SUPPLEMENTARY

STATUTORY UPDATES

PAPER - 7 [DIRECT TAXATION] [INTERMEDIATE]
AND
PAPER - 16 [DIRECT TAX LAWS AND INTERNATIONAL TAXATION] [FINAL]

Clarification related to guidelines for establishing 'Place of Effective Management' (PoEM) in India [Circular 25/2017 dated 23-10-2017]

The concept of "Place of Effective Management" (POEM) for deciding residency status of a company, other than an Indian company, was introduced in the Income-tax Act, 1961 which has become effective from 1st April, 2017, i.e. Assessment Year 2017-18 onwards.

Guiding Principles for determination of POEM of a company were issued on 24th January, 2017 vide Circular No. 06 of 2017. Further, vide Circular No. 08 of 2017 dated 23rd February, 2017, it has been clarified that the POEM provisions shall not apply to a company having turnover or gross receipts of ₹ 50 crore or less in a financial year.

The stakeholders have been raised concern that as per the extant guidelines, POEM may be triggered in cases of certain multinational companies with regional headquarter structure merely on the ground that certain employees having multi-country responsibility or oversight over the operations in other countries of the region are working from India, and consequently, their income from operations outside India may be taxed in India.

In this regard, it may be mentioned that Para 7 of the guidelines provides that the place of effective management in case of a company engaged in active business outside India (ABOI) shall be presumed to be outside India if the majority meetings of the board of directors (BOD) of the company are held outside India.

However, Para 7.1 of the guidelines provides that if on the basis of facts and circumstances it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person(s) resident in India, then the POEM shall be considered to be in India.

It has also been provided that for this purpose, merely because the BOD follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking Operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BOD of companies standing aside.

In view of the above, it is clarified that so long as the Regional Headquarter Operates for subsidiaries/ group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of Pay roll functions, Accounting, HR functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; it would, in itself, not constitute a case of BoD of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of PoEM for such subsidiaries/ group companies.

It is further clarified that the provisions of General Anti-Avoidance Rule contained in Chapter X-A of the Income-tax Act, 1961 may get triggered in such cases where the above clarification is found to be used for abusive/ aggressive tax planning.

Clarification on applicability of section 9(1)(i) relating to indirect transfer in case of redemption of share or interest outside India [Circular No. 28/2017, dated 07-11-2017]

As per sec. 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India or through the transfer of a capital asset situate in India, shall be deemed to accrue or arise in India.

Explanation 5 to section 9(1)(i) provides that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Concerns were raised by investment funds, including private equity funds and venture capital funds that on account of the extant indirect transfer provisions in the Act, non-resident investment funds investing in India, which are set up as multi-tier investment structures, suffer multiple taxation of the same income at the time of subsequent redemption or buyback. Such taxability arises firstly at the level of the fund in India on its short term capital gain / business income and then at every upper level of investment in the fund chain on subsequent redemption or buyback.

Vide Finance Act, 2017, Category I and Category II FPIs have already been exempted from indirect transfer provisions of the Act through insertion of proviso to Explanation 5 to section 9(1)(i) of the Act, with effect from 01.04.2015.

There could be situations in multi-tiered investment structures, where interest or share held indirectly by a non-resident in an Investment Fund or a Venture Capital Company or a Venture Capital Fund (hereinafter referred to as 'specified funds'), is redeemed in an upstream entity outside India in consequence of transfer of shares or securities held in India by the specified funds, the income of which have been subject to tax in India. In such cases, application of indirect transfer provisions on redemption of share or interest in the upstream entity may lead to multiple taxation of the same income. In respect of Category I and Category II FPIs though, such multiple taxation will not take place on account of the insertion of proviso to Explanation 5 to section 9(1)(i) of the Act, vide Finance Act, 2017.

The CBDT has received representations to exclude investors above the level of the direct investor who is already chargeable to tax in India on such income from the ambit of indirect transfer provisions of the Act.

In order to address this concern, the CBDT has clarified that the provisions of section 9(1)(i) read with Explanation 5, shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds (namely, investment funds, venture capital company and venture capital funds) if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India.

However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

Maximum exemption limit in case of gratuity

In case of gratuity received at the time of termination of service by an employee being covered by the Payment of Gratuity Act, minimum of the following is exempt from tax u/s 10(10)(ii):

1. Actual Gratuity received;
2. ₹ 10,00,000; or
3. $^{15}/_{26}$ x Completed year of service x Salary p.m.

The maximum limit for gratuity notified under the Payment of Gratuity Act, 1972 has been increased from ₹ 10 lakh to ₹ 20 lakh with effect from 29.3.2018.

Clarification on Cash sale of agricultural produce by cultivators / agriculturist [Circular No. 27/2017, dated 03-11-2017]

The provisions of sec. 40A(3) provide for the disallowance of expenditure exceeding ₹ 10,000 made otherwise than by an account payee cheque/draft or use of electronic clearing system through a bank account. However, Rule 6DD carves out certain exceptions from application of the provisions of section 40A(3) in some specific cases and circumstances, which *inter alia*, include payments made for purchase of agricultural produce to the cultivators of such produce. Therefore, no disallowance under section 40A(3) can be made if the trader makes cash purchases of agricultural produce from the cultivator.

Further, section 269ST, subject to certain exceptions, prohibits receipt of ₹ 2 lakh or more, otherwise than by an account payee cheque/draft or by use of electronic clearing system through a bank account from a person in a day or in respect of a single transaction or in respect of transactions relating to an event or occasion from a person. Therefore, any cash sale of an amount of ₹ 2 lakh or more by a cultivator of agricultural produce is prohibited under section 269ST.

Furthermore, the provisions relating to quoting of PAN or furnishing of Form No. 60 under Rule 114B do not apply to the sale transaction of ₹ 2 lakh or less.
In view of the above, it is clarified that cash sale of the agricultural produce by its cultivator to the trader for an amount less than ₹ 2 lakh will **not** -

a) result in any disallowance of expenditure under section 40A(3) in the case of trader.
b) attract prohibition under section 269ST in the case of the cultivator; and
c) require the cultivator to quote his PAN/ or furnish Form No. 60.

Long-term specified asset notified for the purpose of claiming exemption u/s 54EC

Section 54EC provides exemption from capital gain from the transfer of a long-term capital assets where the assessee has invested the whole or any part of the capital gain in a long-term specified asset. As per clause (ba) of *Explanation* to section 54EC "long term specified asset" means any bond redeemable after three years and issued on or after 01.04.07 by the National Highways Authority of India (NHAI) or by the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf.

The Central Government has further notified that any bond redeemable after three years and issued by the **Power Finance Corporation Limited** on or after 15.06.17 or by the **Indian Railway Finance Corporation Limited** on or after 08.08.17 as 'long-term specified asset'.

Further, no tax shall be deducted on interest payable on aforesaid bonds u/s 193.

Contributory Health Service Scheme notified for the purpose of section 80D [Notification No. 9 / 2018 dated 16-2-2018]

Under section 80D, a deduction to the extent of ₹ 25,000 (₹ 30,000, in case of resident senior citizens) is allowed in respect of premium paid to effect or keep in force an insurance on the health of self, spouse and dependent children or any contribution made to the Central Government Health Scheme or such other health scheme as may be notified by the Central Government.

Accordingly, the Central Government has notified the Contributory Health Service Scheme of the Department of Atomic Energy, contribution to which would qualify for deduction under section 80D.

Amendments to the Tax Return Preparer Scheme, 2006 as notified u/s 139B [Notification No. 4/2018, dated 19-01-2018]

Section 139B provides that for the purpose of enabling any specified class or classes of persons in preparing and furnishing returns of income, the CBDT may, without prejudice to the provisions of section 139, frame a Scheme, by notification in the Official Gazette, providing that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

As per scheme, any individual who hold a graduation degree from a recognized Indian University in the fields of Business Administration or Management or Commerce or Economics or Law or Mathematics or Statistics shall be eligible to act as Tax Return Preparer.

As per amended scheme, an individual, who holds a bachelor degree from a recognised Indian University or institution, or has passed the intermediate level examination conducted by the Institute of Chartered Accountants of India or the Institute of Company Secretaries of India or the Institute of Cost Accountants of India, shall be eligible to act as Tax Return Preparer.

Other amendment to the scheme were also made vide this notification.

Exception, Modification and Adaptation for Taxation of Foreign Companies as Resident in India based on POEM u/s 115JH [Notification No. 29/2018 dated 22/06/2018]

In a case where a foreign company is said to be resident in India on account of its Place of Effective Management (hereinafter referred to as PoEM) being in India u/s 6(3) of the Act in any previous year and such foreign company has not been resident in India in any of the previous years preceding the said previous year, then, notwithstanding anything contained in the Act, the provisions of the 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 special provisions relating to avoidance of tax shall apply to the foreign company for the said previous year with exceptions, modifications and adaptations specified here under:

(i) If the foreign company is assessed to tax in the foreign jurisdiction, and,—
   - (a) where it is required to take into account depreciation for the purpose of computation of its taxable income, the written down value (hereinafter referred to as 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 said previous year,
   - (b) in cases not covered by (a), the WDV shall be calculated in the manner, as though the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction and the WDV so arrived at as on the 1st day of the previous year, shall be adopted to be the opening WDV for the said previous year.

(ii) If the foreign company is not assessed to tax in the foreign jurisdiction, then WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.

(iii) If the foreign company is assessed to tax in the foreign jurisdiction, its brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year.

(iv) If the foreign company is not assessed to tax in the foreign jurisdiction, its brought forward loss and unabsorbed depreciation as per the books of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year.

(v) The brought forward loss and unabsorbed depreciation of the foreign company as arrived at paras (iii) or (iv), as the case may be, shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year.

Provided that the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which have become chargeable to tax in India on account of it becoming Indian resident.

(vi) In cases where the brought forward loss and unabsorbed depreciation referred to in para (iii) or (iv), as the case may be, originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward as referred to in para (v).

(vii) In cases where the accounting year does not end on 31st March, the foreign company shall be required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has become resident. The foreign company shall also be required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its PoEM.

(viii) For the purpose of carry forward of loss and unabsorbed depreciation in cases where the accounting year followed by the foreign company does not end on 31st March and the period starting from the date on which immediately following year begins upto 31st March of the year, immediately preceding the period beginning with 1st April and ending on 31st March during which it has become resident, is,—

(a) less than six months, it shall be included in that accounting year;

(b) equal to or more than six months, that period shall be treated as a separate accounting year.

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

(ix) In cases covered under para (viii), loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.

(x) Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply.

(xi) Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to its becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter.

(xii) The provisions contained in sub-section (2) of section 195 of the Act shall apply in such manner so as to include payment to the foreign company.

(xiii) The foreign company shall be entitled to relief or deduction of taxes paid in accordance with the provisions of section 90 or section 91 of the Act.

(xiv) In a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income-tax Rules, 1962.

Explanation. — For the purposes of this notification,—

(i) the term “Foreign jurisdiction” would mean the place of incorporation of the foreign company.

(ii) 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.

B. the exceptions, modifications and adaptations referred to in para A shall not apply in respect of such income of the foreign company becoming Indian resident on account of its PoEM being in India which would have been chargeable to tax in India, even if the foreign company had not become Indian resident.

C. in a case where the foreign company is said to be resident in India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations referred to in para A shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.

D. any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident.

E. 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 and all the provisions of the Act shall apply accordingly. Consequently, the provisions specifically applicable to,—
   (i) a foreign company, shall continue to apply to it;
   (ii) non-resident persons, shall not apply to it; and
   (iii) the provisions specifically applicable to resident, shall apply to it.

F. in case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail. Therefore, the rate of tax in case of 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.

   This notification shall be deemed to have come into force from the 1st day of April, 2017.

Relaxation for Start-ups on Issue of Shares at Price exceeding their FMV [Notification No. 24/2018 dated 24/05/2018]

As per provision of sec. 56(2)(viib), where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be treated as income of the company

It is notified that the provisions of sec. 56(2)(viib) of the Act shall not apply to consideration received by a company for issue of shares that exceeds the face value of such shares, if the consideration has been received for issue of shares from an investor in accordance with the approval granted by the Inter-Ministerial Board of Certification in respect of start ups having capital upto specified limit.

Relaxation in the provisions relating to levy of Minimum Alternate Tax (MAT) in case of companies against whom an application for corporate insolvency resolution process has been admitted under the Insolvency and Bankruptcy Code, 2016 [Press Release dated 06/01/2018]

The existing provisions of section 115JB of the Income-tax Act, 1961 ('the Act'), inter alia, provide, that, for the purposes of levy of Minimum Alternate Tax (MAT) in case of a company, the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account shall be reduced from the book profit.

In this regard, representations have been received from various stakeholders that the companies against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016 ('the IBC'), are facing hardship due to restriction in allowance of brought forward loss for computation of book profit under section 115JB of the Act.

With a view to minimize the genuine hardship faced by such companies, it has been decided, that, with effect from Assessment Year 2018-19 (i.e. Financial Year 2017-18), in case of a company, against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the IBC, the amount of total loss brought forward (including unabsorbed depreciation) shall be allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB of the Act.