Residential Status of Individuals – Amendment to Sec 6 of the Income tax Act

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Current provisions relating to Residential status of Individuals and HUF:

Apropos to the provisions of Section 6 of the Indian Income-tax Act, 1961 ('the Act'), an individual is said to be a resident in India in a previous year if he fulfills any one of the following two basic conditions:

i. He is in India in that previous year for a period or periods amounting in all to 182 days or more; or

ii. He is in India for a period or periods amounting in all to (a) 60 days or more during the previous year, and (b) 365 days or more during the 4 years preceding that previous year;

The above basic conditions for determining the residential status are relaxed for the benefit of Indian Citizens who go abroad for the purposes of employment or as member of the crew of an Indian Ship during any previous year and also for the benefit of an Indian citizen or Person of Indian Origin who has settled abroad but come to India on a visit, accordingly Explanation to Clause (1) of Section 6 provides that:

a) An individual, who is a citizen of India, leaving India in any previous year for employment outside India or as a member of the crew of an Indian ship, is considered as resident in India in that year only if he has been in India in that year for 182 days or more;

b) A citizen of India or a person of Indian origin (PIO) who is residing outside India and comes on a visit to India in any previous year is required to stay in India for 182 days for being treated as a resident in India.

As a result of these beneficial exceptions, it is only the first basic condition, i.e. staying in India for a period of 182 days or more, that applies to an Indian citizens or a PIO, who residing outside India, comes on a visit to India in any previous year and to an Indian citizen leaving India in any previous year for employment outside India or as a member of the crew of an Indian ship. The second basic condition under Section 6(1) has no relevant at all in these cases.

In the case of Individual and HUF, there is also a concept of 'not ordinarily resident' carved out by Clause (6) of Section 6 of the Act. In addition to fulfilling one of the above two basic conditions, if such individual or Karta of a HUF, as the case may be, satisfies any one or both of the following two conditions, such individual is treated as 'not ordinarily resident' in India:

a) he has been a non-resident in India in 9 out of the 10 preceding previous years;

b) he has been in India for a period not exceeding 729 days during the 7 preceding previous years;

It is only appropriate to mention at this juncture that the above test of 'not ordinary resident' of an individual or a HUF in India is vital for determining the scope of their total income chargeable to tax in India as provided in Section 5 of the Act. In the case of an individual or a HUF, not ordinarily resident in India, the income which accrues or arises to him outside India is not taxable in India unless it is derived from a business controlled in or a professional set up in India.

So far, the citizenship of a country, the nature of Visa granted, the purpose of the visit or place of stay, had no relevance for determining the residential status of an individual. A person may be a resident of more than one country simultaneously for tax purposes. What had to be seen is only the number of days of stay in India.

The Hon'ble Kerala High Court in the case of CIT Vs Abdul Razaq 337 ITR 267 held that *even taking up its own business by the individual abroad satisfies the condition of 'going abroad for employment' and therefore the individual was entitled to claim his status to be non-resident for the relevant period.*

This provision and the above-mentioned decision of the Hon'ble Kerala High Court were abused by many Indian Citizens and PIO by arranging the number of days of stay in India and other countries in such a way that he is neither resident of India nor of any other Country. Thus, becoming a stateless actor for tax purposes.

Many of them also became residents of no-tax jurisdictions like Bermuda, Monaco, Bahamas, Andorra, UAE, etc. and they continued to manage their 'non-resident' status in India by staying in India for less than 182 days, although carrying out their substantial economic activities from India.

Amendments as proposed in the Finance Bill 2020:

The Finance Bill, 2020, proposed that the beneficial exception pertaining to the number of days of stay in India for a visit by an Indian Citizen or a PIO specified in clause (b) of Explanation 1 to Section 6(1) of the Act, be decreased to 120 days from the existing 182 days. This amendment was aimed to counter the arrangements of individuals who carry out substantial economic activities from India but manage their period of stay in India to less than 182 days and thereby, remain a non-resident.

It may be noted that this change was proposed only in clause (b) of Explanation 1 which deals with an individual, residing outside India, who comes to India for a visit in the previous year. The period prescribed for an individual leaving India in any previous year for employment outside India or as a member of the crew of an Indian ship has not been proposed to be changed.

Another amendment that was proposed to Section 6 of the Act, which created an all across panic among the Indian expatriates working in no tax jurisdiction, was the introduction of deemed residency concept for the very first time in the Indian tax law by way of insertion of a new Clause (1A).

It was proposed that an Indian Citizen would be deemed to be a resident in India in any previous year if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

To ensure that these newly become residents of India are not suddenly burdened with taxation and compliance requirements, the existing beneficial provisions relating to 'not ordinarily resident' of India was proposed to be further relaxed to the effect that an individual, who becomes resident or deemed resident by virtue of above-proposed amendments, would be considered as 'not ordinarily resident' of India if such individual has been a non-resident in India in any 7 out of 10 preceding previous years. Resultingly, they would not chargeable to tax in India with respect to their foreign-sourced income so long they hold on to their status of 'not ordinarily resident' in India. They would also not be required to disclose their foreign assets to the Indian tax authorities.

Amendment in the Finance Act 2020:

The Finance Act, 2020 in line with the Finance Bill, 2020 has amended the Clause (b) of Explanation 1 to Section 6(1) of the Act to provide that an Indian citizen or a PIO, who comes to India on a visit in any previous year will be considered to be a resident in India if his total period of stay in India in the previous year exceeds 119 days as against the earlier applicable period of 181 days. However, this amendment is made applicable only for individuals, whose total income in the previous year, other than income from foreign sources, exceeds INR 15 Lakh. Other individuals will continue to be regulated by the existing provision.

However, the Finance Act, 2020 provides a corresponding relief to such individuals, who will be affected by the above amendment, vide insertion of a new sub-clause (c) to Clause (6) of Section 6(1) of the Act wherein these individuals will be considered as 'not ordinarily resident' of India if their total period of stay in India during such previous year does not exceed 181 days.

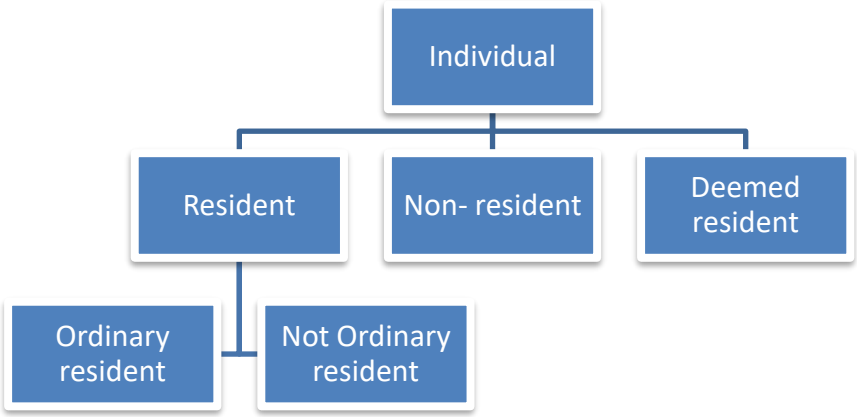
Another amendment vide the Finance Act, 2020 to the provisions of Section 6 of the Act is the insertion of a new Clause (1A) provides that an individual, being a citizen of India shall be deemed to be a resident in India in that previous year if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. The amendment is also made appliable only for individuals, whose total income in the previous year, other than income from foreign sources, exceeds INR 15 Lakh.

In such cases also the Finance Act, 2020 has provided a corresponding respite by insertion of a new sub-clause (d) to Clause (6) of Section 6(1) of the Act to provide the much needed relief that these deemed residents will be considered only as a 'not ordinarily resident' in India.

The term 'income from foreign source' is defined to mean income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

Other proposed amendment to Clause (6) to Section 6(1) have been omitted.

The provisions of Residential status after the amendment may be summarised as below



Issues:

Is the intention of the legislature served?

On February 1, 2020, the Hon'ble Finance Minister presented the Finance Bill, 2020 before the Parliament. It, *inter alia*, contained proposals to amend the provisions of Section 6 of the Act by reducing the period of stay for an Indian Citizen or POI to become a resident of India and by introducing the concept of deemed residency of Indian citizens.

These proposals created complete havoc and raised many eyebrows among High Networth Individuals. It also created a genuine fear for Indians working in countries such as the UAE, which do not levy income-tax, that they will be deemed as residents of India.

The Government immediately issued a press release stating that the new provision is not intended to include in tax net those Indian citizens who are bonafide workers in other countries.

In conformity with the press release, these amendments proposed in the Finance Bill, 2020 have been modified to ensure that the individuals who are treated as residents of India due to the above amendments are not chargeable to tax in India with respect of their foreign incomes. Further, these amendments have been made applicable only to those individuals whose total income, other than the income from foreign sources exceeds INR 15 Lakh during the tax year.

Though the modifications to the Finance Bill, 2020 have been a huge relief to all the Indians living abroad, the question that remains is whether, in the sway of pleasing the sentiments of the Non-Resident Indians, the amendments have lost its original intention. If one reads into

the memorandum to the Finance Bill, 2020 the answer, unfortunately, appears to be in affirmative.

The memorandum discusses the issue of stateless persons and admits that an individual can arrange his affairs in such a fashion that he is not liable to tax in any country or jurisdiction during a year. It also concedes that current rules governing tax residence make it possible for HNWIs and other individuals, who may be an Indian citizen to not to be liable for tax anywhere in the world. It describes that such a circumstance is certainly not desirable, particularly in the light of current development in the global tax environment where avenues for double non-taxation are being systematically closed.

Despite making their intentions very clear that it wishes to tighten the screws on those seeking to escape taxation in India by exploiting their non-resident status, the modifications made to the proposals of the Finance Bill, 2020 are unfortunately not in that direction. The modifications only ensure that these individuals will be chargeable to tax in India only concerning their Indian income and not on their foreign income. Also, they will not be required to disclose their foreign assets. Interestingly, non-residents have always been taxed in India on their Indian sourced income and thus, the amendments made by the Finance Act, 2020 does not seem to be much effective.

The concept of deemed residency is, however, not new to the taxation world. Countries like Canada also have deemed residency provisions which tax the resident on its worldwide rather than the locally sourced income as applicable in the deemed residency provisions introduced in India.

Domestic tax provisions vs. Tax Treaties

By bringing the concept of deemed residency in the Indian Income-tax Act, the Government of India has undoubtedly made its intention clear that it will not allow its citizens to artificially arrange their domicile in such a way that they are not liable to income tax in any of the countries. The introduction of deemed residency will discourage such practices, which are often adopted by High Net Worth Individuals. Yet, one cannot ignore that when it comes to intercountry arrangements, any amendments in the domestic tax law, which does not concur with the Double Taxation Avoidance Agreements ('DTAA'), is not adequate unless a corresponding change is also made in the latter, which is a bilateral agreement between two

Governments can not be changed unilaterally. Section 90(2) of the Act is very clear on it that whenever provisions of Income Tax Act and DTAA differ, DTAA will prevail, to the extent it is more beneficial to the assessee.

The criteria for determining the residential status of a person is laid out explicitly in each DTAAs. In most of the case, it refers to the domestic tax law of the respective contracting states. However, the DTAAs also contains the provision, which is commonly called as 'tie breaker rule'. This applies when a person is a resident of both the contracting states as per the domestic tax law of each country or as per the provisions of the DTAA.

Thus, let us take a situation where Mr. A, who is a Non-resident Indian Citizen staying in UAE, is considered to be a deemed resident of India since he is not liable to tax in UAE because of his domicile or residence or any other criteria of similar nature. In such cases, Mr. A would be eligible to invoke the tie-breaker rule provided in the India – UAE DTAA and can claim himself to be a resident of only UAE, thereby side-stepping the provision relating to deemed residency under the domestic tax law of India.

Implications of MLI Provisions

It is pertinent to note that the Government of India has signed and ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, as a result, MLI has entered into force for India on October 1, 2019 and its provisions will be applicable on India's DTAAs from FY 2020-21 onwards, subject to matching.

The MLI is an outcome of the G20-OECD project to tackle Base Erosion and Profit Shifting (the BEPS Project), i.e. innovative tax planning strategies to shift profits thus eroding the tax base of high-tax jurisdictions.

The Finance Act, 2020 has amended the provision of Section 90 of the Act, in accordance with Article 6 of the MLI, to empower the Central Government to enter into agreements with governments of other countries to give effect to MLI for the avoidance of double taxation of income but without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty-shopping arrangements aimed at obtaining reliefs for the indirect benefit of residents of any other country or territory.

This amendment will enable the Tax Authorities to deny the benefit of a tie-breaker rule prescribed under the DTAAs and tax a person based on his residential status determined in accordance with the Indian domestic tax laws.

Residential status vis-à-vis General Anti Avoidance Rules (GAAR)

GAAR targets tax avoidance. It is applicable if the tax benefit exceeds Rs. 3 crore. Sec 95(1) empowers Revenue to declare an 'arrangement' entered into by an assessee to be an Impermissible Avoidance Agreement (IAA) if its main objective is to obtain tax benefit and occurrence of one or more of the four tainted elements entailed in Section 96 of the Act. Sec 98 of the Act provides for the Consequences of IAA accordingly, the Tax Authorities, *inter alia*, can treat the place of residence of an individual to the arrangement at a place other than the place of residence thus denying tax benefit under a tax treaty. If the HNWI arranges his residential status to get a tax benefit, the Revenue can disregard his non-resident residential status and treat India as his place of residence, apply domestic tax laws, tax his global income to tax in India.

Total Income

A deemed resident of India under section 6(1A) of the Act will be taxed in India on its 'total income', other than the income from foreign sources. The scope of total income is defined under Section 5 of the Act and is computed in accordance with provisions of the Act including the provision of Section 90. Thus, the provisions of the respective DTAAs will also play its role in determining the total income of such deemed residents, taxable in India.

Applicability of the amendments to HUFs

It is pertinent to note that the provisions relating to restricting the period of visit for Indian Citizens and a PIO to maintain their 'non-resident' status from 181 days to 119 days and the concept of deemed residency do not extend to HUFs. Therefore, a Karta of a HUF, even though is treated as a resident or deemed resident of India under the Act, such HUF cannot be held to a resident or deemed-resident of India. The existing provision relating to the determination of the residential status of HUFs as elucidated in Clause (2) to Section 6 of the Act remains unaffected.

The burden of tax and compliance

Some of the tax provisions under the Indian tax law viz. tax deduction at source, tax collection at source, etc. apply differently for a resident and a non-resident. Arguably, a resident in India is obligated to comply with more number of compliances and requirements under the Act as compared to a non-resident. Thus, it would remain to be seen if any of the requirement is relaxed for such newly become resident or deemed resident Indians under the amended tax law.

Residential status vis-a vis COVID 19

Coronavirus has turned to be a global issue, which has brought the world economy to a standstill. As countries globally began enforcing strict lockdowns to prevent the spread of the coronavirus, India, the world's second-most populous country, followed the suit. The lockdown includes banning international flights. The lockdown is from Mar 22 to Apr 14.

Due to the lockdown, a situation may arise where an individual temporarily away from home country and gets stranded in the host country and attains tax residency in the host country. If the individual is foreigners or Indian Citizens or PIOs, who had come to India for a temporary visit and have got stranded here, would become a resident of India if their period of stay in India exceeds the threshold period of 59 days or 181 days, as the case may be during the previous year 2019-20.

Going by the bare provisions of the Indian Income-tax Act, unfortunately, they will become residents of India under the provisions of Indian domestic tax law as it does not provide any scope for 'involuntary stay' in India. It works purely on the period of stay of such individuals in India, and so is the case in many other countries in the world.

Tax Authorities in the UK and Australia have guided in this regard. They have provided that the days spent in their respective countries due to exceptional circumstances will be disregarded to determine the tax residency. The OECD Secretariat **Analysis of Tax Treatise and the Impact of COVID – 19 Crisis in** para 33 and 34 provides that if an individual becomes a resident of both the host as well as the home country because of COVID 19 situation the tie-breaker rule in Article 4 to be applied. It seems likely that the tie-breaker test would mostly award treaty residency to the home country. This is because it is probably unlikely that the person would have a permanent home available to him in the host country. But if he did he would be treated as treaty resident of the host country. Where a person has a permanent

home in both the countries, it seems likely that the other tie-breaker tests (center of vital interest, place of habitual abode, and nationality) would award residence to the home country.

The Government of India over the last few days has come out with various measures to provide tax relief in response to the pandemic, viz postponement income tax return filing due date for the FY 2018-19, or waiver of late filing penalties or reduced rate of interest on late payment of tax, etc and it is time that the Government comes out with a clarification addressing this issue of tax residency.

The word 'involuntary stay' is not new to the Indian tax judicial system. It was discussed last by the Hon'ble Delhi High Court in the case of Suresh Nanda reported in [2015] 57 taxmann.com 448 wherein the Court held that "w*e must, however, add a caveat here. The conclusion reached by us on the facts and in the circumstances of the case at hand cannot be treated as a thumb rule to the effect that each period of involuntary stay must invariably be excluded from computation for purposes of Section 6(1)(a) of Income Tax Act……For purposes of Section 6(1)(a), each case will have to be examined on its own merits in the light of facts and circumstances leading to "involuntary" stay, if any, in India. Another factor that needs to be born in mind that in this case, it was "wrongful impounding" of passport leading to involuntary stay and this aspect may be distinguished. In light of the above, one needs to be very cautious before relying on this Judgement."*

The above judgment of the High Court excludes the period of involuntary stay for determining the residential status of an individual. Where it is true that the above judgment may not impulsively be applied in all cases relating to the determination of the residential status of an individual, it shall certainly be useful in the current exceptional circumstances.

Until the Government comes out with a clarification in this regard, the affected individuals may petition to the CBDT under sec 119(2)(b) of the Income-tax Act wherein the board may for avoiding genuine hardship, in any case, or class of cases, provide relief under this Act

Conclusion:

While the above amendments will play a role in preventing tax abuse by Indian Citizens and PIOs, it has most certainly missed out its intention. Yet, the Indian Citizens and PIOs staying outside India do need to take note of the above amendments for planning their visit to India

from April 1, 2020. They are becoming a resident or a deemed resident of India, though 'not ordinarily', may result in them adhering to numerous compliance requirements under the domestic tax laws of India.