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Residence in India - A New Colour by Finance Act, 2020

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As all of you are aware, under the taxation statues, mainly direct taxation, 'residence' of a person plays an important and significant role. Many of the direct taxation laws across the globe, stipulate that a person resident in their jurisdiction has to offer all the global income to tax. Being resident of a jurisdiction brings to tax all their income which would have not been subjected to tax if he was not a resident in the first place. Hence, the concept of 'residence' is of utmost importance since it has direct bearing on the taxes.

In the Indian scenario, Section 6 of Income Tax Act, 1961 (for brevity 'ITA') deals with 'Residence in India'. The said section deals with residence of all type of persons namely individual, Hindu Undivided Family, firm, association of persons and company. Of all the lot, we will be dealing with 'individual' in the current article. The said article is written in the context of changes to Section 6 brought vide Finance Act, 2020.

Residence vis-à-vis Scope of Total Income:

Before proceeding to understand the impact of the changes brought in by Finance Act, 2020, it is important to understand the basic objective that Section 6 intends to achieve. Section 6 stipulates among other things, when an individual is treated as resident in India. The said section also stipulates conditions when an individual is treated as not ordinary resident. In other words, when an individual satisfies the conditions laid down for 'resident', he first becomes a 'not ordinary resident' and then later becomes a ordinary 'resident' (if we may call so). The intention of the legislature in carving out the concept of 'not ordinary resident' appears to be giving certain time or relief to such individual who was erstwhile a non-resident till he becomes ordinary resident.

The intention would be vivid when we juxtapose Section 6 with Section 5, which deals with scope of total income. Section 6 has only a mundane task of determining whether a person in resident or not during a previous year, where as Section 5 deals with consequences on total income depending on the results of Section 6. Section 5 of ITA states that if an individual is resident, then his global income is subjected to tax in India. If an individual is not a resident (that is a non-resident), then his total income would be restricted to 'received or deemed to be received in India' or 'accrues or arises or deemed to accrue or arise to him in India' and would not bring into the tax the 'accrues or arises to him outside India'. However, in case of 'not ordinary resident', the scope of total income as stipulated to a resident would apply with only exception that the 'income which accrues or arises to him outside India' shall not get included unless it is derived from a business controlled or profession set up in India. The summarised version is as under:

Status	Received or Deemed to be Received in India	Accrues or Arises or is deemed to accrue or arise to him in India	Accrues or Arises to him outside India
Resident	Scoped -In	Scoped-In	Scoped-In
Not Ordinary Resident	Scoped-In	Scoped-In	- *

Non-Resident	Scoped-In	Scoped-In	-

* scoped-In only if such income is derived from a business controlled in or a profession set up in India

From the above, it is evident that if the impact of Section 5 on 'not ordinary resident' and 'non-resident' is similar. The position would continue till the individual continues to be 'not ordinary resident'. Once the individual stops being 'not ordinary resident' and becomes 'resident', then the global income would be subjected to tax.

Hence, in absence of shelter of status of 'not ordinary resident', the non-resident would become resident immediately on satisfying the conditions laid down for resident, which would make his income outside India immediately taxable in India without any additional time. Hence, the concept of 'not ordinary resident' is to provide a respite to the non-resident so that he can make adequate arrangements to his affairs.

Conditions for Resident and Not Ordinary Resident:

Pre- Amendment:

Resident:

An individual is said to be resident in India in any previous year, if he:

- is in India in that year for a period(s) amounting in all to 182 days or more (say 'C1') or
- having within 4 years preceding that year been in India for a period(s) amounting in all to 365 days or more and is in India for a period(s) amounting in all to 60 days or more in that year (say 'C2')

In other words, an individual is said to be resident in India, if he satisfies any of the C1 or C2. C1 is a pretty simple text. An individual has to check whether he has stayed in India during the previous year for more than 182 days or not. If he has stayed, then he is resident of India. If not, he has to proceed to check C2 to decide the status.

C2 is bit complicated when compared to C1. C2 stipulates two conditions to be satisfied to call an individual as resident during the previous year. One being that the individual has to be in India for more than 365 days in preceding 4 years to the previous year. If he has satisfied that condition, then he has to proceed to examine the second condition of C2. The second condition stipulates that he has to be in India for a period of 60 days or more during the previous year. On satisfying the second condition, then he becomes resident in light of C2. That is an individual having stayed less than 182 days in a previous year but more than 59 days can be a resident, if he has satisfied the 365 days in 4 years test.

Explanation 1(a) to Section 6(1) states that a citizen of India, who leaves India in a previous year as a member of crew of an Indian Ship or for the purposes of employment, the 60 days in second condition in C2 can be substituted with 182 days. In other words, if the individual who is tested is an individual leaving India for purposes of employment, then he shall not be treated as resident even his stay is more than 59 days but not exceed 182 days.

Not Ordinary Resident:

As stated in the opening remarks, an individual may not be called as resident immediately after satisfying C1 or C2. He should be examined whether he could enjoy the status of 'not ordinary resident' before becoming ordinary resident. An individual is said to be 'not ordinary resident', if he satisfies the conditions mentioned in Section 6(6)(a). The said section states that an individual would be 'not ordinary resident' during the previous year:

- If he was a non-resident in India in 9 out of 10 years preceding the previous year (say C3) or
- Has not during 7 years preceding previous year stays in India for 730 days or more (say C4)

If the individual satisfies any of the conditions C3 or C4, then he is said to be 'not ordinary resident' for that previous year. Every year the same test has to be repeated by the individual and the year he stops satisfying C3 or C4, then he would be treated as ordinary resident and his entire income would be subjected to tax in India. As long as he is 'not ordinary resident' his outside India income shall not be included unless in exceptional circumstances.

Post Amendment:

Finance Act, 2020 has amended the provisions of Section 6. The changes which have a major impact are listed for better clarity and discussion:

- New clause to Explanation 1has been added to Section 6(1)
- New sub-section (1A) has been inserted
- New sub-sections namely (c) and (d) has been added to Section 6(6)

New clause to Explanation 1has been added to Section 6(1)

As stated earlier, Section 6(1) deals with conditions for treating an individual as resident. Explanation 1 (a) provides a relief to citizen of India, who is leaving India during a previous year as member of crew or for the purposes of employment, then 60 days appearing in second condition in C2, shall be replaced with 182 days. As discussed earlier, this provides a greater relief to person who leaves India during the previous year for purposes stated therein to be treated as not a resident if he was in India for 59 days or more and less than 182 days.

However, it was noticed that certain individuals were using the above relaxation as tax avoidance measure and planning visit and stay in India so that they do not meet the threshold of 182 days. In other words, such individuals were staying for more than 59 days and making sure that they do not exceed 182 days so that they can continue to be a non-resident.

In order to curb such practices, a new clause vide (b) to Explanation 1 to Section 6(1) has been brought by Finance Act, 2020, wherein an individual who is a citizen of India or person of Indian Origin (for brevity 'PIO'), who being outside India, comes on a visit to India in a previous year, then 60 days appearing in second condition of C2 has to be replaced with 120 days. In other words, the time limit which was available by clause (a) for 182 days has now been reduced to 120 days. However, such restriction of number of days to 120 shall apply to only such citizens or PIOs who have total income (excluding foreign income) exceeding INR 15 lakhs. In all other cases, the time limit of 60 days appearing in second condition to C2 shall be extended to 182 days.

By inserting the above clause, the Finance Act, 2020 aims to achieve that citizens or PIOs who have total income (excluding foreign income) [referred herein after as to 'Indian total income'] exceeding

INR 15 lakhs qualify to become resident even he stays for a shorter duration of 120 days in the previous year. A question may arise, what benefit would tax authorities would achieve by reducing 62 days from the earlier quota of 182 days. The response would be by making sure such citizen or PIO spends less time in India may expose such citizen or PIO as resident in other country, which he would have been escaping hitherto because of 182 days.

Further, another important aspect that can be seen because of the amendment is even though there may not be any change in scope of total income for such citizen or PIO because of reduced duration, he would be qualified as resident or not ordinary resident instead of non-resident. This would have a greater consequence in case of payments made to such citizens or PIOs. The rates that would be applicable for deduction would be such rates as applicable to residents and not to non-residents[1].

If the citizen or PIOs, Indian total income does not exceed INR 15 lakhs, he has nothing to worry and he continues to be guided by the position which was existing prior to Finance Act, 2020. He can stay for a period of 182 days and still be a non-resident for that previous year.

New sub-section (1A) has been inserted:

Finance Act, 2020 has inserted a new sub-section (1A) to the Section 6. The new sub-section is first of its kind in Indian tax law. The said sub-section states that notwithstanding to the conditions mentioned in Section 6(1) – that is C1 or C2, a citizen of India who is having total income (excluding foreign income) exceeding INR 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.**

In other words, a citizen of India (PIO is not covered) having Indian total income exceeding specified threshold would be deemed to be resident in India if he is not a resident in any other country. Such citizen need not satisfy the conditions of 182 days stay or 365 days in 4 years and 60 days in previous year test. He shall be deemed to be resident even he has not spent a single day in India if he is not a resident elsewhere as per such country's local tax laws.

For example, a citizen of India earns rental income of INR 16 lakhs during Financial Year 20-21 and he stays in United States of America (for brevity USA). Assuming he is not a resident of USA for the Financial Year 20-21, then he shall be deemed to be a resident of India by virtue of Section 6(1A) despite of the fact that such citizen has not come to India during Financial Year 20-21 for a single day.

The Government wants to curb practices of certain high networth individuals who were planning to make sure that they do not become resident of any jurisdiction to avoid payment of taxes. In order to curb such practices the stateless person is deemed to be resident of India if he satisfies certain conditions.

New sub-sections namely (c) and (d) has been added to Section 6(6)

As discussed earlier, Section 6(6) deals with conditions to be satisfied to call an individual as 'not ordinary resident'. Finance Act, 2020 has inserted two sub-sections in Section 6(6) as a consequence to amendments to Section 6(1) and insertion of Section 6(1A). Let us understand the same.

[1] Assuming that India becomes his resident country as per tie-breaker test in the tax treaty with country in which he resides.

Section 6(6)(c) states that citizen or PIO who is covered by Explanation 1(b) to Section 6(1) and becomes resident by staying in India for more than 120 days in previous year, will be continued to be a 'not ordinary resident' if he does not crosses the 182-day threshold.

Section 6(6)(d) states that a person who is deemed to be a resident of India in terms of Section 6(1A) is to be treated as 'not ordinary resident' and accordingly the foreign income (unless it is derived from a business controlled or profession setup in India) would not be taxable.

Case Studies:

Let us take certain case studies to understand the impact of amendment brought in by Finance Act, 2020.

CS # 1:

Mr AB is citizen of India. He stays in Switzerland for his employment purposes. He pays a visit to his parents in India during Christmas every year. For the Financial Year (FY) 20-21, he has visited and stayed in India for 135 days and left India prior to March 2021. Prior to FY 20-21, he has stayed in India more than 365 days during the 4 years preceding FY 20-21. What would be the status of Mr AB in India for FY 20-21 pre and post amendment. Assuming his total income (excluding foreign income) is INR 20 lakhs during FY 20-21 in India.

Response:

Status (as per Pre-Amendment position):

As stated earlier, an individual becomes resident in India if he satisfies any of the conditions mentioned in Section 6(1). Since he has stayed less than 182 days in India during FY 20-21, C1[2] gets failed. As far as C2 is concerned, Mr AB has to satisfy two conditions. One the stay should exceed 365 days in the preceding 4 years to FY 20-21, which he has satisfied. The second condition in C2 is that stay during FY 20-21 should not exceed 60 days. However by virtue of Explanation 1(a) to Section 6(1), the 60-day limit gets extended to 182 days if he leaves India during the FY 20-21 for purposes of employment. Since he has stayed 135 days and left India for the purposes of employment, the 182 days limit shall be applicable and he shall not be treated as resident in India for FY 20-21.

Status (as per Post – Amendment position):

As stated earlier, the Explanation 1(b) to Section 6(1) states that 60 days limit has to be restricted to 120 days if the citizen or PIO has total income exceeding INR 15 lakhs during FY 20-21. Since Mr AB has total income excluding foreign income exceeding INR 15 lakhs during FY 20-21 and his stay is more than 120 days, he shall be treated as 'not ordinary resident' for FY 20-21.

However, if Mr AB also satisfies the residence test in Switzerland, then he has to apply the tie-breaker test as specified in Article 4(2) of Indo-Swiss Confederation and accordingly zero in on the status. If the tie-breaker results in Switzerland as his resident jurisdiction, then applying provisions of Section 90(2) of ITA he may chose to be resident of Switzerland and the amendment would not affect him.

[2] refer our discussion in earlier paras

CS # 2:

Continuing with the above question, assuming all facts remain so, other than the fact that Mr AB has Indian total income of INR 13 lakhs. What would be the status post amendment?

Response:

Since the total income excluding foreign income is less than INR 15 lakhs, then the normal condition of 182 days would apply instead of 120 days. Hence, Mr AB would be a non-resident during the FY 20-21.

Summing Up:

As understood from the above amendments, the Government of India is trying to catch up with such tax evaders who does not leave any stone unturned for evading payment of taxes. Even though such practices appear to be within four corners of the law, in long run would disincentivise honest tax payers. Hence, the changes are quite necessary to see that the Government leaves no stone untouched to make sure that taxes are being collected. Carving out exception for citizens or PIOs whose Indian total income does not exceed INR 15 lakhs would make sure that genuine citizens or PIOs are put out of the ambit. We are confident that after a year or so, the number may be revisited and increased to higher limits adding many more to the exception.