NOTIFICATION ON PLACE OF EFFECTIVE MANAGEMENT (POEM)
Notification no 29/2018 dated 22nd June 2018

INTRODUCTION TO THE CONCEPT OF 'POEM'

The tests for determining whether a foreign company (**FCO**) is resident in India or not, have changed from "entire control and management being in India" to "its place of effective management" (**POEM**) during a given year being in India" w.e.f. assessment year (**AY**) 2017-18. Section 6(3) of the Income tax Act (**ITA**) provides that POEM *"means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made".* Circular Nos. 6/2017 and 8/2017 provide detailed guidelines for determination of POEM in India.

Section 115JH was inserted in ITA empowering the Central Government to lay down the exceptions, modifications and adaptations to ITA which shall apply to the POEM-resident FCO. Accordingly, CBDT has come out with a Notification No. 29/2018 dated 22nd June 2018 which is effective from April 1, 2017, i.e., in line with the applicability of POEM provisions.

SYNOPSIS OF NOTIFICATION NO 29/2018

Let's understand the notification with the help of an example. Say, a foreign company (**FCO**) is incorporated in Singapore and is a tax resident of that country. FCO becomes a POEM resident in India for FY 2018-19.

The Notification provides for:

1. Applicable tax rate:
   The Notification states that FCO, upon becoming a POEM-resident in India, shall be taxed at 40% - at the rate applicable to any other foreign company. FCO shall be entitled to relief from double taxation as per Double Taxation Avoidance Agreements or as per S. 91 of ITA where there is no such treaty.

2. Compliance with Chapter XVII-B for deduction of tax at source (**TDS**)

a. The Notification states that where more than one TDS provision applies to the FCO (as a resident as well as FCO) during FY 2018-19, during which it becomes a POEM-resident in India, the provision applicable to foreign companies alone shall apply.

b. Further, compliance to those provisions of Chapter XVII-B as are applicable to the foreign company prior to its becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter.

3. Determination of opening Written Down Value (**WDV**) for FY 2018-19:

The opening WDV of depreciable assets of FCO, i.e., WDV as on 1st April 2018 relevant for FY 2018-19, shall be determined as under:

Whether FCO is assessed to tax in Singapore	**Yes**		**No**
Whether depreciation is considered for taxability in Singapore	Yes	No	Not applicable
Then, opening WDV of FCO for FY 2018-19 shall be	WDV as on 1st April 2018 as per Singapore tax records	WDV as on 1st April 2018 assuming that depreciation is actually allowed	WDV as on 1st April 2018 as per FCO's books of account maintained as per Singaporean laws

4. Determination of brought forward losses and unabsorbed depreciation (**L&D**):

a. The value of L&D, as on 1st April 2018, shall be determined as under:

Whether FCO is assessed to tax in Singapore	Yes	No
Then, L&D of FCO as on 1st April 2018 shall be	L&D of FCO as on 1st April 2018 as per Singapore tax records	L&D of FCO as on 1st April 2018 as per FCO's books of account maintained as per Singaporean laws

b. Such L&D shall be allowed to be set-off and carried forward as per ITA for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year.

c. Further, such L&D shall be allowed to be set-off only against such incomes of FCO which have become chargeable to tax in India by virtue of FCO becoming a resident.

d. L&D of FCO should be re-aligned as per para 5 below where accounting years as per India and Singapore are different.

5. <u>Preparation of financial statements where accounting years are different:</u>

Different countries have different financial years eg. July to June or January to December. FCO is required to align its financial statements to suit the April to March financial year as per ITA. Accordingly, assuming that FY 2018-19 is the first year of FCO becoming a POEM-resident in India, FCO shall prepare financial statements for the following period:

a. If FCO follows July to June as its accounting year in Singapore, it shall be required to prepare financial statements for FY 2018-19 from 1st July 2017 to 31st March 2019 (9 + 12 months).

b. If FCO follows calendar year as its accounting year in Singapore, it shall be required to prepare financial statements for FY 2018-19 from 1st January 2018 to 31st March 2019 (3 + 12 months).

6. <u>Others</u>
   a. The provisions of S. 195(2) of ITA shall apply in such manner as to include payment to the foreign company.
   b. The fact that FCO becomes a POEM-resident in India shall not impact / alter:
      i. Taxability of such income of FCO which would have been chargeable to tax in India, even if the FCO had **not** become POEM-resident in India
      ii. any transaction of FCO with any other person or entity under the ITA

c. Paras E & F of the Notification provide that subject to the exceptions, modifications and adaptations laid out in the Notification, all provisions of ITA shall applicable to residents and foreign companies shall apply to FCO. However, in case there's a conflict between provisions applicable to a resident and to a foreign company, the latter shall prevail.

OPEN ISSUES

As per the Notification, the POEM-resident FCO is sought to be taxed at 40% on worldwide income, i.e., at rates applicable to a FCO, while complying with the detailed provisions applicable to a resident company which shall be gradually taxed at 25%. Though the notification provides the manner of calculation of WDV, L&D and re-alignment of the accounting year, there are many crucial issues left unanswered. To illustrate:

1. There is no mention about the applicability of transfer pricing provisions including detailed reporting and maintenance of documentation.

2. There is no specific relief from the compliance provisions like advance tax, tax audit, Minimum Alternate Tax (**MAT**) u/s 115JB etc.

3. Also, the Notification does not mention about interest and penalty in cases where POEM is determined in India during assessment.

CONCLUSION

The Notification, which is worded too vaguely *sans* the vital elements of taxation of a POEM-resident FCO, has shifted the onus of determination of taxability of such FCO in India from the Revenue to the foreign companies and their tax advisors.

Though small foreign companies (having turnover or gross receipts less than or equal to Rs. 50 crores) are exempted from the concept of POEM based residence, other POEM-resident foreign companies can avoid the wrath of POEM regulations through the Advance Ruling mechanism and appropriate tax planning.