
CBDT issues draft notification specifying condition for conversion of Indian branch of foreign bank into an Indian subsidiary company

November 24, 2017

In brief

Currently, foreign banks have a presence in India through their branches.

During 2008, a global financial crisis occurred and the major reason for it was the domestic incorporation of foreign banks. Having said the above, the Reserve Bank of India (RBI), in the public interest and in the interest of banking policy, had issued a 'Scheme for setting up of wholly owned subsidiaries (WOS) by foreign banks in India'.

To incentivise the foreign banks to set up wholly owned subsidiaries in India, Finance Act, 2012, inserted Chapter XII-BB, consisting of section 115JG of the Income-tax Act, 1961 (Act), Section 115JG of the Act provides for the following benefits:

- Exemption from capital gains tax arising upon conversion of the Indian branch of a foreign bank into a Indian subsidiary company, in accordance with scheme framed by RBI; and
- Exceptions, modifications and adaptations with regard to treatment of unabsorbed depreciation, set off or carry forward of losses, availability of Minimum Alternative Tax (MAT) credit and the computation of income of the foreign bank and the Indian subsidiary company.

However, these benefits were further subject to the conditions that may be notified by the Central Government.

The Central Board of Direct Taxes (CBDT) has now issued a draft notification¹ which provides for conditions that an Indian branch of a foreign bank needs to adhere to at the time of its conversion into an Indian subsidiary company in order to avail benefits under section 115JG of the Act.

The stakeholders have been requested to send their comments/ suggestions on the draft notification by 30 November, 2017 to the email address dirtpl2@nic.in.

In detail

The Finance Act, 2012 inserted Chapter XII-BB, consisting of section 115JG of the Act, which contains 'Special provisions relating to conversion of Indian branch of a foreign

bank into a subsidiary company'.

Section 115JG of the Act, *inter alia*, provides that where a foreign company, being a company engaged in the business of banking in India, through its branch situated in India, converts its branch into

a subsidiary company, **in accordance with scheme framed by the RBI**, then subject to the conditions notified by the Central Government, the capital gains arising from such a conversion shall not be chargeable to tax.

¹ F. No. 370133/34/2017-TPL, dated 17 November, 2017

Further, section 115JG of the Act also provides that the provisions relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary pursuant to such conversion shall apply with such exceptions, modifications, etc., as may be specified in the notification.

The CBDT has, under the draft notification, proposed that the following conditions need to be fulfilled, in addition to the scheme framed by the RBI, for availing benefits of section 115JG of the Act:

- a) all the assets and liabilities of the Indian branch immediately before conversion become the assets and liabilities of the Indian subsidiary company;
- b) the foreign company referred to in sub-section (1) of section 115JG of the Act or its nominees hold the whole of the share capital of the subsidiary company; and
- c) the foreign company referred to in sub-section (1) of section 115JG of the Act does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Indian subsidiary company;

To summarise, where a conversion of an Indian branch of a foreign bank to Indian subsidiary company is done in accordance with RBI scheme and the above conditions, capital gains arising on account of such conversion shall not be taxable.

Further, the draft notification proposes following exceptions, modifications and adaptations with regard to applicability of provisions of the Act for treatment of unabsorbed depreciation, set off or carry forward of losses, availability of MAT credit and the computation of income of the foreign bank and the Indian subsidiary company:

S. No.	Particulars	Exception/Modification/Adaptation
1	Allowance of depreciation under section 32 of the Act	<ol style="list-style-type: none"> a) The aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates, if the conversion had not taken place; b) deduction shall be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them
2	Accumulated losses and unabsorbed depreciation	<p>The accumulated loss and the unabsorbed depreciation of the Indian branch, shall be deemed to be the loss or allowance or depreciation of the Indian subsidiary company for the purpose of the previous year in which conversion was effected and provisions of the Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.</p> <p>For the purpose of this clause, ‘Accumulated losses’ means so much of the loss of the Indian branch before conversion into Indian subsidiary company under the head ‘Profits and gains of business or profession’ (not being a loss sustained in a speculation business) which such Indian branch would have been entitled to carry forward and set off under the provisions of section 72 of the Act if the conversion had not taken place.</p> <p>‘Unabsorbed depreciation’ means so much of the allowance for depreciation of the Indian branch before conversion into Indian subsidiary company, which remains to be allowed and which would have been allowed to the Indian branch under the provisions of this Act, if the conversion had not taken place.</p>
3	Actual cost of capital asset	For the purposes of clause (1) of section 43, the actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the date of conversion of the Indian branch into the Indian subsidiary company.

		The actual cost of any capital asset on which deduction has been allowed or is allowable to the taxpayer under section 35AD of the Act, shall be treated as 'nil' for the purposes of clause (1) of section 43 of the Act if the capital asset is acquired or received as a result of conversion referred to in sub-section (1) of section 115JG of the Act
4	MAT credit	<p>The tax credit of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected and the provisions of section 115JAA of the Act shall apply accordingly.</p> <p>For the purposes of this clause, tax credit means so much of the tax credit of the Indian branch before conversion into Indian subsidiary company which such Indian branch would have been entitled to carry forward and set off under the provisions of section 115JAA of the Act, if the conversion had not taken place;</p>
5	Cost of acquisition of capital asset	Where the capital asset became the property of the Indian subsidiary company as a result of conversion of Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which previous owner had acquired it.
6	Credit balance of provision for bad and doubtful debts	The credit balance in the provision for bad and doubtful debts account made under clause (viia) of sub-section (1) of section 36 of the Act of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Act shall apply accordingly.

Further, for the purpose of the notification, 'date of conversion' shall be the date on which the RBI appoints for the vesting of undertaking of the Indian branch in Indian subsidiary company under paragraph 20(i) of the 'Scheme for setting up of wholly owned subsidiary by foreign bank in India'.

The takeaways

The finalisation of the draft CBDT notification, shall provide clarity to foreign banks on the

following:

- Conditions which needs to be adhered to, at the time of conversion of the Indian branch of a foreign bank into a subsidiary, in order to qualify as a tax neutral conversion;
- Guideline for treatment of unabsorbed depreciation, set off or carry forward of losses, availability of MAT credit and the computation of income of the foreign bank and the Indian subsidiary company

(upon conversion of Indian branch into subsidiary); and

- Pursuant to the above, foreign banks shall be in a position to take a more informed decision on the conversion of Indian branch into Indian subsidiary company and tax issues surrounding such conversions

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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