1, 2017.

VA Comments:

- The Notification proposes to bring much needed clarity on application of various provisions of the Act on such foreign companies, being deemed as resident in India on account of POEM, like, adoption of accounting year, opening WDV in case of depreciable assets, treatment of carry forward and set off of brought forward loss and unabsorbed depreciation, relief for taxes paid in the foreign country, conversion of foreign currency into rupees, etc.

- The Notification provides that, subject to modifications or exceptions contained in the said Notification, all other provisions specifically applicable to a foreign company shall continue to apply to the foreign company deemed to be resident in India on account of POEM. The Notification further provides that provisions applicable to non-residents shall not apply to such company; however, provisions specifically applicable to a resident shall apply.
- The aforesaid clarification proposes to remove the ambiguity qua status of foreign company having POEM in India. The aforesaid Notification unambiguously provides the status of such company as foreign company, which will be subject to the provisions of Act as a resident in India.
- For any details and clarifications, please feel free to write to:

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- 3 Rule 115A provides for adoption of telegraphic transfer buying rate of foreign currency as on the specified date i.e. the rate or rates of exchange adopted by the State Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer. (Refer Explanation to Rule 26)



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