# **Introduction to Non Resident Taxation in India**

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## 1. Introduction

The recent changes in the Finance Act 2020, raises several questions in our minds with scope of income and related taxation of Non Residents. This article explains who are treated as Residents and Non Residents and the scope of Income in India for Non Residents.
We will be coming up with series of articles on the taxation of Non Residents in India, this being the introductory article an overall aspects of Scope of the Income is only discussed.

## 2. Meaning of Non - Resident

To understand the meaning of Non- Resident, we must first understand the meaning of Resident.

2.1. Definition of Resident - Applicable from 1St April 2021.

Sec 6 - For the purposes of this Act,—

(1) An individual is said to be resident in India in any previous year, if he—

(a) Is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more; or

(b) [* * *]

(c) having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

[Explanation 1].—In the 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 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 **and in case of the citizen or person of Indian origin having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted.**

**New Insertion (1A) - Notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees 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;**
Explanation.—*For the removal of doubts, it is hereby declared that this clause shall not apply in case of an individual who is said to be resident in India in the previous year under clause (*1*).*

2.2. Definition of Resident - Other than Individuals

a) A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India

b) A company is said to be a resident in India in any previous year, if—
(In) It is an Indian company; or
(ii) Its place of effective management, in that year, is in India.

2.3. Definition of Not Ordinary Resident

Sec 6(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 nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less; or

(b) a Hindu undivided family whose manager has been a non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less 7[; or

**(c) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, as referred to in clause (b) of Explanation 1 to clause (1), who has been in India for a period or periods amounting in all to one hundred and twenty days or more but less than one hundred and eighty-two days; or**

**(d) A citizen of India who is deemed to be resident in India under clause (1A) of Sec 6.**

2.4. Definition of Non-Resident Individual

As per section 2 (30)"non-resident" means a person who is not a "resident" (as defined above in clause 2.1. and 2.2.), and for the purposes of sections 92, 93 and 168, includes a person who is not ordinarily resident within the meaning of clause (6) of section 6 (as defined above in clause 2.2.)

2.5. Important Aspects of the New Definition

Individuals are classified into three categories based on their stay in India

a. Those who are staying in India for ≥182 days
b. Those who are staying in India for ≤ 181 days, or ≥ 120 days with income exceeding Rs 15 lakhs from Sources in India.

c. Those citizens who are not Resident outside India – They will be Resident in India Irrespective of their stay in India if they are not tax residents in any country outside India and having total income of > Rs 15 lakhs from Sources in India.

2.6. Implications of the New Definition

The amendments have been carried out at three different places to S.6 of the ITA by introducing new explanation 1A to treat person as deemed residents who were treated as Non Residents; treating person as resident who are outside India and on a visit to India by amending explanation (b) to S.6 (1) and lastly expanding the list of persons as NOR by introducing clause (c) and (d) to S.6 (6)

a. Explanation 1A : This applies only to citizens of India

i. A Citizen of India who is not liable to tax in any other country by his domicile or residence or similar criteria were treated as Non Resident and now he may continue to be Non Resident in India, if his total income from sources other than foreign source (Income which accrues or arise outside India )i.e. Indian Source is Rs 15lakhs or lower in the financial year

ii. If such Citizen of India has total income of more than Rs 15 lakhs from Indian sources irrespective of his stay in India , he will be treated as deemed resident but Not Ordinarily Resident (NOR)

b. Explanation (b ) applies to Citizens and Person of Indian origin ( PIO )who are outside India and on a visit to India

i. In this case if their total income from Indian source is more than Rs 15 lakhs and if their stay in India on a visit is 120 days or more then they are Resident in India else they are Non Resident however

ii. If such Income is Rs 15 lakhs or lower then in such a case they will be Resident in India only if stay in India is more than 181 days, stay of more than 120 days will not make them Resident.

iii. Thus Citizens and PIO whose total income from Indian source exceeds Rs 15 lakhs and they visit India for more than 120 days but less than 182 days, then in such a case they will be Resident but will be treated as not ordinary resident.

c. Issues consequent upon the amendment:

i. In determining Indian source of income exceeding Rs 15 lakhs. Exempt income received from Bank in India, Interest received on Fixed Deposit in Foreign Exchange to be included in Indian source or foreign source. Other issue is whether exempt income to be included or not. When Income is exempt from tax, it does not form part of the total Income. Can it be said that it does not accrue or arise in India. If it is assumed that it does not accrue or arise in India can it be said that it accrues or arise out side India

It is a difficult proposition to say that Income that does not accrue or arise in India is the one which accrues or arise outside India.

ii. Whether a Person who is the citizen of India or PIO is the one who is outside India

iii. Whether test of Resident in ITA on the basis of source of Income in India or partly based upon particular level of Income is sourced in India, can be ignored for Double Tax Avoidance Agreement under the tie breaker rule. As per International jurisprudence, a person is to be treated as a resident of one of the Contracting States if the person is a resident of that Contracting State on the basis of the or domicile or physical stay or a similar criterion for the purposes of its tax. (India- Australia treaty clearly states that, a person is not a resident of a Contracting State for the purposes of this Agreement if the person is liable to tax in that State in respect only of income from sources in that State)

d. As per the provisions in the ITA a person is a resident of India based on its income in India (i.e. above Rs 15 lakhs)

e. The definition as per ITA is not in line with article 4 of the international tax treaties which lays down the criterion for the test of Resident in the concerned states and in case person is resident in both the state then method to resolve the Residential status.

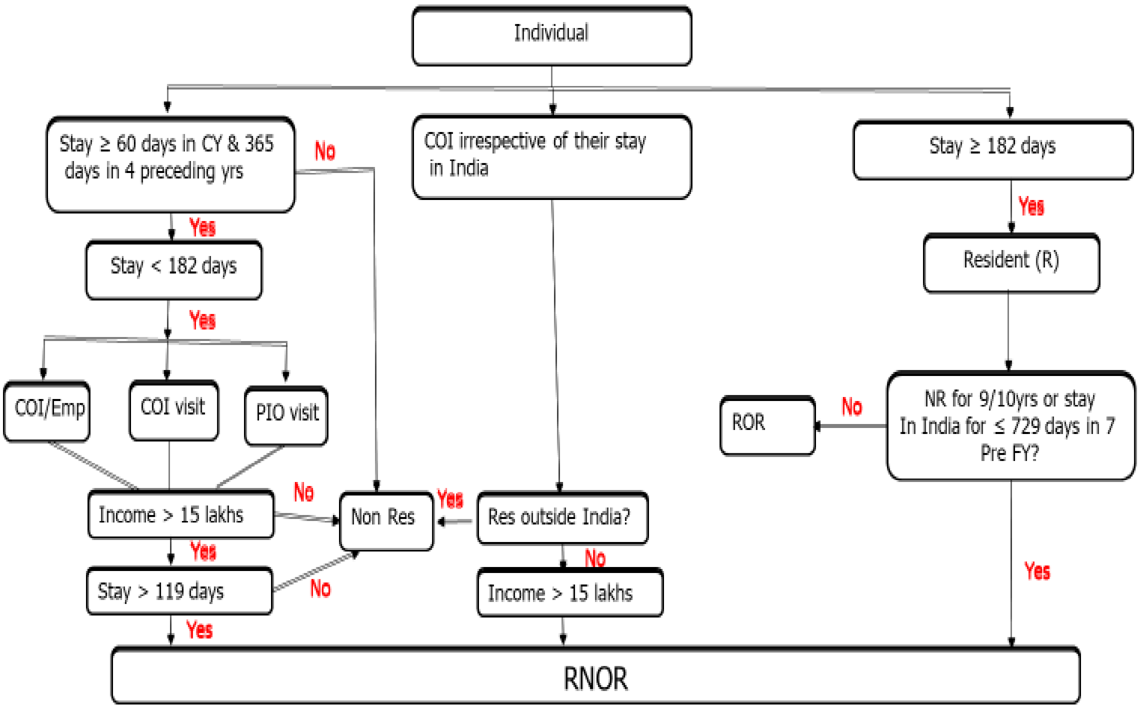
2.7. <u>Residential Status and Arithmetic:</u>

While determining the residential status, the following needs to be kept in mind;

a. Date of Travel
b. Purpose of travel
c. Previous travel record
d. Stay period in the year of arrival/departure

A common mistake that NRIs do is that they calculate the no. of days they have spent outside India rather than in India. Whereas that is not the condition to determine residential status. For Eg: staying outside for 181/182 days means he has stayed in India for 183/184 days and hence becomes Resident. Both the days, day of arrival and departure is required to be counted as in India.

2.8. <u>Residential Status – Flow chart</u>




3. **<u>Income chargeable to tax-Non Residents:</u>**

The scope of income chargeable to tax in India in case of non-residents is dealt in section 5(2) of the Act. As per the said subsection, a non-resident is chargeable to tax in respect of the following.

a. Income Accrues or arise in India
b. Income Deemed to Accrue or arise in India
c. Income Received in India
d. Income Deemed to have been received in India

3.1 If a person is a deemed resident for one source of income, then, he will be treated as resident for all incomes in that particular year.

3.2 Income accruing and received outside India is not taxable in the case of a non-resident. Receipt of income in India is a matter of fact and cannot be disputed. Instances of deemed receipt are described in sections 7 and 198. Illustrative example of these Income could be

   a. Contribution made by the employer to the recognized provident fund in excess of 12% of the salary of the employee
   b. Interest credited to the RPF of the employee which is in excess of 9.5% p.a

c. Transferred balance in case of reorganisation of unrecognised provident fund
d. Tax deducted is treated as Income deemed to have been received in India

**4. <u>Income Deemed to accrue or arise in India for Non Residents</u>:**

In the case of a Non Resident, the scope of total income taxable in India is limited, as incomes accruing or arising outside the taxable territories is excluded. Section 5(2) (b) provides that income 'accruing or arising' or 'deemed to accrue or arise' ***in India*** shall be chargeable to tax [in India]. Thus incidence or the event has to be in India which gives rise to Income Accrued in India. The ITA provides for these events on the basis of which accrual is determined to be deemed to be in India.

Section 5, thus proceeds on the assumption that income earning activity has some connection in India though there is no indication as to how such connection/Source is to be determined. The source of income could be an asset, an activity, a service or some business or other connection in India may be a payer is located in India. Even in some other situations it may so be expressly provided that although the consideration is paid in India place or test of accrual of Income could be different. Thus source of Income could be in India but accrual or the entitlement of Income may be under certain conditions be at a later point in time then the Source of Income.

The charge under section 5 is on accrual of income in India. Section 9 deals with describing the various test where by certain incomes may accrue or arise in India.

Thus there is an intimate relation between Sec 5 and Sec 9.

The statute does not provide any guidance on the process or methodology of determining the place of accrual of income. It is a fact-based exercise. There cannot be a single yardstick to reckon the locale of income.

**5. <u>Income Deemed to Accrue or arise in India</u>**

As per section 9(1) (i), **all income accruing or arising**, whether directly or indirectly, through or from any **business connection** in India, or through or from any **property** in India, or through or from any asset or source of income in India, or through the transfer of a **capital asset** situated in India is deemed to accrue or arise in India.

The opening portion of section 9(1) (i) reads - *'all income accruing or arising'*. It thus deals with those incomes which is accruing or arising through 'business connection', property, asset or source. Clause (i) clarifies the place of accrual of such income in various circumstances

Similarly, clause (iv) clarifies that payment of dividend by an Indian company outside India is deemed to accrue or arise in India. Although, dividend paid by an Indian company to its shareholders would actually accrue in India, clause (iv) clarifies that the place of payment of such dividend does not matter.

If the income accrues or arises due to the causes enlisted in clause (i), the place of accrual is always in India irrespective of where the actual place of accrual or place where the income arises was different under the normal understanding.

Similarly Section 9(1) (ii) deals with place of accrual of salary. It provides that the place of accrual is the place where services are rendered. Thus the locale of income follows the activity of employment. The fact of rendering services in India is sufficient for it's accrual in India irrespective of the residential status of the employee, or of the employer or receipt of salary. Clauses (v), (vi) and (vii) also could result in altering the place of accrual.

5.1. Business Income

All Income accruing or arising directly or indirectly through or from any business connection in India or through or from any property or capital asset or source of income or transfer of capital asset situated in India

a. In case part of the Business operations are not carried out in India then Income shall be deemed to accrue or arise in India only to the extent which is reasonably attributable to the operations carried out in India .Exp 1 (a) to Sec 9(1)(i)
   No income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export (Explanation 1(b) to Sec 9(1)(i)
b. Business connection shall include any business activity carried out through a person who, acting on behalf of the non-resident,—
   i. has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are—
      - in the name of the non-resident; or
      - for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
      - for the provision of services by the non-resident; or

   ii. has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
   iii. habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:
      Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business
      (Explanation 2 to Sec 9(1)(I)
c. Business connection shall include Significant Economic Presence: significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

- transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

- Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) The agreement for such transactions or activities is entered in India; or

(ii) The non-resident has a residence or place of business in India; or

(iii) The non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India. Explanation 2A
The explanation now seeks to cover the situation of soliciting Business by digital interaction and transaction of Goods, Services and Property including provision of downloading of data or software in India.
It is interesting to cover the first part where Non Resident is engaged in soliciting a business through a digital mode but the transaction of Goods, Services and Properties may lead to duplication with the opening paragraph of Sec 9(1)(i) as to how business connection is conventionally understood that supply of goods cross Border is generally do not attract the tax incidence.

d. Explanation 3 A For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from—

   (i) Such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

   (ii) Sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

   (iii) Sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

   It is also provided that Explanation 3A to clause (i) of sub-section (1) of section 9 by the ITA w.e.f. 1-4-2022 shall also apply to Explanation 2A

Explanation 3A is an explanation to explanation 1 ,seeks to covers Income from, Advertisement generally targeted to Indian Population, Sale of the data collected from Indian and Sale of goods and Services through such data as part of the activities attributable to the operations carried out in India irrespective of the physical presence in India.

e. Asset located in India as referred and Its meaning :An asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India

**6. <u>Character of Income and it's Accrual</u>**

Tax Laws do provide distinguished source as well as it's Accrual rule where the character of the Income is different. These are discussed as under for income of the nature other than the Business. Normally Source of Income precedes it's accrual and Accrual precedes receipt of Income.

6.1. <u>Accrual of Interest Income</u>

When the interest is payable by the Govt. or by a resident to a Non Resident (unless it is paid for the purposes of a business or earning any income from source, outside India).

6.2. <u>Accrual of Royalty</u>

When the Royalty is paid by Govt. or a resident (unless for the purposes of a business or source of Income outside India). The real test of accrual specified by the section is the Licensing of the IPR, Use of the Equipment/Property, Licensing of copy rights etc in Indian by the Non Residents for which consideration is paid either by a Resident or a Non Resident

6.3. <u>Accrual of Fees for Technical services</u>

When the fees for Technical Services is paid by Govt. or a resident (unless for a business or source outside India).The real test specified by the section is utilisation of Services irrespective where such services are physically performed

6 Interpretation:Section 9(1)(i) is general in nature. The other limbs of section 9 deal with specific streams of income. In the context of sections 9(1)(vi) and 9(1)(vii) dealing with particular nature of income viz., "royalty" or "fees for technical services" it may be interesting to note that there could be some overlapping between these specific section and Sec 9(1)(i) however once an item falls within the specific category [of sub-clause (vi) or (vii) of section 9(1)], the general category [of sub-clause (i)] will not apply . This was the view held in various court decisions.

**7. <u>Attribution of the Income to the territory of India</u>**

It may be noticed while Sec 5 provides for the general Rule of the Accrual or the Scope of the Income it's actual quantification may be provided by Sec 9 as it conveys the principal that Accrual of the Income may take place in stages and stages which are carried out in the territory may only be treated as accrued in India. If the income is deemed to accrue or arise in India, the Explanations under clause (i) above should be followed.

These explanations assume that accrual may be in stages, each stage corresponding to an 'operation' and there will be an apportionment in the case.

## 8. Computation of Income for Non Residents

Scheduler method as provided u/s 14 of ITA shall apply to Non Residents with exemptions as provided u/s 10 and certain provisions of Presumptive Taxation. Additionally certain provisions are made applicable only to Non Residents which are essentially a special Tax Rates and incentive provisions for making Investment in India.

## 9. Taxation of Non Resident – Treaty Operation

9.1. A Person who is considered as a resident in India as well as a resident of another country can resort to the tie breaker test provisions of the treaty however in such cases he is treated as Resident of other State only for the purposes of the treaty to ensure beneficial provisions of the Tax Treaty however Provisions dealing with the Non Residents are not applicable to such a dual Resident as he is regarded as Resident for the computation of the Income as being Resident in India.

9.2. A Non Resident or a Resident of the other contracting State(dual Resident) has an option to be taxed in accordance with the provisions of the treaty and at the treaty rates, in case the treaty rates are more beneficial

## 10. Conclusion

Double Taxation Avoidance Agreement ("Tax treaty" or "DTAA" or DTC ) is designed to avoid double taxation or provide relief in case of double taxation of the same income. Section 90(2) along with relevant circulars confirm that the provisions of the Act would apply to the extent they are beneficial as compared to the Tax treaty.

As noted from Sec 5 and Sec 9 that a Non Resident in India could be chargeable to tax in India under the relevant provisions of the Act. Typically, such income will be categorised in one class of Income as (i) business income; (ii) royalty or (iii) fees for technical services. Correspondingly, other set of Income will be Interest, Dividend and salaries and the solitary type is about the Capital Gains. One will have to examine the relevant articles of the applicable tax treaty while dealing with the former class of Income as they tend to overlap over each other very easily.

In the other set of Income Over lap does arise due to characterisation of Employment Income as Fees For Technical Services in cases of cross Border deputation of the Personnel and on few occasions characterisation of Dividend Income as Interest and vice versa.

'FTS' or 'Royalty' income generally is a constituent of business income. It should accordingly be assessed under the head 'Profits and gains from business or profession'. Many Tax Treaties however provide for technical services and royalty being dealt with under separate articles.

Under the Tax Treaty therefore, three articles which can have bearing on overlapping nature of Income are – Business Profit article (read with PE article) or FTS article or Royalty article. Two articles, one on Interest and other on Dividend could be overlapping or to employ one of them as an alternative article in case of Hybrid Instrument.

Once an appropriate tax is computed in accordance with the provisions of the ITA, Tax treaty also provides for Tax credit to Non Resident in their own state of Residence for the Taxes paid in India