

Central Government issues notification for implementation of POEM based taxation for foreign companies

July 2, 2018

In brief

The Central Government *vide* notification dated 22 June 2018 released the final notification¹ under section 115JH(1) of the Income-tax Act, 1961 (the Act) prescribing exceptions, modifications and adaptations to various provisions of the Act for taxing foreign companies treated as resident in India on account of their place of effective management (POEM), and where such foreign company has not been resident of India in any of the previous year.

The notification provides for determination of written down value (WDV), the availability of brought forward loss and unabsorbed depreciation (UD) in the transitional year. In addition, it also provides for the foreign tax credit (FTC) availability to foreign companies, where the income is offered to tax in more than one year and the applicability of the notification in subsequent years. The notification has been made applicable with effect from 01 April, 2017.

In detail

- The draft notification issued on 15 June, 2017² included the determination of WDV, availability of brought forward loss and UD, etc. in respect of the first year in

which a foreign company is considered as a resident in India. The draft notification was issued to seek public comments.

- The final notification has now been released by the

Central Government in exercise of its powers conferred under section 115JH of the Act.

- The notification is summarised as under:

S. No.	Particulars	Provisions under the final notification
1.	Determination of opening WDV of depreciable assets for the relevant year	<p>When the foreign company is assessed to tax in the foreign jurisdiction</p> <ul style="list-style-type: none"> WDV of depreciable asset as per tax record in foreign country on the first day of previous year shall be considered as opening WDV for the relevant year. Where WDV is not available in tax records, the WDV shall be calculated assuming the asset was installed, utilised and the depreciation actually allowed as per laws of that foreign jurisdiction. The WDV so determined shall be considered as opening WDV for the relevant year.

¹ Notification No. S.O. 3039(E) dated 22 June 2018

² Please click [here](#) refer to refer to our news alert dated 19 June 2017 on the draft notification.

S. No.	Particulars	Provisions under the final notification
		<p><i>When the foreign company is not assessed to tax in the foreign jurisdiction</i></p> <p>WDV of depreciable asset as appearing in the books on first day of the previous year maintained in accordance with laws of the foreign jurisdiction shall be considered as opening WDV on first day of the relevant year.</p>
2.	Determination of brought forward loss or UD for the relevant year	<p><i>When the foreign company assessed to tax in the foreign jurisdiction</i></p> <p>Brought forward loss or UD as per tax record determined year-wise on the first day of the previous year shall be deemed as losses or UD.</p> <p><i>When the foreign company not assessed to tax in the foreign jurisdiction</i></p> <p>Brought forward loss or UD as per the books of account prepared in accordance with laws of that country as on first day of the previous year shall be deemed as losses or UD.</p> <p><i>Other provisions applicable to all foreign companies</i></p> <ul style="list-style-type: none"> • The losses or UD determined shall be eligible to be set-off and carry forwarded in accordance with the provision of the Act for the remaining period only calculated, from the year in which brought forward loss or UD occurred for the first time. • Loss or UD shall be allowed to be set-off only against such income that has become chargeable to tax in India on account of POEM being in India. • In case of any revision or modification in the amount of brought forward loss and UD in the foreign jurisdiction, consequent revisions to be made in India for set-off and carry forward.
3.	Accounting year followed by the foreign company does not end on 31 March	<ul style="list-style-type: none"> • The foreign company shall be required to prepare a balance sheet and profit and loss account for the “interim period” until which the foreign company has become resident. For example, if the accounting year of the foreign company is a calendar year (i.e. ending on 31 December, 2015) and it becomes “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. • For the purpose of carry forward of loss and UD, the following provision will apply: <ul style="list-style-type: none"> a) 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; b) 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.

S. No.	Particulars	Provisions under the final notification
		<ul style="list-style-type: none"> The loss and UD as per tax records or books of account, as the case may be, shall be allocated on proportionate basis. Where the foreign company is resident in India in the subsequent year also on account of POEM, then the brought forward loss and UD to be adopted on the first day of the previous year should be in accordance with the provisions contained in the notification.
4.	Provisions under Chapter XVII – B of the Act (TDS provisions)	<ul style="list-style-type: none"> If more than one provision of Chapter XVII-B of the Act, i.e., provision related to withholding tax is applicable to such foreign company as a resident, and a foreign company, the provisions applicable to a foreign company shall apply. Further, it also extends the 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. Compliance to provisions of Chapter XVII – B of the Act as applicable on foreign company, prior to its becoming resident, shall be considered as sufficient compliance under this chapter.
5.	FTC	<ul style="list-style-type: none"> The foreign company is entitled to relief/ deduction of taxes under sections 90 and 91 of the Act. In case income is offered to tax in more than one year, then FTC shall be allowed across those years in the same proportion in which the income is offered to tax in India in respect of the income to which it relates to.
6.	Definitions	<ul style="list-style-type: none"> Rate of exchange - for conversion into rupee to be in accordance with Rule 115 of the Income-tax Rules, 1962. Foreign jurisdiction - means the place of incorporation of a foreign company.
7.	Other provisions	<ul style="list-style-type: none"> Any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident. The foreign company shall continue to be treated as a foreign company and all provisions of the Act shall apply accordingly. The tax rate of 40% plus applicable surcharge and cess shall continue to apply. The notification will not apply to income that is otherwise taxable in India, even if the foreign company does not become a tax resident in India. In case of conflict between the provisions applicable to a foreign company as resident and the provisions applicable to a foreign company, the latter shall generally prevail.

The takeaways

- The notification has aimed to address the grey areas in the taxability of a foreign company and withholding tax

obligations.

- The notification clarifies that in case of conflict, the provisions applicable to a foreign company shall primarily apply.

- The notification has now clarified that companies will be treated as a foreign company for the purpose of withholding tax obligations of various parties dealing with such

companies.

- The notification also clarifies taxability in the subsequent year, when a foreign company becomes resident in the succeeding year.

- The notification has kept the resident companies and foreign companies at par in case of carry forward of brought forward loss. The period will be determined in accordance with the provisions of the Act,

considering the first year to be that in which the loss occurred.

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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