

New budget definition of 'resident' status may lead to rise in litigation

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The government is open to selling more than 51% in certain public sector units as part of its "strategic sale". (AFP File Photo)

The budget has been widely hailed for making foreign companies and overseas investors happy. But, it is likely to increase litigations, especially with respect to the definition of 'resident of India' for offshore companies.

Till now, offshore companies have been treated as non-resident in India, unless they are wholly-controlled and managed from India. This has kept their income outside the purview of Indian tax authorities, unless distributed to an Indian resident shareholder. Even in cases where the offshore company is 100% owned by Indian residents, and has majority of Indian directors, the tax authorities were satisfied that there is no tax incidence, if board meetings are held outside the country.

In his budget speech, the finance minister Arun Jaitley proposed moving this qualification to a more subjective test of Place of Effective Management (POEM). The Finance Bill has suggested that a foreign company will be resident in India if its POEM is in India at any time in the relevant financial year. Under the Bill, POEM has been defined to mean "a 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".

“This is a retrograde provision, which has resulted in almost no litigation in last 65 years. Going back to old concepts would lead to enormous and infructuous litigation for Indian corporates globalising themselves, as well as structures set up for legitimate personal wealth and succession planning as well as carried interest purposes. Double taxation issues will arise and tax credits may not also be available,” said Nishith Desai, founder of Nishith Desai Associates.

This would apply in various cases, which are representative of many Indian business groups also. If an offshore company has 100% Indian resident shareholders and majority of Indian directors and one director offshore, the company could now be considered Indian resident, which would then lead to the profits of the offshore company to be taxable in India.

“The intention of the government could be honest. But the move will fuel litigations and disputes over the interpretations,” said Milind Kothari, managing partner and head direct tax, BDO India LLP.