

# ***CBDT issues draft notification for implementation of PoEM based taxation for foreign companies and invites comments and suggestions by 23 June***

June 19, 2017

## ***In brief***

On 15 June, 2017, the Central Board of Direct Taxes (CBDT) issued a draft notification prescribing exception, modification and adaptation in respect of taxation of foreign companies said to be resident in India under section 115JH of the Income-tax Act, 1961 (the Act) and invited comments from stakeholders and public on the same by 23 June, 2017. The date of coming into force of final notification is proposed to be 01 April, 2017.

## ***In detail***

### ***Background***

- The Finance Act, 2015 by amending section 6(3) of the Act, introduced a provision wherein the residence of a company could be in India if its Place of Effective Management (PoEM) is in India. PoEM is as “a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.” Through this amendment, the earlier requirement that the control and management of the affairs of the company should be wholly situated in India to qualify as resident was replaced with a wider concept of PoEM. By way of subsequent amendment, applicability of the provision was deferred to assessment year (AY) 2017-18 onwards.
- A new Chapter XII-BC consisting of section 115JH was inserted into the Act *vide* Finance Act, 2016 with effect from AY 2017-18. The section *inter-alia* provides that where a foreign company is a resident in India during any previous year (being the first year) by virtue of section 6(3) of the Act, the provisions of the Act relating to the computation of total income, treatment of unabsorbed depreciation (UD), set off or carry forward and set off of losses, collection and recovery, and special provisions relating to avoidance of tax shall apply for that year with such exceptions, modifications and adaptations, as may be notified.
- The section also provides that where the aforesaid determination of a foreign company as a resident in India has been made in the assessment proceedings of the relevant year, then the aforesaid provision shall apply to any other previous years as well, ending on or before the date of completion of assessment.
- Accordingly, the Government has now issued the draft notification clarifying various aspects for public comments. The notification provides for determination of written down value (WDV), availability of brought

forward loss and unabsorbed depreciation (UD), etc. in respect of the transitional year i.e. the first year in which a foreign company is considered

as a resident in India. Further, the notification also requires preparation of profit and loss account and balance sheet for each of the relevant years.

Additionally, it provides guidance on situations where the accounting year does not end on 31 March, applicability of tax withholding provisions etc.

### **Draft Provisions**

	Determination of WDV of depreciable assets for the relevant year	Determination of brought forward loss and UD for the relevant year
Foreign Company assessed to tax in foreign jurisdiction	WDV of depreciable asset as per tax record in foreign country on the first day of previous year shall be considered.	Brought forward loss or UD as per tax record determined year wise on the first day of previous year shall be deemed as losses or UD brought forward and eligible for set off and carry forward in accordance with the provisions of the Act.
Foreign Company not assessed to tax in foreign jurisdiction	WDV of depreciable asset as appearing in the books maintained in accordance with laws of the foreign jurisdiction shall be considered.	Brought forward loss or UD as per books prepared in accordance with laws of that country on first day of previous year shall be deemed as losses or UD brought forward and eligible for set off and carried forward in accordance with the provisions of the Act.

### *Where accounting year does not end on 31 March*

- The foreign company shall be required to prepare a balance sheet and profit and loss statement for the “interim period” until which the foreign company has turned resident. For example, if the accounting year of the foreign company is a calendar year (i.e. ending on 31 December, 2015) and it turns “resident” basis PoEM provisions from financial year 2016-17, then the interim period for which the profit and loss account and balance sheet shall be drawn will be from 01 January, 2016 to 31 March, 2016.
- However, for the purpose of carry forward of loss, the following apply:
  - if the “interim period” is less than six months (as in the example above), it shall be included in the previous accounting year i.e. the

profit and loss account and balance sheet shall be prepared for the period of 15 months starting from 01 January, 2015 to 31 March, 2016;

- if the “interim period” is equal to or more than six months, then the interim period would be classified as a separate accounting year, and the foreign company is required to prepare profit and loss account and balance sheet for such interim period.

### *Other important provisions*

- The draft notification also seeks to provide clarification on the applicability of tax withholding provisions in a PoEM situation. It provides that if more than one provision of Chapter XVII-B of the Act related to tax withholding are applicable to such foreign company as a resident as well as a foreign company, the provisions applicable to a

foreign company shall apply. Further, it also extends applicability of the provisions of section 195(2) of the Act related to the determination of appropriate proportion of income chargeable to tax in India in respect of payment to a foreign company resident in India on account of PoEM.

- The notification also provides for conversion of values expressed in foreign currency by applying the provisions of existing Rule 115 of the Income-tax Rules, 1962.
- All transactions of the foreign company with other parties shall not be altered only on the ground that such foreign company has turned resident on account of its PoEM in India.

### *Concluding remarks in the notification*

- Subject to the specific provisions as notified, foreign company shall continue to be

treated as foreign company, and all provisions of the Act shall apply accordingly. The notification specifically provides that the rate of income-tax shall be as applicable to foreign companies i.e. 40% plus applicable surcharge and cess, even though the company is treated as resident because of PoEM in India.

### ***The takeaways***

- The Government has attempted to address certain concerns around the implementation of PoEM provisions. Additionally, the notification clarifies the

availability of relief/ deduction of taxes under sections 90 and 91 of the Act. The seeking of public and stakeholder comments is important, as there are certain grey areas requiring clarifications to avoid ambiguity as regards determination of tax liability of such foreign company in India and tax withholding obligations of various parties dealing with such companies.

- The notification makes its applicability only to those companies that are said to be resident in India on account of PoEM for the first time. Determination of PoEM is a yearly exercise, and there may

be situations where a company does not have its PoEM in India in successive years. The notification does not address such situations. The notification also does not provide guidance on the deposit of advance tax, applicability of various penal provisions under the Act, etc. Additionally, there appears to be an ambiguity as regards applicability of tax withholding provisions in subsequent years.

### ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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