
Final notifications issued under section 115JG(1) for conversion of Indian branch of foreign bank into an Indian subsidiary company

December 11, 2018

In brief

The Reserve Bank of India (RBI), in public interest and in the interest of banking policy, had issued a “Scheme for setting up of WOS by foreign banks in India.” Amongst others, the Scheme provides for the following:

Foreign banks that have commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch or to convert those branches into a wholly owned subsidiary (WOS).

Other foreign banks, carrying on or proposing to carry on banking businesses in India, shall be set-up only through WOS, if any matter as specified in the scheme of RBI are applicable.

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

- Capital gains arising upon conversion of the Indian branch of a foreign bank into a Indian subsidiary company, in accordance with the scheme framed by the RBI shall not be chargeable to tax; and
- Exceptions, modifications and adaptations with regard to the 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 Government had issued a draft notification¹ with the conditions that an Indian branch of a foreign bank needs to adhere at the time of its conversion into an Indian subsidiary company in order to avail benefits under section 115JG of the Act. Comments were invited from various stakeholders on the draft notification.

Based on the feedback received on the draft notification, the Central Government has now issued two final notifications,² notifying the conditions that need to be satisfied to avail benefits under section 115JG of the Act.

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

² Notification no. 85/ 2018/ F.No.370133/ 34/ 2016-TPL and Notification no. 86/ 2018/ F.No.370133/ 34/ 2016-TPL (Part) dated 06 December, 2018

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 the 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.

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.

In the final notification no. 85/2018, it has been stipulated that the following conditions need to be fulfilled for availing the benefits of section 115JG of the Act:

- a) The Indian branch amalgamates with the

Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI under paragraph 20(h) of the Framework for setting up of WOSs by foreign banks in India issued by the RBI *vide* press release number 2013-2014/ 936 dated 6 November, 2013.

- b) All the assets and liabilities of the Indian branch immediately before conversion become the assets and liabilities of the Indian subsidiary company.
- c) The asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.
For determining the value of the assets for the purposes of this clause, any change in the value of assets consequent to their revaluation shall be ignored.
- d) The foreign bank referred to in section 115JG(1) of the Act or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period

beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place, and continue to hold the share of the Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year; and

- e) The foreign company referred to in section 115JG(1) 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 the scheme of the RBI and in compliance with the above conditions, the capital gains arising on account of such conversion shall not be taxable.

Further, the final notification specifies the following exceptions, modifications and adaptations with regard to the 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 (referred in section 115JG(1) of the Act) and the Indian subsidiary company:

S. No.	Particulars	Exception/ Modification/ Adaptation
1	Allowance of depreciation under section 32 of the Act	a) The aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licenses, 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;

S. No.	Particulars	Exception/ Modification/ Adaptation
		b) Deduction shall be apportioned between the Indian branch and its 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 the 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 an 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 an 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	<p>For the purposes section 43(1) of the Act, 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 an Indian subsidiary company.</p> <p>The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD of the Act, shall be treated as “nil” for the purposes of section 43(1) of the Act in the case of the Indian subsidiary company, if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch.</p>
4	Cost of acquisition of capital asset	Where the capital asset other than those referred in point 3 (above) became the property of the Indian subsidiary company as a result of conversion of the 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 the previous owner had acquired it.
5	MAT credit	<p>The tax credit of the Indian branch shall be deemed 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 an 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>
6	Deduction of expenses under voluntarily retirement scheme	The provisions of section 35DDA of the Act shall as far as possible apply to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place.
7	Credit balance of provision for bad and doubtful debts	The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viiia) 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.

S. No.	Particulars	Exception/ Modification/ Adaptation
8	Deemed other income	The provisions of section 56(2)(x) of the Act shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company referred to in section 115JG(1) of the Act or its nominee in consequence of the conversion of the Indian branch into an Indian subsidiary company.

Further, for the purposes of this 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 framework for setting up of WOSs by foreign banks in India issued by the RBI *vide* press release number 2013-2014/936 dated 6 November, 2013.

Separately, notification no. 86/2018 amends Rule 8AA of the Income-tax Rules, 1962 as follows:

- In case of a capital asset

which became the property of the Indian subsidiary company in consequence to conversion of a branch of a foreign company referred to in section 115JG(1) of the Act, it shall include the period for which the asset was held by the said branch of the foreign company and by the previous owner, if any, who has acquired the capital asset by a mode of acquisition referred to in section 49(1) or section 115JG(1) of the Act.

The takeaways

The final notifications provide

clarity to foreign banks, enabling them to take a more informed decision on conversion of their Indian branches into Indian subsidiary companies, and the tax issues around such conversions. However, the notifications remain silent on the deduction of expenses incurred for conversion, applicability of transfer pricing provisions on conversion, etc.

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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