



CBDT issues a press release and a draft notification on special transitional provisions for a foreign company said to be resident in India on account of POEM

Finance Act 2015 amended the provisions dealing with residential status of a company under Section 6(3) of the Income-tax Act, 1961 (the Act). It provides that a company would be resident in India in any previous year if it is an Indian company or its Place of Effective Management (POEM) in that year is in India. In the context of implementation of POEM based residence rule, certain issues, relating to the applicability of current provisions of the Act to a company which is incorporated outside India and has not earlier been assessed to tax in India, have arisen. In particular, the issues relate to applicability of specific provisions of the Act relating to advance tax payment, applicability of Tax Deduction at Source (TDS) provisions, computation of total income, set off of losses and manner of application of transfer pricing provisions. In order to provide clarity in respect of implementation of POEM based rule of residence and also to address concerns of the stakeholders, provisions of Section 115JH have been introduced with effect from Assessment Year 2017-18.

Section 115JH of the Act, *inter alia*, provides that the central government may notify exception, modification and adaptation subject to which, provisions of the Act relating to computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before. It has been further provided that these transitional provisions would also cover any subsequent previous year upto the date of determination of POEM in an assessment proceeding.

The Central Board of Direct Taxes (CBDT) has issued a press release¹ and a draft notification² providing for exception, modification and adaptation for application of provisions of the Act in case where a foreign company is said to be a resident in India on account of POEM.

CBDT draft notification

- The exceptions, modifications and adaptations for application of provisions of the Act are summarised as under:
 - If the foreign company is assessed to tax in the foreign jurisdiction, the written down value (WDV) of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the relevant previous year.
 - If the said foreign company is not assessed to tax in the jurisdiction where it is based, then WDV of the depreciable asset as appearing in the books maintained in accordance with the laws of that foreign jurisdiction shall be adopted.
 - If the foreign company is assessed to tax in the foreign jurisdiction, its brought forward loss or unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the previous year in which it is said to be resident in India. They shall be deemed as losses or unabsorbed depreciation brought forward on the 1st day and shall be allowed to be set off and carried forward in accordance with the provisions of the Act.

¹ CBDT press release, dated 15 June 2017 – Source: Taxsutra.com

² Draft Notification dated 15 June 2017

- Where the foreign company is not assessed to tax in the foreign jurisdiction, its brought forward loss or unabsorbed depreciation as per the books prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the previous year in which it is said to be resident in India. They shall be deemed as losses or unabsorbed depreciation brought forward on the 1st day and shall be allowed to be set off and carried forward in accordance with the provisions of the Act.
- In cases where the accounting year does not end on 31 March, the foreign company shall be required to prepare Profit & Loss Account and Balance Sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, to 31 March of the year immediately preceding the period beginning with 1 April and ending on 31 March during which the foreign company has turned resident. The foreign company shall also be required to prepare Profit & Loss Account and Balance Sheet for succeeding periods of twelve months, beginning from 1 April and ending on 31 March, till the year the said foreign company remains resident in India on account of its POEM.
- For the purpose of carry forward of loss, in cases where the accounting year does not end on 31 March and the period starting from the date on which immediately following year begins to 31 March of the year, immediately preceding the period beginning with 1 April and ending on 31 March during which the foreign company has turned resident, is –
 - ❖ Less than six months, it shall be included in that accounting
 - ❖ Equal to or more than six months, that period shall be treated as a separate accounting year.

Thus, if the accounting year of the foreign company is calendar year, the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India on the basis of its POEM, shall be increased by three months, i.e., 1 January to 31 March and if the accounting year of the foreign company is from 1 July to 30 June, the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India on the basis of its POEM, shall be of nine months from 1 July to 31 March.

- Where more than one provision of Chapter XVII-B of the Act apply to the foreign company as resident as well as foreign company, the provisions applicable to the foreign company shall apply.
- The provisions of Section 195(2) of the Act shall apply in such manner so as to include payment to the foreign company.
- Once the foreign company is held to be resident in India on account of its POEM in India, it shall be entitled to relief or deduction of taxes paid under the provisions of Section 90 or Section 91 of the Act.
- The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of Rule 115 of the Income-tax Rules, 1962.
- The above exceptions, modifications and adaptations shall be applicable where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and such foreign company has not been resident in India in any of the previous years preceding the said previous year for the purposes of taxation of said foreign company only and all transactions of the said foreign company with other person or entity under the Act shall not be altered only on the ground that the said foreign company has turned resident on account of its POEM being in India.
- Subject to the above, the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India on account of its POEM being in India and all the provisions of the Act shall apply accordingly. Consequently the provisions specifically applicable to a foreign company shall continue to apply to it; and non-resident persons shall not apply to it and the provisions specifically applicable to a resident shall apply to it.

Thus, the rate of tax in case of a foreign company shall remain the same, i.e., rate of income-tax applicable to the foreign company; even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.

- The notification shall be deemed to have come into force from 1 April 2017.
- Stakeholders may send their comments and suggestions electronically by 23 June 2017 at the email address, dirtpl1@nic.in.

Our comments

CBDT has issued the much awaited draft notification on transitional provisions for a foreign company said to be resident in India on account of POEM. The draft notification states that the foreign company will be eligible for depreciation, brought forward and unabsorbed depreciation as per tax records in the foreign country or as per books of accounts maintained in accordance with the laws of the foreign country, as the case may be. The draft notification provides clarity with respect to accounting year to be taken. These transitional provisions would also cover any subsequent previous year upto the date of determination of POEM in an assessment proceeding.

The draft notification provides that where more than one TDS related provisions of Chapter XVII-B of the Act apply to the foreign company as resident as well as foreign company, the provisions applicable to the foreign company shall apply. Also, it is proposed to allow foreign tax credit under Section 90/91 of the Act. Section 195(2) (relating to application to AO for lower TDS) shall apply in such manner so as to include payment to the foreign company.

However, it has been provided that the rate of tax in case of a foreign company shall remain the same even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.

Though the draft notification has considered various issues which may impact foreign companies in the first year in which it becomes resident in India on account of POEM, it has not considered some of the issues like point of time for determining POEM for the purpose of residential status, non-applicability of provisions relating to collection and recovery of tax in the first year, no disallowance under Section 40(a)(i)/(ia) of the Act, etc.

To consult with the stakeholders and general public before issuing a final notification/rules, the CBDT has invited comments and suggestions on the above draft notification, electronically, by 23 June 2017.



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