Research Paper Law

Redefining Tax Residence of Companies

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ABSTRACT

: Regarding tax, the major aspect that counts is where one inhabits – "the residency". The residential status of a company essentially determines the taxability of a company's income in India. For a company, which is a resident of India, the whole lot of income that is earned by it becomes taxable whereas a non-resident company only pays taxes for its income sourced in India. Hence, in order to evaluate the taxability on income, determining the residential status of a company is of the utmost significant. The paper will evaluate the significant changes that are brought about in the Finance Bill widening the scope of residency to a great extent.

KEYWORDS | Tax, Residency, Finance Bill

Regarding tax, the only thing that counts is where one inhabits – "the residency". The residential status of a company essentially determines the taxability of a company's income in India. For a company which is a resident of India, the whole lot of income that is earned by it becomes taxable whereas a non-resident company only pays taxes for its income sourced in India. Hence, in order to evaluate the taxability on income, determining the residential status of a company is of the utmost significant.

In the process of determining the tax residency of a company under the Indian Laws of Taxation, the incorporation of a company in India, which makes it a de facto tax, resident of India, has remained constant. The evolution of the test of residency has seen various discussions over the second criterion, i.e. the control and management of the affairs of the company should be wholly situated in India. Many foreign companies have conveniently manipulated the idea of the control and management being situated in India 'wholly' by simply holding a board meeting outside India. Hence, this benefit of having the 'whole' of control and management to be situated in India for the 'entire' financial year was deliberated to scrap out by the proposed Direct Taxes Code ('DTC'), 2009.

The abovementioned code provided the control and management to be wholly or partly situated in India 'at any time' of the year. This proposition touched base as a bedlam for the remote companies setting off a series of changes prompting a misfortune for the foreign companies. The proposal of the threshold of 'place of effective management ('POEM')' instead of Control and management added to their misery as it to mean decision-making by the board of directors. Carrying it forward to the DTC 2013, it brought the amendment keeping pace with the OECD Commentary holding POEM to mean a spot where key management and business decisions that are vital to carry out the company's business all in all, are, in substance, made, at last prompting the amendment in Finance Bill 2015 (FB2015).

The initially proposed amendment in FB 2015, to be made applicable from the tax year 2015-16, provided for a company to be a resident in India, if its "place of effective management, at any time in that year, is in India" (to be read with the above definition of POEM). This raised two important points of concern for international business — one, the term "key management and commercial decisions" is undefined under any law in India and hence it's subjective and arbitrary, two, the criterion "at any time," appears to run counter to for the most part the acknowledged rule of an overall central management – which now stands erased moving the focus to "that year".

Missing out the term "at any time" from the meaning of POEM now corresponds to the proposal by the OECD Model Convention which is additionally the assembly's aim as clarified in the Explanatory Memorandum. One should be careful that the OECD analysis does not allude to any particular period to focus POEM while the ITL now then again requires that POEM ought to be with reference to the Indian tax year. One may need to wait for the CBDT rules to be issued for pragmatic application on this viewpoint as it goes to recommend that the determination whether POEM of an element is in India ought to be seen from a complete tax year's point of view.

The personnel of all companies, today, have become increasingly mobile and coupled with the advancement in technology and connectivity, there seems to be a potential risk by all travelling executives which could create significant unforeseen tax burdens in India. Hence, considering holding board meetings anywhere in the world and directors attending the same via video conferencing, the active participation of directors in decision making in "substance" may or may not amount to decisions being made in India and will fiddle with the tax burdens in India.

In light of the above test, once there is a trigger of tax residency in India for a foreign company, the outcomes could be noteworthy! Being dealt with as a resident company, the company will be obligated to tax in India on its overall global income, which was generally at risk to tax on Indian source pay as a non-resident company. In any case, it may in any case be viewed as a non-resident/foreign company (expecting the profit assertion and installment course of action is not made inside of India) and may be at risk to tax at forty percent, however profit paid by such company does not trigger profit circulation tax in its grasp in India. In spite of the fact that useful procurements of ITL to remote organizations, for example, lower withholding tax rate, concessional tax rate on capital increases and so on., proceed, there are unfavorable results, for example, pertinence of exchange estimating procurements, withholding tax suggestions (i.e. installment made to remote company u/s 195 versus installment to occupant u/s 194C/J/ and so on) and so on., could be a state of verbal confrontation. Treaty override procurements must be broken down in particular truths to figure out if the trigger of POEM under the ITL will offer route to an alternate criteria under Article 4 or equivalent in a Treaty.

The words' removal "at any time" decreases the meticulousness of POEM yet at the same time leaves space for understanding. It is however expected that the Government should concoct clearer rules which are more target in application.

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