



Draft Notification on computation of income, depreciation, losses, etc. for foreign companies that are resident in India

Background:

With effect from financial year 2016-17, a foreign company is considered as a tax resident of India, if its place of effective management (POEM) is in India. The Central Board of Direct Taxes (CBDT) had earlier this year issued guiding principles for determining when a company's place of effective management would be in India¹.

A new section 115JH was also introduced to enable the Central Government to notify the manner in which provisions of the Income-tax Act, 1961 (Act) relating to the computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and provisions relating to avoidance of tax would apply to foreign companies treated as a resident of India.

Draft Notification:

A draft of the notification under section 115JH of the Act was released by the CBDT for comments and suggestions from stakeholders². The key features of the proposals regarding computation of income, treatment of unabsorbed depreciation/losses and other related items are summarised below:

Written Down Value (WDV) of Depreciable Assets

If the foreign company is assessed to tax in the foreign jurisdiction:	WDV of depreciable asset as per tax record in the foreign country on the 1 st day of the previous year should be adopted as the opening WDV for the relevant previous year.
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¹ Refer our alert for details (http://dhruvaadvisors.com/files/Direct_Tax_Alert_24jan17.pdf)

² Comments and suggestions can be submitted electronically by 23 June 2017



If the foreign company is not assessed to tax in the foreign jurisdiction:	WDV of depreciable asset as appearing in the books maintained in accordance with the laws of that foreign jurisdiction on the 1 st day of the previous year.
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Brought forward losses or Unabsorbed Depreciation

If the foreign company is assessed to tax in the foreign jurisdiction:	Brought forward loss or unabsorbed depreciation as per the tax record shall be determined year-wise on the 1 st day of the previous year. These shall be deemed as losses or unabsorbed depreciation brought forward on the 1 st day of the previous year and shall be set off/carried forward in accordance with the Act.
If the foreign company is not assessed to tax in the foreign jurisdiction:	Brought forward loss or unabsorbed depreciation as per the books prepared in accordance with the laws of the foreign company's jurisdiction shall be determined year-wise on the 1 st day of the previous year. These shall be deemed as losses or unabsorbed depreciation brought forward on the 1 st day of the previous year and shall be set off/carried forward in accordance with the Act.

Preparation of profit & loss account and balance sheet where the Accounting Year does not end on 31 March

<p>The foreign company will be required to prepare:</p> <ul style="list-style-type: none">• Profit and loss account and balance sheet for the period starting from the date on which its accounting year begins to the 31 March of the year immediately preceding the previous year during which the foreign company has become resident in India; and• Profit and loss account and balance sheet for succeeding twelve month periods starting 1 April till such time as the company remains a resident in India on account of its POEM being in India	<p>Example:</p> <p>The accounting year of the foreign company ends on 31 December 2016 and the foreign company turns resident in FY 2017-18).</p> <p>The foreign company will be required to prepare the profit and loss account and balance sheet for the period:</p> <ul style="list-style-type: none">• 1 January 2017 to 31 March 2017 (i.e. starting from the date on which the accounting year begins to 31 March of the year immediately preceding the year during which it became resident in India).• Succeeding twelve month periods from 1 April 2017 so long as it remains resident in India.
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Determination of Accounting Year for carry forward of losses

<p>Where the accounting year of the foreign company does not end on 31 March, for the purposes of determining the carry forward of losses the following rule shall apply:</p> <p>If the period commencing from the beginning of the foreign company's accounting year to the 31st March of the year immediately preceding the previous year during which the foreign company became resident in India:</p> <ul style="list-style-type: none">• <i>Is less than six months:</i> the period will be included in that accounting year;• <i>Is equal to or more than six months:</i> the period shall be treated as a separate accounting year	<p>Example:</p> <p><u>Situation 1:</u> The accounting year of the foreign company is the calendar year i.e. ends on 31 December 2016 and it turns resident of India in the financial year 2017-18.</p> <p><i>The period from 1 January 2017 to 31 March 2017 shall form part of the foreign company's accounting year ending 31 December 2016 (i.e. its accounting year for the purposes of carry forward of loss will be from 1 January 2016 to 31 March 2017).</i></p> <p><u>Situation 2:</u> The accounting year of the foreign company is from 1 July 2015 to 30 June 2016 it turns resident of India in the financial year 2017-18.</p> <p><i>The period from 1 July 2016 to 31 March 2017 (9-month period) shall be treated as a separate accounting year.</i></p>
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Other important points:

- Where more than one provisions relating to withholding under Chapter XVII-B of the Act apply to the foreign company as a resident as well as a foreign company, the provisions applicable to the foreign company will apply. In other words, if royalty is paid to a foreign company which is treated as a resident in India, withholding will apply under section 195 and not section 194J (which would also get triggered since the payment is to a person resident in India).
- The provisions contained under section 195(2) of the Act shall apply in such manner as to include payment to a foreign company resident in India.
- Once a foreign company is held to be a resident in India on account of having its PoEM in India, it shall be entitled to relief or deduction of taxes paid in accordance with the provisions of Section 90 or Section 91 of the Act.
- 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 rate of tax in case of a foreign company having its POEM in India shall continue to be the rate of income-tax applicable to the foreign company; even though residency status of the foreign company changes from non-resident to resident.
- It is provided that all transactions of the foreign company with any other person or entity under the Act shall not be altered only on the ground that such foreign company is treated as a resident on account of its POEM being in India. This suggests that transfer pricing provisions may continue to apply even if a foreign associated enterprise is considered resident in India under POEM.



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