



NRI - INTERPLAY OF TAX AND FEMA ISSUES - RESIDENCE OF INDIVIDUALS UNDER THE INCOME-TAX ACT

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Editorial Note: This article starts a series of articles on Income-tax and FEMA issues related to NRIs with a focus on the interplay thereof. Apart from a residential status definition under both Income-tax and FEMA, the series of articles will cover issues under both laws related to change of residence; investments, gifts and loans by NRIs; as well as transfers by them from India.

1. PRELIMINARY

Countries exercise their sovereign right to tax based on whether the income arises in their country or whether a person has a close connection with that country. The taxation laws define that close connection — an extended period during which the person stays in a country, or has his domicile there, or any similar criteria. Given a sufficient territorial connection between the person sought to be charged and the country seeking to tax him, income tax may properly extend to that person in respect of his foreign income.¹ The Income-tax Act, 1961 (the “Act”) imposes such comprehensive or full tax, on persons who are residents.

Section 5 of the Income-tax Act, 1961 (the “Act”) provides for the scope of total income for persons. The scope differs according to the residential status of the person. A non-resident's total income consists of income received or deemed to be received in India in a previous year or income accruing, or arising, or deemed to accrue or arise in India in a previous year.

In contrast, the scope of the total income of a resident in India includes, apart from the income covered within the scope for non-residents, income accruing or arising outside India during such year. In effect, a resident is taxable on his global income. At the same time, the total income of a resident but not ordinarily resident, as defined in section 6(6) of the Act, excludes income accruing or arising outside India unless it is derived from a business controlled in or a profession set up in India.

2. RESIDENTIAL STATUS

A person is said to be resident in India per the rules in section 6 of the Act. The residential status for (a)

individual, (b) company, (c) Hindu Undivided Family, firm or association of persons and (d) other persons is to be determined by different rules. The nationality aspect does not enter the determination of residential status under the Indian income-tax law.

A non-resident is a person who is not a resident [section 2(30)]. When a person may be said to be “not ordinarily resident” is provided in section 6(6). The residential status is to be determined for a previous year and applies to all income for that year that comes within the scope of total income applicable to the assessee. In other words, a person cannot be a resident for one part of the year and non-resident for the other part, as India does not recognise split residency. The effect of this provision is that a person's total income earned in a Financial Year is taxed basis his residential status in India, even if he may be resident of two countries due to his part stay in India. However, such a person can avail relief under a tax treaty by applying tie-breaking tests. It is not possible to have different residential status under the Act for different sources of income. Whether an assessee is a resident or non-resident is a question of fact.²

2.1 Tests for residence

There are two tests to determine if an individual is resident in India in any previous year. These tests are alternative and not cumulative.

According to the first test, an individual is said to be resident in India in any previous year if he is in India for a period or periods of 182 days or more [sec. 6(1)(a)]. The alternative test is an individual having within the four years preceding the previous year, been in India for a period or periods amounting in all to three hundred and

1 Wallace Bros. & Co Ltd vs. CIT (1948) 16 ITR 240 (PC).

2 Rai Bahadur Seth Teomal vs. CIT (1963) 48 ITR 170 (Cal).

sixty-five days or more, and is in India for a period or periods amounting in all to sixty days or more in that year [sec. 6(1)(c)].

Explanation 1 to section 6(1)(c) provides relaxation from the second test in some circumstances [discussed in paragraph 2.3 below].

2.2 Stay in India

The phrase “being in India” implies the individual’s physical presence in the country³ and nothing more. The intention and the purpose of his stay are irrelevant; the stay need not be in connection to earning income, which is sought to be taxed. Nor is it essential that he should stay at the same place. Stay may not be continuous: the individual’s presence in India must be aggregated to ascertain whether the threshold is crossed.

How the number of days shall be counted has been contested. In an Advance Ruling, it was held that even a part of the day would be construed as a full day, and even though for some hours on the day of arrival and departure, the applicant can be said to have been out of India, both the days will be reckoned for ascertaining 182 days.⁴ Contrarily, the Mumbai Tribunal, in this case,⁵ noted that the period or periods in section 6(1) requires counting of days from the date of arrival of the assessee in India to the date he leaves India. The Tribunal relied upon section 9 of the General Clauses Act, 1897, which provides that the first day in a series of days is to be excluded if the word ‘from’ is used and held that the words ‘from’ and ‘to’ are to be inevitably used for ascertaining the period though these words are not mentioned in the statute, and accordingly, the date of arrival is not to be counted.

2.2.1 Involuntary stay

Section 6 does not limit an individual’s freedom to arrange his physical presence in India such that he is not a resident in the previous year and his foreign income falls outside the Indian tax net. On the other hand, section 6 does not distinguish between a stay in India that is by choice and that is involuntary. However, the Delhi High Court held that, given that the Act provides a choice to be in India and be treated as a resident for taxation purposes, his presence in India against his will or without his consent should not ordinarily be counted. In that case, the assessee could not leave India as his passport was

impounded by a government agency. The Court held that the fact that the impounding was found to be illegal and, therefore, was in the nature of illegal restraint, the days the assessee spent in India involuntarily should not be counted. At the same time, the Court cautioned that the ruling cannot be treated as a thumb rule to exclude every case of involuntary stay for section 6(1), and the exclusion has to be fact-dependent.

A similar relaxation has been provided to individuals who had come to India on a visit before 22nd March, 2020, and their stay is extended involuntarily due to the circumstances arising out of the Covid-19 pandemic to determine their residential status under section 6 of the Act during the previous year 2019-20.⁶

Representations for a similar general relaxation for the previous year 2020-21, in relation to an extended stay in India by individuals due to travel restrictions during the Covid pandemic resulting in their residence under section 6(1) was denied by the CBDT, which stipulated examining on a case-by-case basis for any relief.⁷ According to that Circular, an individual with a forced stay in India would still have the benefit of applying treaty residence rules, which are more likely to determine residence in the other State. The Circular points out that even if an individual becomes a resident in the previous year 2020-21 due to his forced stay in the country, he will most likely become an ordinary resident in India and accordingly, his foreign source income shall not be taxable in India unless it is derived from a business controlled in India or a profession set up in India, so there would be no double taxation. The Circular states that if a person becomes a resident due to his forced stay during the previous year 2020-21, he would be entitled to credit for foreign taxes under rule 128 of the IT Rules, 1962.

2.2.2 Seafarers

Explanation 2 to section 6(1) and rule 126 were brought into the statute with effect from A.Y. 2015-16 to mitigate difficulty in determining the period of stay in India of an individual, being a citizen of India, who is a crew member on board a ship that spends some time in Indian territorial waters.

The provisions apply to an Indian citizen who is a member of the crew of a foreign-bound ship leaving India. The period of stay in India of such a person will exclude the

3 CIT vs. Avtar Singh Wadhwan (2001) 247 ITR 260 (Bom).

4 Advance Ruling in P. No. 7 of 1995, In re (1997) 223 ITR 462 (AAR).

5 Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang).

6 Circular No. 11 of 2020 dated 8th May, 2020.

7 Circular No. 2 of 2021 dated 3rd March, 2021.



period from the date of joining the ship to the date of signing off as per the Continuous Discharge Certificate. The “Continuous Discharge Certificate” shall have the meaning as per the Merchant Shipping (Continuous Discharge Certificate-cum-Seafarer’s Identity Document) Rules, 2001, made under the Merchant Shipping Act, 1958. The days in Indian territorial waters by such a ship on an eligible voyage would fall within the period of joining and end dates in the Continuous Discharge Certificate and, thus, will not be treated as the period of stay in India of the concerned individual crew member.

An “eligible voyage” is defined in the rule to mean a voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where the voyage originated from any port in India, has as its destination any port outside India, and for the voyage originating from any port outside India, has as its destination any port in India. The rule has no application where both the port of origin and destination of a voyage are outside India or where the Indian citizen leaves India to join the ship at a port outside India and the ship is on a voyage with a destination outside India. In such cases, his presence in India will usually be determined based on entries in his passport.

Notably, Explanation 2 and Rule 126 are for the purposes of the entire clause (1) (and not limited to clause (a) in Explanation 1). The rule prescribes the manner of computing the period of days in India of a crew member of a foreign-bound ship leaving India and is not restricted to only Indian-registered ships. Accordingly, the rule applies even while computing the period of stay of 182 days and 60 days contained in clauses (1)(a) and (1)(c).

2.3 Relaxations

There are some relaxations to the alternative test for residence in section 6(1)(c), which provides for substituting the period of stay in India for 60 days in section 6(1)(c) for 182 days. Consequently, in cases where the relaxation is applicable, the threshold of stay in India for residence will be 182 days under both tests, making the alternative test redundant. These relaxations are discussed below.

2.3.1 Citizens leaving India [Explanation 1(a)]

Explanation 1(a) provides for substituting the period of stay in India for 60 days in section 6(1)(c) by 182 days if the assessee, being a citizen of India, leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment outside India. The relaxation in *Explanation 1(a)* applies to the previous year

in which the assessee, being a citizen of India, leaves India.⁸

Under the Citizenship Act 1955, citizenship is possible by birth (section 3), by descent (section 4), by registration (section 5), by naturalisation (section 6) and by incorporation of territory (section 8). However, an Overseas Citizen of India under section 7A of that Act is not a citizen and is not covered under this clause.

(a) Citizens leaving India as a member of the crew of Indian ship

The relaxation under clause (a) of Explanation 1 is available only where the assessee leaves India as a crew member of an Indian ship as defined in section 3(18) of the Merchant Shipping Act, 1958. Relaxation is not available if the ship is other than an Indian ship. An individual who is not a citizen, too, is not eligible.

In this case,⁹ the assessee claimed the benefit of relaxation under Explanation 1(a) as he had left India in that previous year as a crew member of an Indian ship and had spent 201 days outside India. However, the benefit was denied because the assessee had stayed in foreign waters while employed on the ship(s) for only 158 days, i.e., less than 182 days. However, the ruling requires reconsideration since there is no condition in that provision that the assessee should spend his entire days outside India on a ship to be eligible for relaxation. Explanation 1(a) provides only that the individual leaves India in that previous year as a member of a crew on an Indian ship for the sixty days in clause (1)(c) to be substituted by 182 days.

Explanation 2 to section 6(1) and rule 126 that provide for the manner of determining the period of stay in India of a crew member of a foreign bound ship leaving India would be relevant for Explanation 1(a) as well in ascertaining whether the thresholds of 60 days and 182 days in section 6(1) is crossed. Thus, an Indian ship leaving for a foreign destination would be an ‘eligible voyage’ under rule 126, and his period of stay in India will exclude the period from the date of joining the ship to the date of signing off as per the Continuous Discharge Certificate. Where the Indian ship does not qualify to be on an eligible voyage, the individual’s period or periods in India will impliedly include the ship’s presence in Indian territorial waters.

⁸ Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang), Addl DIT vs. Sudhir Choudrie [2017] 88 taxmann.com 570 (Delhi - Trib.).

⁹ Madhukar Vinayak Dhavale vs. Income-tax Officer (2011) 15 taxmann.com 36 (Pune).

(b) For the purposes of employment

The Kerala High Court held in this case¹⁰ that no technical meaning is intended for the word “employment” used in the Explanation, and going abroad for the purposes of employment only meant that the visit and stay abroad should not be for other purposes such as a tourist, or medical treatment or studies or the like. Therefore, going abroad for employment means going abroad to take up employment or any avocation, including taking up one’s own business or profession. The expression “for the purposes of employment” requires the intention of the individual to be seen, which can be demonstrated by the type of visa used to travel abroad.

In this case, where the assessee travelled abroad on a transit visa, business visa and tourist visa, it was held that the entire period of travel abroad could not be considered as ‘going abroad for the purposes of employment’.¹¹ It was also held that multiple departures from India by the individual in a previous year could also qualify under this clause. The provision does not require him to leave India and be stationed outside the country as the section nowhere specifies that the assessee should leave India permanently to reside outside the country.

The requirement under clause (a) of Explanation 1 is not leaving India for employment, but it is leaving India for the purposes of employment outside India. For the Explanation, an individual need not be an unemployed person who leaves India for employment outside India. The relaxation under this clause is also available to an individual already employed and is leaving India on deputation.¹²

2.3.2 Citizen or person of Indian origin on a visit to India [Explanation 1(b)]

Explanation 1(b) to section 6(1)(c) provides for a concession for Indian citizens or persons of Indian origin who, being outside India, come on a visit to India in any previous year. In such cases, the prescribed period of 60 days in India to be considered a resident under clause (1)(c) is relaxed to 182 days. The objective behind this relaxation is to enable non-resident Indians who have made investments in India and who find it necessary to visit India frequently and stay here for the proper supervision and control of their investments to retain their status as non-resident.¹³

10 CIT vs. O Abdul Razak (2011) 337 ITR 350 (Kerala).

11 K Sambasiva Rao vs. ITO (2014) 42 taxmann.com 115 (Hyderabad Trib.).

12 British Gas India P Ltd, In re (2006) 285 ITR 218 (AAR).

13 CBDT Circular No. 684 dated 10th June, 1994.

The expression “being outside India” has been examined judicially. Where the assessee has been a non-resident for many years, and during the years, he had far greater business engagements abroad than in India, it cannot be assumed that he did not come from outside of India.¹⁴ It is not justified to look at the assessee’s economic and legal connection with India (i.e. his centre of vital interest being in India) to assume that he did not come from outside of India.¹⁵ When the assessee had migrated to a foreign country and pursued his higher education abroad, engaged in various business activities, set up his business interests and continued to live there with his family, his travels to India would be in the nature of visits, unless contrary brought on record.¹⁶

The expression ‘visit’ is not limited to a singular visit as contended by the Revenue but includes multiple visits.¹⁷ The return to India by an individual on termination of his overseas employment is not a visit, and the relaxation in Explanation 1(b) is not available.¹⁸

In that case,¹⁹ the assessee working abroad visited for 18 days during the year. Later that year, on termination of his employment, he returned to India and spent 59 days in the country. The Tribunal held that a visit to India does not mean that if he comes for one visit, then *Explanation (b)* to section 6(1) will be applicable irrespective of the fact that he came permanently to India during that previous year. Looking at the legislative intention, the status of the assessee cannot be taken as resident on the ground that he came on a visit to India and, therefore, the period of 60 days, as mentioned in 6(1)(c) should be extended to 182 days by ignoring his subsequent visit to India after completing the deputation outside India. The alternative contention of the assessee that, for the purpose of computing 60 days as mentioned in section 6(1)(c), the period of visit to India would be excluded was accepted.

2.3.3 Limiting the relaxation [Explanation 1(b)]

An amendment was brought in by the Finance Act 2020

14 Suresh Nanda vs. Asstt. CIT [2012] 23 taxmann.com 386/53 SOT 322 (Delhi).

15 Addl Director of Income-tax vs. Sudhir Choudhrie (2017) 88 taxmann.com 570 (Delhi-Trib).

16 Pr. Commissioner of Income-tax vs. Binod Kumar Singh (2019) 107 taxmann.com 27 (Bombay).

17 Asstt. Commissioner of Income-tax vs. Sudhir Sareen (2015) 57 taxmann.com 121 (Delhi-Trib).

18 V. K. Ratti vs. Commissioner of Income-tax (2008) 299 ITR 295 (P&H); Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang); Smita Anand, In Re. (2014) 362 ITR 38 (AAR).

19 Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang); affirmed in [2011] 12 taxmann.com 326 (Karnataka)



(effective from A.Y. 2021-22) to counter instances where individuals who actually carry out substantial economic activities from India manage their period of stay in India to remain a non-resident in perpetuity and not be required to declare their global income in India. The amendment restricts the relaxation in clause (b) in Explanation 1.

When a citizen or a person of Indian origin outside India who comes on a visit to India has a total income other than the income from foreign sources exceeding ₹15 lakhs during the previous year, the time period in India in section 6(1)(c) of 60 days is substituted with 120 days as against 182 days available before this amendment. The expression income from foreign sources is defined in Explanation to Section 6.

An individual who becomes a resident under this provision shall be not ordinarily resident under clause (6). The provision expands the scope of residence under the Act. It could result in cases of dual residence needing the application of the tie-breaker rule under the relevant tax treaty.

2.4 Deemed Resident [section 6(1A)]

A new category of deemed resident for individuals was introduced with effect from 1st April, 2021 to catch within the Indian tax net, Indian citizens who are “stateless persons”, that is, those who arrange their affairs in such a fashion that they are not liable to tax in any country during a previous year. This arrangement is typically employed by high net-worth individuals to avoid paying taxes to any country / jurisdiction on income they earn. A citizen is as defined by the Citizenship Act 1955.

Under this clause, an individual who is a citizen of India, having a total income other than income from foreign sources exceeding ₹15 lakhs during the previous year shall be deemed to be 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.²⁰ This clause, an additional rule of residence for individuals, shall not apply if the individual is resident under clause (1). Clause (1A) applies only where an Indian citizen is liable to tax by reason of the various connecting factors listed in the clause.

2.4.1 Liable to tax

The meaning of the term “liable to tax” in the context of

²⁰ The expression “income from foreign sources” is defined in Explanation to section 6 and discussed under para 3.3.3 above.

treaties has been the subject of several court rulings.²¹ Some rulings have found that a person is liable to tax even if there is no income-tax law in force for the time being if a potential liability to tax exists, irrespective of whether or not such a right is exercised.²² To nullify such interpretation, a definition in section 2(29A) has been inserted by the Finance Act 2021 with effect from 1st April, 2021. The provision defines ‘liable to tax’ in relation to a person and with reference to a country to mean that there is an income-tax liability on such a person under an existing income-tax law in force of that country. The definition includes a person liable to tax even if he is subsequently exempted from such liability. Primarily, there should be an existing tax law in the other country imposing a tax liability on a person to be ‘liable to tax’.

2.4.2 Connecting factors

For clause (1A) to apply, the individual should *not* be liable to tax in any other country by reason of the connecting factors listed. The clause is worded similarly to the treaty definition of residence: both refer to the person being ‘liable to tax’, which must be by reason of the specified connecting factors. Article 4(1) of the OECD and UN Models refers to domicile, residence, place of management or any other criterion of similar nature while in section 6(1A), connecting factors are residence, domicile or any other similar criteria.

There is a causal relationship between the listed factors and the extent of taxability that is required for the factors to become connecting factors. The OECD Commentary describes this condition of being liable to tax by reason of certain connecting factors as a comprehensive liability to tax — full tax liability — based on the taxpayers’ personal attachment to the State concerned (the “State of residence”). What is necessary to qualify as a resident of a Contracting State is that the taxation of income in that State is because of one of these factors and not merely because income arises therein. This interpretation can be validly extended to residence under clause (1A).

The challenge to establish that the income tax that a person is liable in a foreign jurisdiction is by reason of domicile, residence or similar connecting factors is demonstrated by the Chiron Behring ruling.²³ In that case, the Tribunal held that a German KG (fiscally transparent

²¹ Union of India vs. Azadi Bachao Andolan (2003) 263 ITR 706 (SC);

²² ADIT vs. Greem Emirate Shipping & Travels (2006) 100 ITD 203 (Mum).

²³ ADIT vs. Chiron Behring GmbH & Co [2008] 24 SOT 278 (Mum), affirmed in DIT vs. Chiron Behring GmbH & Co. (2013) 29 taxmann.com 199 (Bom).

partnership)²⁴ was a resident of Germany and entitled to the India-Germany treaty since it was liable to trade tax in Germany (a tax covered under the India-Germany Treaty). Considering that the German trade tax is a non-personal tax levied on standing trade or business to the extent that it is run in Germany,²⁵ an examination of whether the KG was liable to that tax *by reason of domicile, residence or other connecting factors* was required to determine treaty residence which was not undertaken.

In conclusion, it is not enough that the assessee is liable to income taxation in the concerned country or territory for clause (1A) not to apply: an examination of that tax law is necessary to ascertain whether he is liable by reason of the connecting factors listed in section 6(1A).

2.5 Income from foreign sources

The expression 'income from foreign sources' is found in the amendments to section 6 of the Act by the Finance Act 2020. The expression is relevant to apply the lower number of days in India in Explanation 1(b) to section 6(1)(c) in respect of citizens and persons of Indian origin being outside India coming on a visit to India and to the deemed residence provisions under section 6(1A). Explanation to section 6 defines income from foreign sources to mean income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India.²⁶

Since the words used in Explanation 1(b) as well as clause (1A) are "having total income, other than the income from foreign sources exceeding ₹15 lakhs", total income as defined in section 2(45) and its scope in section 5 is relevant. Notably, income accruing or arising outside India and received in India is not included in the definition of income from foreign sources. Consequently, such income within the scope of the total income of a non-resident is not to be excluded from the threshold of ₹15 lakhs.

Total income is computed net of exemptions, set off typically. A question arises whether income exempted if the assessee is a non-resident is to be excluded while computing the threshold of ₹15 lakhs. The provisions are ambiguously worded. A harmonious interpretation could be that since the objective for determining the

threshold is to ascertain whether an individual who is otherwise a non-resident is to be treated as a resident, such exemptions should not be considered, and the items of income should be included. This interpretation avoids a circular reference which arises otherwise. A similar question arises regarding items of income excluded due to treaty provisions. Since the residence under the Act is the foundational basis for ascertaining residence under a treaty, items of income excluded due to treaty provisions are not to be excluded for the same reason.

3. RESIDENT AND NOT ORDINARILY RESIDENT

"Not ordinarily resident" is a subcategory of residence available to individuals and HUFs. The scope of his total income is the same as that of resident assesses but excludes income accruing or arising outside India unless it is derived from a business controlled in or profession set up in India.

Under this provision, an individual should be a non-resident for nine years out of ten preceding years or during his seven 'previous years' preceding the previous year in question, and he was present in India in the aggregate for seven hundred and twenty-nine days or less [sec. 6(6)(a)]. An individual will be "not ordinarily resident" if he fulfils either of the two conditions. The Mumbai Tribunal, in this case,²⁷ rejected the Revenue's stand that the conditions in section 6(6)(a) are cumulative while interpreting section 6(6)(a) before its substitution by the Finance Act, 2003 based on the well-settled literal rule of interpretation as per which the language of the section should be construed as it exists. The Tribunal's conclusion that when one of these two conditions, as laid down in section 6(6)(a) is fulfilled, the resident status is that of not ordinarily resident, should extend to the substituted provisions based on their text.

A citizen of India or a PIO who becomes a resident for being in India for more than 120 days due to the provision inserted in clause (b) of Explanation 1 (vide Finance Act 2020) has the status of not ordinarily resident [sec. 6(6)(c)]. Likewise, a person who is deemed resident under section 6(1A) is not ordinarily resident [sec. 6(6)(d)]

4. RESIDENCE UNDER THE ACT – RELEVANCE FOR TREATIES²⁸

Double tax avoidance agreements entered by India

²⁴ A fiscally transparent partnership is a pass-through with its partners being liable to pay tax on its income.

²⁵ *Gewerbesteuer-gesetz* (Trade Tax Law, GewStG), Sec. 2(1).

²⁶ This expression is relevant for the amendment to clause (b) of Explanation 1 to section 6(1) as well as the deemed resident provisions inserted vide section 6(1A) [see para for discussion on this clause].

²⁷ *Satish Dattatray Dhawade vs. ITO* (2009) 123 TTJ 797 (Mumbai).

²⁸ The topic is covered only briefly here to give the reader a perspective of how residence under the Act can impact treaty application. A separate article dealing with treaty rules on residence is scheduled for publication.



are bilateral agreements modelled on the OECD Model Convention and the United Nations Model Convention. To access these benefits, the person should be a resident of one or either of the Contracting States (i.e., parties to the double tax avoidance agreement) (Article 1 of the OECD / UN Model). Article 4 of the OECD Model states as follows: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature," Thus, residential status under the domestic tax law is relevant to accessing a double tax avoidance agreement and being eligible for the reliefs available.

5. RESIDENCE UNDER THE ACT VERSUS TAX TREATIES

In treaty cases where the person is a resident of both Contracting States concerning a treaty between them, the dual treaty residence is resolved through tie-breaker rules, and that person is deemed a resident of one of the States. A question arises whether a person deemed to be a resident of the other Contracting State under a treaty is also to be treated as a non-resident for the Act, and consequently, his income and taxes are to be computed as applicable to non-residents. This question and the discussion below are relevant for individuals and other persons.

The question gains significance since there are variations in computing income and its taxation for non-residents compared to residents. Such variations are found under several sections of the Act apart from the scope of total income under section 5. Some instances are the computing capital gains on transfer of shares in foreign currency and without indexation (section 48), tax rate on unlisted equity shares (sec.112(1)), computing basic exemption of ₹1 lakh from short-term and long-term capital gains on listed shares (sections 111A and 112A), flat concessional tax rate on gross dividends, interest, royalty and fees for technical services without deductions, different slabs of maximum amount not chargeable to tax for senior citizens in the First Schedule to Finance Acts. Some of these provisions are more beneficial to residents, some to non-residents, and some depend on the facts of the case.

The argument for adopting treaty residence for residential status under the Act is that under section 90, more beneficial treaty provisions have to be adopted in preference to the provisions under the Act. However, such

treatment is debatable for several reasons, as discussed below:

Firstly, the text of the provisions under the Act and in Article 4 dealing with residence in tax treaties militate against such substitution. Article 4 on residence states that such determination is "for the purposes of the Convention" and not generally. Section 6 of the Act is also "for the purposes of the Act" when a person is resident, non-resident or not ordinarily resident.

The literature on treaty residence is also overwhelmingly against substituting residential status under domestic law with treaty residence. Klaus Vogel states that since the person is "deemed" to be non-resident only in regard to the application of the treaty's distributive rules, he continues to be generally subject to those taxations and procedures of the "losing State" which apply to taxpayers who are residents thereof.²⁹ According to Phillip Baker,³⁰ Article 4 determines the residence of a person for the purposes of the Convention and does not directly affect the domestic law status of that person. He refers to a situation of a person who is a resident of both States A and B, under their respective domestic laws. Even though under the tie-breaker rules of the A-B Treaty, he is a resident of State A for the purposes of the Convention, he does not cease to be a resident of State B under its domestic law.

Courts have held that section 4 (charging provisions) and 5 (scope provisions) of the Act are made subject to the provisions of the Act, which means that they are subject to the provisions of section 90 of the Act and, by necessary implication, they are subject to the terms of tax treaties notified under section 90.³¹ However, section 6, containing the provisions for determining residence under the Act, is for the purposes of the Act and is not subject to section 90 and, by implication, treaty provisions.

The mandate in section 90(2) to adopt the provisions of the Act to the extent they are more beneficial to the assessee than the treaty provisions may, at first glance, enable the substitution of treaty residence as the residential status under the Act but deserves to be rejected. The sub-section envisages a comparison of the charge of income, its computation and the tax rate under

29 Klaus Vogel on Double Tax Conventions, Third Edn, Article 4, m.no. 13-13a.

30 Phillip Baker on Double Tax Conventions, October, 2010 Sweet & Maxwell, Editor's Commentary on Article 4, para 4B.02.

31 CIT vs. Visakhapatnam Port Trust (1983) 16 Taxman 72 (Andhra Pradesh) approved in Union of India vs. Azadi Bachao Andolan (2003) 132 Taxman 373 (SC).

the Act to be compared with the same criteria under the relevant treaty *qua* a source of income.³² The charge, computation and tax rate *qua* an income source under the Act, and the distributive rules in the relevant treaty *follow* from the residential status of the person under the Act and the treaty, respectively. Though section 90(2) refers to its application in relation to an assessee to whom a treaty applies, the application is not at an aggregate level of tax outcome *qua* the assessee.

The determination of treaty residence requires the person to be liable to tax in a Contracting State by reason of connecting factors (which includes residence under its tax law). Residence under the Act is a prerequisite for determining treaty residence. The objective of determining treaty residence is to enable the operation of distributive articles, which allocate taxing rights to one or the other Contracting State based on such residence, as well as to ascertain the State that will grant relief for eliminating double taxation.

Further, tie-breaker rules to determine treaty residence are to be applied to the facts during the period when the taxpayer's residence affects tax liability, which may be less than an entire taxable period.³³ The substitution with treaty residence of a person for computing his income and tax cannot be for a part of the previous year where there is split residency for treaty purposes.

Lastly, income-tax return forms and the guidelines issued by the CBDT also do not support substituting the residence under the Act with treaty residence. The forms and the guidelines require only residential status under the Act to be declared by the assessee. None of the return forms require assessee to fill in his treaty residence.

To conclude, a person's residential status under the Act does not change due to the determination of treaty residence unless a provision in the Act deems such treatment like in some countries.³⁴

6. CONCLUSION

Residence is one of the essential concepts in determining the scope of taxation of a person. The term affects the scope of taxation under the Act as well as the ability of a

taxpayer to access a double tax avoidance agreement. Rules for residence for an individual depend on his physical presence in India. The tests prescribed in section 6(1) and the relaxations available for citizens and persons of Indian origin form the canvas for determining residence under the Act. A long list of judicial precedents must be kept in sight while determining the residential status under the Act.

Newer amendments to the residence rules by limiting the concession available to citizens and persons of Indian origin on visits to India must also be considered. A deemed residential status for Indian citizens who are not liable to comprehensive or full tax liability in any other country brings to the fore the importance of understanding foreign tax laws. It also throws up interpretative challenges for the practitioner.

The meaning of residence under tax treaties necessarily refers to the meaning under domestic law, but they serve different purposes and operate independently in their own fields. It is debatable whether a person who is a treaty non-resident can be treated as a non-resident for the purposes of the Act and the tax consequences following such treatment.

Implications on NRs turning RNORs*	
Adverse to the assessee	Beneficial to the assessee
1. Limited increase in the scope of income – income from business controlled or profession set-up in India. 2. Concessional tax rates under Chapter XIA and certain other exemptions are available only to NR and not to RNOR. 3. Can lead to the presumption that control and management of a firm, HUF, company, etc., in India. 4. Overall reduction in years of NOR relief to Returning NRIs. 5. Clearly within the tax compliance framework, including TDS obligations, tax return filing, etc.	1. Slab rates available for senior citizens, etc., would be available to NORs. 2. TDS Deduction is not as per Section 195 lowering rates in most cases. 3. Eligible to claim Foreign Tax Credit in India for doubly taxed incomes. 4. Can avail concessional tax rates under the DTAA where India is a source country and individual tie-breaks in favour of foreign jurisdiction. 5. Relaxation on reporting requirements (may not be required to file detailed ITR 2 as per extant provisions).
Neutral Points	
1. No Obligation to report Foreign Assets. 2. Assessee continues to be treated as NR for determining the AE relationship for transfer pricing regulations and for the purposes of Section 93. 3. It would not impact FEMA's non-residential status automatically.	

(*contributed by CA Kartik Badiani and CA Rutvik Sanghvi; NR – Non-resident, RNOR – Resident and Not Ordinarily Resident). ■

32 IBM World Trade Corpn vs. DDIT (2012) 20 taxmann.com 728 (Bang.)

33 OECD Model (2017 Update) Commentary on Article 4, para 10.

34 For example, Canada and the United Kingdom have provided in their domestic law that where a person is resident of another state for the purposes of a tax treaty, the person will be regarded as non-resident for the purposes of domestic law also.