In 2016, the Indian Government introduced the “place of effective management” (POEM) regime for determining the residential status of foreign companies incorporated in foreign jurisdictions. POEM provisions have replaced the conventional methodology of determining residency based on control and management of the company. Previously, a foreign company was considered as resident in India only if its control and management were “wholly” situated in India during a given year. Now, however, as per the amended provisions, a foreign company is resident in India if its POEM is in India. Further, the POEM is defined as “the place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.”

In January 2017, the Indian Central Board for Direct Taxes (Indian IRS) issued its final guidelines for determining the place of effective management (POEM) for residence of companies under Section 6 of the Income Tax Act, which is applicable from financial year 2016-17 onwards. The Indian IRS clarified that the intent is not to target Indian multinationals that are engaged in business activities outside India, but to target shell companies and companies that are created for retaining income outside India even though real control and management of affairs are located in India. Further, it has been clarified that the POEM guidelines shall not apply to companies having turnover or gross receipts of INR 500 million or less in a financial year.

In addition, the Indian Budget 2016 inserted Chapter XII-BC (consisting of Section 115H) in the Indian Income Tax Act 1961 to introduce special provisions in relation to computation of income of such resident foreign companies by way of a notification.

A few days ago, the Indian IRS issued a draft notification under Section 115JH, specifying tax consequences in respect of a foreign company said to be resident on account of its POEM in India. The key takeaways from the draft notification are as follows:

- The draft guidelines state that the rate of tax in the case of foreign companies shall remain the same post POEM application (i.e. 40% plus applicable surcharge and cess, as against 30% applicable to domestic companies);
- In cases in which the accounting year of a foreign company does not end on 31 March, it is proposed that the foreign company shall be required to prepare a P&L 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;
- Where more than one provision of Chapter XVII-B regarding withholding of tax is applicable to the foreign company as “resident” as well as “foreign company”, it is proposed that the provisions applicable to the foreign company shall apply;
Indian IRS begins consultation on tax consequences of new residence rules for foreign companies

The draft notification proposes to allow a foreign tax credit under Section 90/91 of the Indian Income Tax Act; and

It is proposed that Section 195(2) (relating to an application to the tax officer for a lower withholding tax rate) shall apply in such manner so as to include payment to the foreign company.

The notification, once finalized, would be effective from 1 April 2017.