OSC KNOWLEDGE ARTICLE

CHANGES TO TAX RESIDENCY PROVISIONS AFTER THE FINANCE BILL, 2020

INTRODUCTION

This month, being the Budget month, brings along a lot of opportunities to have interesting new takes on the Income-tax Act. This year's Union Budget has made many amendments to the Finance Bill with a view to uplift the economy and public's trust and one such amendment is to the definition of tax residency. The residency status of an assesse determines the tax liability for a particular year. It is the residential status under the Act that determines the incidence of tax on any assesse. Explained in section 6 to the Act, this provision has wide implications on an assesse's tax base and hence, must be carefully deciphered. Let's have a look.

TAX RESIDENCY BEFORE THE PROPOSED AMENDMENT

The residential status of an assesse is ascertained with reference to each previous year and are then classified into three broad categories viz. Resident and ordinarily resident (ROR), Resident but not ordinarily resident (RNOR) and Non-resident (NR). It is important to note here that the residential status is ascertained with reference to each previous year and a person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice-versa.

As per sub-section (1) of section 6 of the Act, an individual shall be resident in India in any previous year, if he satisfies any one of the following conditions:

a) he has been in India during the previous year for a total period of 182 days or more, or

b) [***]

c) he has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more *and* has been in India for at least 60 days in the previous year.

Explanation 1- In case of an individual, -

a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 1958, or for the purposes of employment outside India, **the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted;**

b) being a citizen of India, or a person of Indian origin within the meaning of Explanation to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year, **the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted.**

Explanation 1 provides an an exception to sub-section (1) of section (6). The following categories of individuals will be treated as resident in India only if the period of their stay during the relevant previous year amount to 182 days. In other words, even if such persons were in India for 60 days or more (but less than 182 days) in the relevant previous year, they will not be treated as resident due to the reason that their stay in India was for 365 days or more during the 4 immediately preceding years.

i). Indian citizens, who leave India during the relevant previous years as a member of the crew of an Indian ship or for purposes of employment outside India, or

ii). Indian citizen or person of Indian origin engaged outside India in an employment or a business or profession or in any other vocation, who comes on a visit to India in any previous year.

If the individual satisfies conditions mentioned above, he is a resident. If both the above conditions (as mentioned in sub-section (1) of section 6) are not satisfied, the individual is a non-resident. It is very clear that one can easily manage their residential status by manipulating the period of stay and not be required to declare their global income in India.

As laid out earlier, residential status can be classified in three broad categories two of which are resident and ordinarily resident (ROR) and resident but not ordinarily resident (RNOR). Once an individual has been classified as a 'resident', an individual shall determine whether he is ROR or RNOR. In case of ROR, global income is taxable while in case of RNOR only that income is taxed which is sourced in India.

As per the existing provisions of the Act, an individual/HUF shall be considered as a ROR if any of the following conditions is satisfied-

- The individual or the manager (in case of the HUF) was a resident in India in at least 2 out of 10 previous financial years immediately preceding the current financial year; or
- The individual or the manager (in case of the HUF) has a cumulative stay in India for more than 730 days during the 7 financial years immediately preceding the current financial year.

In case the conditions above are not satisfied, an individual/HUF shall be considered as RNOR.

TAX RESIDENCY AFTER THE PROPOSED AMENDMENT

From the Finance Bill, 2020…

The relevant extract from the Finance Bill, 2020 (Section 4 of the bill) reads as under:-

In section 6 of the Income-tax Act, with effect from the 1st day of April, 2021,–

***(a)** in clause (1), in Explanation1, in clause (b), for the words "one hundred and eighty-two days", the words "one hundred and twenty days" shall be substituted;*

***(b)** after clause (1), the following clause shall be inserted, namely:–*

"(1A) Notwithstanding anything contained in clause (1), an individual, being a citizen of India, shall be deemed to be 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.";

***(c)** for clause (6), the following clause shall be substituted, namely:–*

'(6) A person is said to be "not ordinarily resident" in India in any previous year, if such person is-

a) *an individual who has been a non-resident in India in seven out of the ten previous years preceding that year; or*

b) *a Hindu undivided family whose manager has been a non-resident in India in seven out of the ten previous years preceding that year.'.*

The amendment above can be broken down into three parts:

- **Amendment related to substitution of 120 days in place of 182 days for an assesse being a citizen of India or a person of Indian origin.**

  From the Finance Bill, 2020, it is clear that the amendment to section 6 is not with respect to the sub-section (1) but is with respect to the clause (b) in Explanation 1 to section 6(1) of the Act which is the specific provision for Indian citizens and those individuals that are of Indian origin.

  Finance Bill, 2020 proposes to amend the second condition laid out in this explanation, by substituting 182 days to 120 days, thereby making the provisions stricter. Prior to this amendment the individual could spend 182 days in a previous year without being considered a tax resident Indian as long as the stay did not exceed a cumulative of 365 days in the previous 4 years (inclusive of that year).

  However, post amendment, if a person spends more than 120 days a third of a year in India, in any preceding four years (as well as 365 days cumulatively) the said individual shall be considered to be a tax resident in India.

- **Insertion of new clause wherein an individual, being a citizen of India, be deemed to be resident in India, if he is not liable to be taxed in any other country or territory.**

  The Finance Bill, 2020 also proposes to insert a new clause subsequent to clause (1) of section 6, which states that notwithstanding anything contained in clause (1), an individual, who is a citizen of India, shall be deemed to be a resident in India, 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.

  This insertion has been brought with an intent to widen the tax base for individuals who enjoy double non-taxation for the reason of their residential status as they shift their stay to a tax haven country or no tax jurisdiction to avoid payment of tax in India.

This amendment is likely to have a lot of issues. Clause (1A) will be triggered when a non-resident Indian citizen 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. This provision will be subject to the DTAA, if any between India and the foreign country where the assesse claims to be a tax resident. Subject to the treaty, the tie breaker test (as incorporated in the treaty) would be invoked for ascertaining tax residency. If the tie-breaker test determines the tax residency outside India, it is reasonable to presume that the tax residency of the individual would be as per the DTAA as opposed to section 6. The provisions of DTAA would prevail if they are more beneficial to the assesse. It is when there is no DTAA or if an assesse claims to be tax resident of no country, that the newly inserted section 6(1A) will come into play.

❖ **Amendment to clause related to Resident but not ordinarily resident.**

However, with the Finance Bill, 2020, the above condition has been substituted and the following conditions have found their way in clause (6) to section 6 of the Income-tax Act. As per the amendment, an individual shall be considered as R&OR if such person is-

→ Resident in India in at least 4 out of 10 previous financial years immediately preceding the current financial year; or

→ A HUF whose manager has been resident in India in at least 4 out of 10 previous financial years immediately preceding the current financial year.

Accordingly, the condition for cumulative stay in India for 730 days or more during the previous 7 financial years immediately preceding the current financial year has been deleted vide the proposed amendment.

FURTHER DEVELOPMENTS AND OUR CONCLUSION

The Government has brought out a clarification through a press release that states that "This is an anti- abuse provision since it is noticed that some Indian citizens shift their stay in low or no tax jurisdiction to avoid payment of tax in India. In order to avoid any misinterpretation, it is clarified that in case of an Indian citizen who becomes deemed resident of India under this proposed provision, income earned outside India by him shall not be taxed in India unless it is derived from an Indian business or profession."

However, this clarification makes the things more complicated since, even before this amendment, the Indian income of a non-resident, whether citizen of India or not is taxed in India while the global income that is not accrued or deemed to accrue, received or deemed to be received in India is not taxed in India. This clarification does not really help.

Apart from this, a lot of political unsettlement was observed later in the days. On February 6, 2020, Kerala Assembly passed a resolution against this proposed amendment to section 6. This resolution demanded that the Centre should withdraw such proposal since it impacts NRIs negatively.

To conclude the amendment has a lot of grey areas that need to addresses. We are of the opinion that once the Finance Bill is passed one shall gain more clarity with the subsequent amendments within the Act. But the proposed amendment makes the intent of the Government very clear- to widen the tax base and extend the taxability based on one's citizenship.