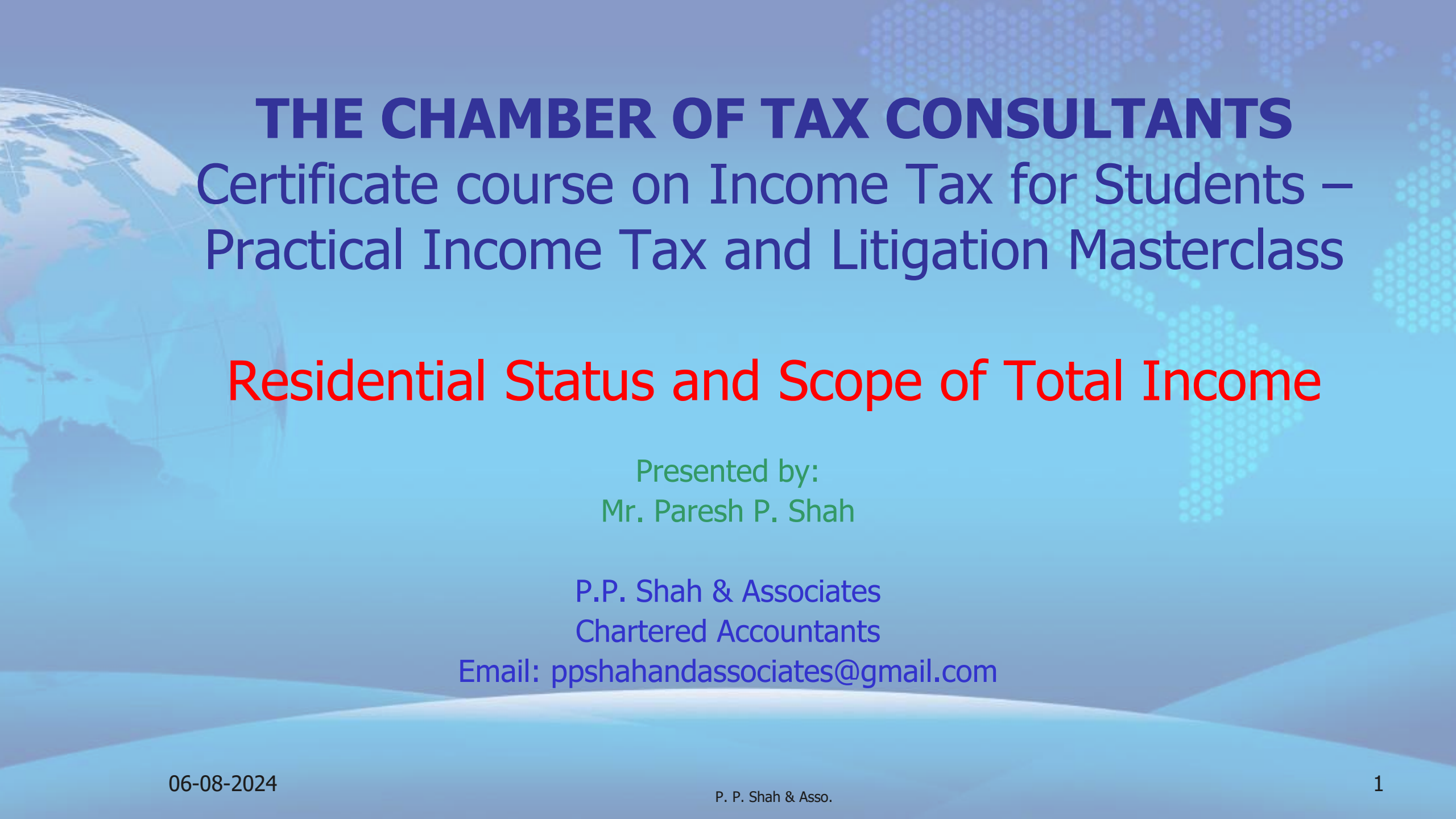




THE CHAMBER OF TAX CONSULTANTS

Certificate course on Income Tax for Students – Practical Income Tax and Litigation Masterclass

Residential Status and Scope of Total Income

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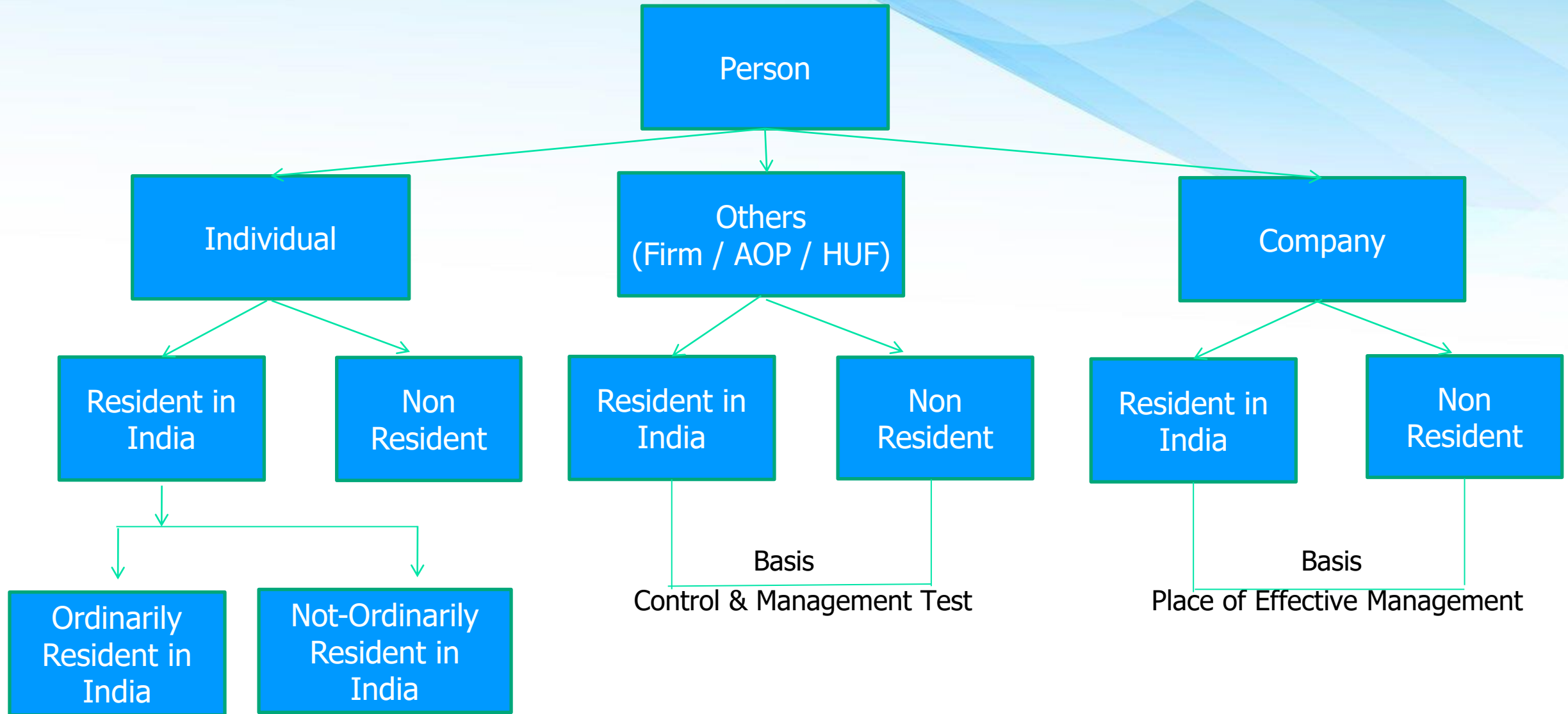
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Introduction – Residential status & Scope of income

- Residential status (Section 6) of an assessee determines chargeability (Section 5) of his income. Whether a person will be charged to tax on a particular income or not depends on his residential status.
- Residential status is determined in respect of each previous year. In other words, residential status of a person may vary from one previous year to another previous year.
- A person can have only one residential status for a previous year i.e. he cannot be a resident for one source of income and non-resident for another source.

Residential Status - Overview



Scope of income – Section 5

- Section 5 prescribes scope of taxable total income for residents, not ordinarily residents and non-residents.
- Scope of Total Income – Residents – Section 5 (1) - Subject to the provisions of ITA, total Income of any previous Year of a Person Resident includes all income from whatever sources derived which
 - (a) is received or is deemed to be received in India in the previous year, by or on behalf of such person [section 5(1)(a)]. In such a case, the date or place of its accrual is immaterial.
 - (b) accrues or arises or is deemed to accrue or arise in India during the previous year [section 5(1)(b)]. In such a case, the date or place of its receipt is immaterial.
 - (c) accrues or arise to him outside India during the previous year [section 5(1)(c)]. In such a case, it does not matter even if it is not received in or brought into India.

Scope of income – Section 5 (cont'd)

- Scope of Total Income – Not Ordinarily Residents – Proviso to Section 5 (1)

Persons who are not ordinarily resident are chargeable in respect of all the three items of income of residents enumerated above, but they are exempt from tax in respect of income accruing or arising outside India as provided in limb 3 i.e. Sec 5(1)(c) unless it is derived from a business controlled in or a profession or vocation set up in India.
[proviso to section 5 (1)]

Scope of income – Section 5 (cont'd)

■ Scope of Total Income – Non Residents – Section 5 (2)

Persons who are not resident in India in the previous year are charged to tax on–

- (a) income received or deemed to be received in India in the previous year, by or on behalf of such person [section 5(2)(a)]. In such a case, the date or place of its accrual is immaterial.
- (b) income which accrues or arises or is deemed to accrue or arise in India during the previous year [section 5(2)(b)]. In such a case, the date or place of its receipt is immaterial.

Scope of income – Section 5 (cont'd)

- Scope of Total Income - Conclusion
 - All assesseees, whether resident or not, are chargeable in respect of:
 - income accruing or arising in India, or
 - deemed to accrue or arise in India or
 - received or deemed to be received in India.
 - While residents alone are chargeable in respect of income which accrues or arises outside India. Except when it accrues or arises outside India ,a Income from Business or Profession controlled in or set up in India in case RNOR.
- Section 9 provides types of income which are deemed to accrue or arise in India. Income which accrues or arises outside India (generally not taxable for NR)but is fictionally deemed to accrue or arise in India under the deeming provisions of section 9, will be subject to tax in India.
- The word 'deemed to accrue' means 'deemed by the statute' to accrue or arise in India. In other words, section 9 (discussed later) enlarges the ambit of taxation by deeming certain income to accrue or arise in India in certain circumstances.

Accruing or arising in India

- The Act contemplates taxation not only on actual receipt but also on 'accrual'
- 'Accrues', 'arises' and 'received' are three different situations contemplated
- The terms 'accrue' or 'arise' are not defined in the Income-tax Act
- The dictionary meanings of the terms 'accrue' or 'arise':
 - The term 'accrue' means 'to arise or spring as a natural growth or result [Murry's Oxford], 'to come into existence as a legally enforceable claim', 'to come as a direct result of some state or action'[Merriam-Webster].
 - The term 'arising' means 'to begin to occur or to exist', 'to come into being or to attention' [Merriam-Webster].

Accruing or arising in India (cont'd)

- The term 'receipt' implies actual receipt with full control over ownership and disbursal.
- The words 'accrues' or 'arises' denote a right to receive.
- While 'accrues' may mean at a future date upon accumulation, 'arises' is more concrete & denotes that a right to receive is more immediate and tangible.
- Both the terms, 'accrues' and 'arises' are used in different context and are not synonymous.

Accruing or arising in India – Landmark jurisprudence

- In a landmark decision in the case of ***E.D. Sassoon and Co. Ltd v. CIT [(1954) (26 ITR 27) (SC)]***, the Supreme Court has interpreted the words “accruing or arising” to mean a right to receive e.g. a debt created in favour of a person gives that person a right to receive.

“If income has accrued to the assessee it is certainly earned by him in the sense that he has contributed to its production or the parenthood of the income can be traced to him. But in order that the income can be said to have accrued to or earned by the assessee it is not only necessary that the assessee must have contributed to its accruing or arising by rendering services or otherwise but he must have created a debt in his favour. A debt must have come into existence and he must have acquired a right to receive the payment. Unless and until his contribution or parenthood is effective in bringing into existence a debt or a right to receive the payment or in other words a debitum in presenti, solvendum in futuro it cannot be said that any income has accrued to him. The mere expression “earned” in the sense of rendering the services etc., by itself is of no avail”.

Accruing or arising in India – Landmark jurisprudence (cont'd)

- However, a mere claim is not a right because there is no reciprocal acknowledgement of the debt unless the claim is legally enforceable.
- Concept of accrual is neutral to considerations like treatment by the taxpayer in the books of account, difficulty of recovery or non-receipt of income.
- In the case of ***Hindustan Housing and Land Development Trust Ltd[(1986) (161 ITR 524) (SC)]*** it was laid down that when the dispute is only regarding quantification of income and not the right to receive the income, the income is said to have accrued or arisen. But, where the right to receive is itself disputed, there cannot be any accrual.
- In the case of ***C.I.T. v. K.R.M.T.T. Thiagaraja Chetty and Co. [(1953) 24 ITR 525 (SC)]*** it was held that mere fact that the company was withholding payment on account of a pending dispute could not be held to mean that the amount did not accrue to the assessee.
- Similar view was adopted in the case of ***[Babulal Narottamdas v. CIT (1991) (55 Taxman 3) (SC)]***

Income and it's Chargeability - Special Rule

Application of Section 5 is subject to other Provisions of the Act

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- Section 14 - Schedular System - Heads of Income
- Sec 15 - Salary due, Salary paid or allowed and Arrears of Salary paid or allowed
- Sec 23 (1) (b) and (c) - Property which is letrent received or receivable,
- Sec 25 A - Unrealised rent will be income in the year in which it is so received

Income and it's Chargeability - Special Rule (cont'd)

- Sec 45 - Any Profits and Gains arising from a transfer of a Capital Asset.....shall be deemed to be the Income
- Sec 56 - Where any sum of money received;
Where any person receives from another Person

Section 5 is subject to other Provisions

Source (Asset)	Accrual	Arising	Receivable	Due	Receipt
Capital Asset		✓ (Capital Gains)			✓ (Rent)
Money			✓ (Interest)		✓
Business activity	✓ (Sale of goods)				
Employment				✓ (Salary)	
Gift					✓

Resident Definition under Income Tax

- 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.

Resident Definition under Income Tax

- [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 ;

Resident Definition under Income Tax

- (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).

Residential Status under ITA

- For Others

Status	Assessee	Conditions
Resident [S 6(2)]	HUF/Firm/AOP	Resident in India EXCEPT where in that year control & management of its affairs is situated wholly outside India
Resident [S 6(3)]	Company	-Indian Company - Control & Management of its affairs is situated wholly in India (upto 31.03.2016) -Place of Effective Management is in India (w.e.f 01.04.2016 r.w. POEM Guidelines dated 24.01.2017) – [Discussed later in this presentation]

Not Ordinary Resident - Definition

- 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: or

Not Ordinary Resident - Definition

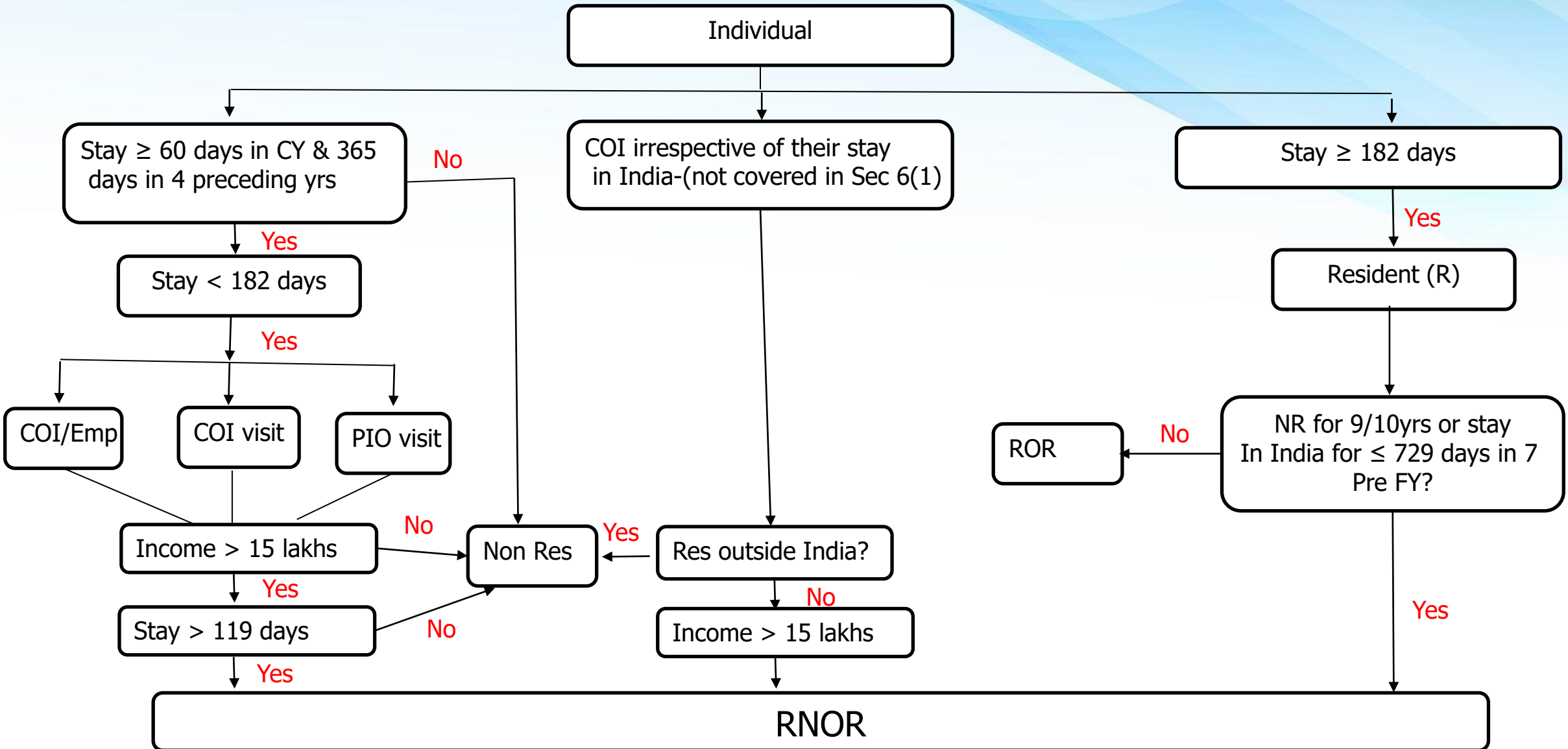
- *(c) citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, who has been in India for a period or periods amounting in all to one hundred and twenty days or more but less than one hundred and eighty-two days; or*
- *(d) a citizen of India who is deemed to be resident in India under clause 6(1)(A)*

Important Aspects of Resident Definition

Individuals may be classified into 4 categories based on their stay

1. Those who are staying in India
for $[\geq 182 \text{ days}]$, $[>= 60 \text{ days and } >= 365 \text{ days in prev. four Years}]$ - R
2. Citizen Of India stayed in India for ≤ 181 days due to Employment
outside India in the year of Departure – NR
3. Citizen of India - a. On a Visit to India for ≥ 120 but ≤ 181 day
b. Having no Tax Residential Status outside India
- in both cases having total income of $> \text{Rs } 15 \text{ lakhs in India}$
4. Those who are NR for 9 out of 10 Previous
Financial year or stayed in India for ≤ 729 days in preceding 7 Years

Definition of Resident – Sec 6



Calculating No. of Days Stay in India

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

- Date of Travel
- Purpose of travel
- Previous travel record
- Stay period in the year of arrival/departure

While calculating the no. of days of stay in India of an individual;

- One must include both, the day of entry in India as well as day of exit from India. *{Petition No. 7 of 1995 225 ITR 462 (AAR)}*
- Both days should be counted as "in India" *{AAR 233 ITR 462}*
- Day of arrival is to be excluded - *Pradeep Kumar Joshi vs. ITO Ahmedabad [2021], Manoj Kumar Reddy v. ITO (International Taxation) [2009] 34 SOT wherein reference was made to section 9 of General Clauses Act, the first day in series of days had to be excluded*
- *Further, in the case of Fausta C. Cordeiro [2012] 24 taxmann.com 193 (Mum.), the Mumbai Tribunal has ruled that while deciding non-resident status, the day of arrival in India is to be excluded if it is not a complete day.*
- Only day of departure has to be considered as "in India" *{ITO v Dr. R.K Sharma (Jaipur Tribunal No. 1230 dated 22.08.86)}*

A better view is to include both the day of entry as well as exit.

Important Case laws

- Return to India after resigning job abroad is not 'visit to India' within the meaning under Expln (b) to sec. 6(1)(c). Explanation (a) to section 6(1)(c) is applicable only in a particular year when a person leaves India for purpose of employment – AAR (Delhi) vs Smita Anand [2014]
- Karnataka High court held in the case of DIT vs Manoj Kumar Reddy Nare [2011] that for the purpose of calculating 60 days under Section 6(1)(c), period of visit to India is excluded. This is so because in the year of Departure 60 days of visit after departure will create an absurdity although stay in India is < 182 days. Also Explanation are exceptions.
- For purpose of determining residential status in India under section 6, term 'going abroad for purpose of employment' means travelling abroad on business visa to take up any employment or for any business carried outside India – ITO (Hyd) Vs. K. Sambasiva Rao [2014]-Includes self employment

Determination of Residential Status

What is his residential status under ITA in F.Y 23-24 in the following cases

- Case 1 - Mr. A, an Indian citizen, leaves India on 26th September 2023 to take up employment in Dubai. He visits India for an aggregate of 122 from October 2023 to March 2024. What would be his residential status if he had visited India in FY 2023 – 24 for 122 days....Although explanation (a) applies, Stay in India is 182 days or more
- Case 2 - Mr. T, an Indian citizen & Managing Director of Global Pharma Co., visits various countries for aggregate of 190 days during the F.Y. 2023-2024, in connection of his export business from India. He stays for less than 182 days in India but more than 120 days. Although Stay in India is < 182, none of the explanation applies
- Case – 3 Mr. S, a Non Resident, research scholar of USA arrives in India for permanent settlement on 10th October 2023. He has never visited in India in last five years before his arrival.....Since NR has returned to India for good.....Exp (b) does not apply to him

Tax Treaty and other remedies

- Sec 90 of ITA provides option to choose a beneficial Provision of the Tax Treaty
- In case of a COI/POI visiting India for more than 120 days and having total income in India of above Rs. 15 lakhs. Its scope and the restriction in the scope by Treaty. Business or Profession controlled from India Vs Treaty PE test.
- In case of a person residing in India for more than 182 days and earning foreign sourced income – tie breaker test
- Sec 6 (1)(A) – Non Discriminatory treatment under Article 14 of the constitution

International Practice vs Deemed resident

- 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 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)
- As per the FA, 2020 a person is a resident of India based on its income in India (i.e. above INR 15 lakhs)
- The definition as per FA 2020 is not in line with article 4 of the international tax treaties which lays down the criteria for the test of Resident in the concerned states to the treaty and provides for a method to resolve Residential Status in a case if person is resident in both the states

Meaning of total income(15 L)

- "Total income" means the total amount of income referred to in section 5, computed in the manner laid down in this Act.
- **Schedular Method of Computation :** Save as otherwise provided by this Act, all income shall, for the purposes of charge of income-tax and computation of total income, be classified under the following heads of income :
 - Salaries.
 - Income from house property.
 - Profits and gains of business or profession
 - Capital gains
 - Income from other sources.
 - All deemed income will also be included (i.e. deemed income from house property and capital gains)
 - It excludes section 10 (i.e. all incomes exempt from tax, head note: Income not included in total Income)
 - Total Income will be considered before any deductions under chapter VI - A

Scope of Income/ Disclosure

Sr. No	Particulars	Resident (R-OR)	Non Resident (NR)	Not Ordinary Resident (NOR)
1.	Income received/deemed to be received in India	Taxed	Taxed	Taxed
2.	Income accrues/arises or deemed to accrue/arise in India	Taxed	Taxed	Taxed
3.	Income accrues/arises outside India	Taxed	NO	NO
4.	Income accrues or arises outside India from business controlled in/profession set up in India	Taxed	NO	Taxed

	ROR	NR	NOR
Disclosure Requirements	Foreign Assets, Financial Interest, Beneficial owner, Beneficiary, Signatory in any bank A/c of entity	No disclosure of foreign assets and financial interests required	No disclosure of foreign assets and financial interests required

Indian income means income accruing, arising or received in India or deemed to accrue or arise or be received in India.

Taxability of Non-Residents under the Income Tax Act, 1961

Section	Nature of Income	Description / Source Rule
9(1)(i)	Business Income	Income from a 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
9(1)(ii)	Salaries	Salaries for services rendered in India
9(1)(iii)	Salaries	Salaries by Govt. to Indian citizen for services outside India
9(1)(iv)	Dividend	Dividend paid by an Indian company outside India
9(1)(v)	Interest	Interest paid by Govt. or by a resident (unless for the purposes of a business outside India or for earning of Income from source of Income outside India)
9(1)(vi)	Royalty	Royalty by Govt. or a resident (unless for the purposes of a business outside India or earning of Income from source of Income outside India)
9(1)(vii)	FTS	Fees for Technical Services by Govt. or a resident (unless for a business ...orsource outside India)
9(1)(viii)	Gift	Income arising outside India, being any sum of money referred to in section 2(24)(xvii), a and b) r.w.s 56(2)(vii) to 56(2)(x)

Residential Test for Company in case of PoEM

- The concept of PoEM has been explained in section 6(3) of the Act which reads as under:

“(3) A company is said to be a resident in India in any previous year, if -

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.”

Explanation.—For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.”

Residential Test for Company in case of PoeM (cont'd)

Analysis of the definition

- “A place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made”

Important words	Test required
Key management and commercial decisions	<u>Decision test</u> – Which are the key decisions?
<u>Process:</u> The decision making of the key aspects of the entity in the business strategy, managerial and commercial sense have to be taken into consideration.	

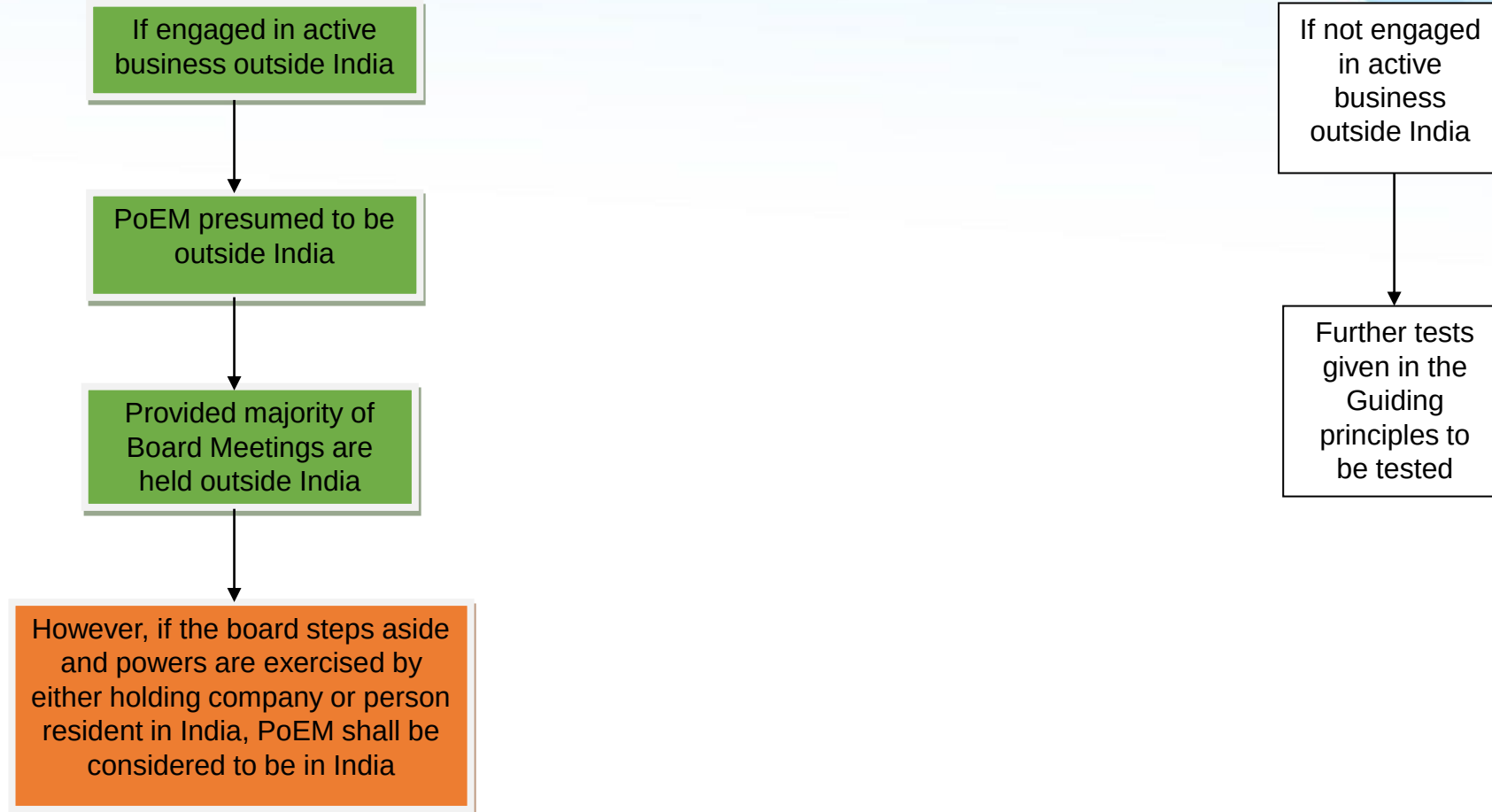
Important words	Test required
That are necessary for conduct of business	<u>Necessity test</u> – The decision making to be considered should be in respect of issues that are of paramount importance for the conduct of the business.
Of an entity as a whole	<u>Pervasiveness Test</u> – The decision making is in respect of issues that affect the entity as a whole.
<u>Process:</u> It is imperative to identify and understand the decisions taken by the management of group entities for conduct of its business. It must be evaluated whether the necessary decisions that impact the entity as a whole are taken by the respective group entity at a local level or not.	

Important words	Test required
Are in substance made	<u>Substance Test</u> – It is of utmost importance to consider substance over form and identify that who in essence is responsible for making the decisions.
<u>Process:</u> Evaluation whether decision making process, in substance, is carried out at the local level or not is required. This may call for a change / refinement in the decision making structure where Indian personnel may need to relegate their authority and power in favour of local personnel with reservation of overseeing shareholder objectives rather than Board function. They may continue to exercise the oversight as a part of the stewardship function given that the Indian entity is a parent / shareholder.	

Residential Test for Company in case of PoEM (cont'd)

Guiding Principles for determination of PoEM as per CBDT

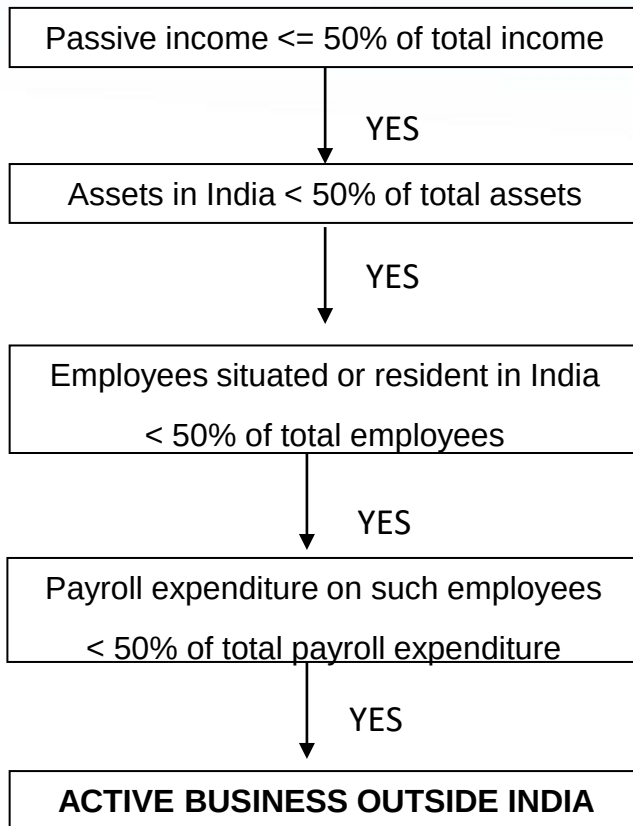
- The process of determining PoEM would depend on whether it is engaged in 'active business' outside India and the place of conduct of the board meetings of the entity:



Residential Test for Company in case of PoeM (cont'd)

Determination of Active Business outside India

- Key ingredients are Assets, Employees, Employees remuneration and passive income:
A company shall be said to be engaged in “active business outside India if all the following conditions are met:



What is Passive income?

- income from transactions where both purchase and sale of goods is from / to its associated enterprises; and
- income by way of royalty, dividend, capital gains, interest or rental income.

Press Release dt. 24.01.2017 of CBDT

POEM guidelines shall not apply to companies having turnover or gross receipts of Rs. Fifty crore or less in a financial year

Residential Test for Company in case of PoEM (cont'd)

- **Determination of PoEM in case of companies other than those engaged in active business outside India:**

In case of companies other than those engaged in active business outside India, the determination of PoEM would be a two stage process, namely:

- a) Identification or ascertaining of person (s) who actually make the key management and commercial decisions for conduct of the company's business as a whole; and
- b) Determination of place where these decisions are in fact being made.

The place where the key management and commercial decisions are taken would be more important than the place where such decisions are implemented.

In this context, specific guiding principles are provided such as location of Board meetings, location of Head office, etc., which are as covered in subsequent slides

Residential Test for Company in case of PoEM (cont'd)

- **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Location of Board Meeting

- The location where a company's Board meets regularly and makes decisions would be relevant provided that the Board:
 - i. Retains and exercises its authority to govern the company; and
 - ii. Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

Delegation by Board

- Where the Company's Board delegates some/all of its authority to a committee (s) consisting of key members of senior management, PoEM would be the location where the members of the committee are based and where it develops and formulates the key strategies for mere formal approval by the full Board.

Residential Test for Company in case of PoEM (cont'd)

■ **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Location of Head Office

- The location of a company's head office will be a very important factor as it often represents the place where key decisions are made. The Guidelines provide for various points which are to be considered for determination of the location of Head office depending on whether the management is centralized or decentralized and cases where the members of the senior management participate in meetings via telephone or video conferencing.

Meetings through Video Conference / technology

- The use of modern technology may not necessitate persons taking decisions to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases, the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

Residential Test for Company in case of PoEM (cont'd)

■ **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Circular resolution or round robin voting

- In case decisions are made through circular resolutions or round robin voting, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. needs to be considered. The location of the person who has the authority and who exercises the authority to take decisions would be more important in determination of PoEM.

Shareholders activity

- Decisions taken by the shareholder, which are reserved for them under the company law, which typically affect the existence of the company itself or the rights of the shareholders as such (rather than the conduct of the company's business from a management or commercial perspective) are not relevant for the determination of PoEM.
- Whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

Residential Test for Company in case of PoEM (cont'd)

■ **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Secondary factors

- If the above factors do not lead to clear identification of PoEM, secondary factors such as place where main and substantial activity of the company is carried out or place where the accounting records of the company are kept can be considered.

Non-relevant factors

- Day to day routine operational decisions in relation to oversight of the day-to-day business operations and activities of a company undertaken by junior and middle management shall not be relevant for the purpose of determination of PoEM.

The Guidelines emphasize that the determination of PoEM is based on all the relevant facts rather than on isolated facts. The following examples illustrate where PoEM is not established based on isolated facts-

- the fact that a foreign company is completely owned by an Indian Company
- the fact that there exist a Permanent Establishment of a foreign company in India
- cases where one / some of the directors of a foreign company reside in India
- the fact of local management situated in India in respect of activities carried out by a foreign company in India
- the existence of support function in India that are preparatory and auxiliary

Residential Test for Company in case of PoEM (cont'd)

■ **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Additional clarifications provided

- The place where management decisions are taken would be more important than the place where such decisions are implemented.
- The principles for determining PoEM are only for guidance purposes and no principle is decisive in itself.
- The activities performed over a period of time, during the previous year, needs to be considered. A 'snapshot' approach is not to be adopted.
- In cases where PoEM is determined to be in India and also outside India, then the PoEM shall be presumed to be in India if it has been mainly / predominantly in India.

Administrative safeguards

Administrative safeguards have been incorporated in the Guidelines by mandating that the Assessing Officer ('AO') before initiating inquiry for PoEM in the case of a taxpayer, shall seek approval from Principal Commissioner / Commissioner. The AO shall also obtain approval from Collegium of Principal Commissioners of Income-tax before holding that PoEM of a non-resident Company is in India. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Residential Test for Company in case of PoEM (cont'd)

- **Determination of PoEM in case of companies other than those engaged in active business outside India (cont'd):**

Illustrations

The Guidelines also includes illustrations on interpretation and determination of PoEM. Specifically, the illustration clarifies that,

- i. Only transactions where both purchase and sale is from/to associated enterprise needs to be considered in computing passive income;
- ii. All conditions viz. income, value of assets and number of employee in India and payroll expenses needs to be seen on a collective basis.
- iii. For a company engaged in active business outside India, even in a case wherein all the directors are Indian residents, the PoEM shall be presumed to be outside India if the majority of the board meetings have been held outside India.
- iv. In case shareholders involvement results in effective management of the Company, then the same needs to be considered in determination of PoEM.

Income deemed to accrue or arise – Section 9

- Sec. 9 of the ITA provides for list of income which is deemed to accrue or arise in India
 - Income accrues directly or indirectly from any business connection in India or from or through- any property/source of income or transfer of asset [Sec (9)(1)(i)] r.w. Exp 1,2,2A,3,3A,4,5,6 and 7.
 - Income from Salaries earned in India [Sec (9)(1)(ii)]& salary paid by Govt for services rendered out side India 9(1)(iii)]
 - Dividend paid by Indian Co. [Sec (9)(1)(iv)]
 - Income in the nature of interest, royalties & fees for technical services [Sec (9)(1)(v), (vi) & (vii)] r.w. Exp 1,2,3,4,5 and 6, Exp 1 and 2 respectively to Sec 9(1)(vi) and 9(1)(vii)
 - S. 9(1)(viii) : Payment by Resident **being a donor** to a Non Resident

Section 9(1)(i) – Business Connection

- Explanation 1—For the purposes of this clause—
 - (a) In the case of a business, [other than the business having business connection in India on account of significant economic presence,] of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India

Business Connection.....Authority to conclude

Authority to conclude contracts / delivery / securing orders, etc.

- W.e.f 01.04.2019 as per Explanation 2 to Section 9.....amended, **originally inserted w.e.f. 1.4.2004**, to include business activity carried out through
 - a. Has and who habitually exercises in India authority to conclude contracts on behalf of the non-resident, conclude contracts or habitually plays principal role leading to the conclusion of contracts , where the contracts are
 - (i) in the name of the non-resident; or
 - (ii) 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
 - (iii) for the provision of services by the non-resident;
 - b. 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
 - c. 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

BC to include Significant Economic Presence-Transaction and Activities....Soliciting Business

- W.e.f 01.04.2019 as per **Explanation 2A** to Section 9 (amended w.e.f. 1.4.20; amended portion in strike mode) it is clarified that SEP of a NR in India shall constitute Business Connection;
- "significant economic presence" (SEP) shall mean—
 - (a) transaction in respect of any goods, services or property carried out by a non-resident ~~in India~~ *with any person 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 (INR 2 crores); or
 - (b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users (3 lakh or more) 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

Attribution for Authority to conclude contracts as referred in Exp 2

- Explanation 3.—Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

Attribution Rule Expanding Scope of exp 1

- Explanation 3A (**Inserted w.e.f. 1.4.21**): Income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from—
- Advertisement targeted to a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;.....how to locate customer of second limb
- sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and.....how to locate Purchaser of the second limb
- 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”.....How to locate Purchaser of Data
- Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A.

Section 9(1)

Explanation 1

In the case of a business, [other than the business through SEP,] the business deemed under this clause to accrue or arise in India shall be only such part of the income as is attributable to the operations carried out in India...**Attribution Rule of S 9**

Explanation 2

Business connection due to agent of non resident in India - Authority to conclude, Securing orders, Principle role in concluding contract. No authority but delivery of goods Provision of Services on behalf on NR

Explanation 2A

Business connection to include Significant Economic Presence

Explanation 3

Attribution for Exp 2
Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India

Explanation 3A

Attribution for exp 1: Income attributable to the operations carried out in India (as per Explanation 1) incl.
-Adv targeting customer in India
-Sale of data from person resides in India
-Sale of goods or services using data collected from a person who resides in India

Analysis of SEP-Narrowing the Scope of Exp 2A

- In case of business connection due to SEP in India, income earned through operations not carried out in India pertaining to the transactions giving rise to SEP in India will also be taxable in India, language may suggest that if such business is carried out through an agent in India then so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India, as opposed to language of Explanation 2A, which does not require operations to be carried out in India
Explanation 3 (Part of Exp 1) also applies to Exp 2A and it may restrict the operation of Exp 2A to the same extent if such a Business is carried out through an agent in India.

Also scope of Exp 3A

In respect of advertising Income, Income from sale of Data as well as sale of goods or services by using those data may be restricted due to Exp 2 and 3

- A non resident may avoid tax liability on account of SEP by resorting to the DTAA provisions
- **Phrase in Exp 2A is transaction with Person in India, however when it comes to Advertising and Data collection, phrase used is.... A person who resides in India**

Sec 5 and Sec 9

- What is the co-relation between Section 5 and Section 9?
Source of Income vs Situs of Income
- Can one say Section 9 relaxes the provisions of Section 5?
Purpose of the Sec 9 vs Safeguard and exclusions
- If an income is chargeable to tax under Section 5, can the same be removed from the scope under Section 9?
Provisions of a Clarificatory nature

Equalisation Levy-NR Ecom Operator

- **EL 1.0** Equalisation Levy was introduced in India in 2016, through Finance Act with the intention of taxing the digital transactions i.e. the income paid to foreign e-commerce companies by Person Resident in India.
- Over the last decade, Information Technology has gone through an exponential expansion phase in India and globally. This has led to an increase in the supply and procurement of digital services. In the digital domain business is conducted without regard to national boundaries and it dissolves the link between an income-producing activity and a specific location. The new business model created new tax challenges and since the tax treaties taxation rules are based on physical presence based nexus rules, the government introduced vide Budget 2016, the equalisation levy to give effect to one of the recommendations of the BEPS (Base Erosion and Profit Shifting) Action Plan.
- Equalisation Levy is a direct tax, which is withheld at the time of payment by the service recipient. The two conditions to be met to be liable to equalisation levy:
 - The payment should be made to a non-resident service provider by a resident in India who carries on business or profession; or made by a non-resident having a permanent establishment in India;
 - The annual payment made to one service provider exceeds Rs. 1,00,000 in one financial year
- The Services covered under the ambit of Equalisation levy is:
 - **Online Advertisement (See Exp 3A to S.9 for a possible overlap, targets a Customer who resides In India)**
 - **Any provision for digital advertising space or facilities/ service for the purpose of online advertisement**
- The tax rate under equalization levy depends on the type of service or transaction. For specified digital services, such as online advertising, the rate **is 6%** of the gross consideration.
- **EL 2.0** In FA 2020 e-commerce transactions were also brought under the ambit of equalisation levy, **such as online sale of goods or services**, the **rate is 2%** of the gross consideration. However, the same is sought to be withdrawn by Finance Bill, 2024 as concerns have been raised that the scope of this 2 per cent levy is ambiguous and thus results in compliance burden.

Equalisation Levy

- When is Equalisation Levy not applicable?
 1. When the non-resident service provider including E Commerce operator has a permanent establishment in India, and the digital services are effectively connected with the permanent establishment.
 2. when the Annual turnover of the e-commerce operator from the e-commerce supply or services is less than rupees 2 crores during the previous year.
 3. the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a permanent establishment in India, does not exceed one lakh rupees
 4. where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

Interplay of Equalisation Levy & SEP

- Both the concepts pertain to taxation of digital economy. The equalization levy provisions and SEP provisions co-exist in the Indian domestic laws. Hence, it is possible that there could be an overlap between the two. It has, however, been provided that if a transaction is subject to equalization levy, then there would be no further Indian income tax liability.
Intention here is to levy taxes where it is likely that it will not be taxed under Tax Law.
- An exemption is provided under Section 10(50) of the Income Tax Act, 1961. Section 10(50) states that any income which has been derived out of such services which are subject to 'Equalization levy' will be exempt. Therefore, once 'Equalization levy' is charged on particular service, the income which would be ordinarily chargeable by virtue of concept of 'significant economic presence' will be exempt.
- The SEP provisions do not seem to impact tax liability of non-residents, with which India has in place tax treaties, providing for a favourable tax regime.

DTAA

- Every jurisdiction adhere to the dual taxing principles of residence and source. In the residence principle, the right to tax income is with the country of residence while in the source principle the right to tax income is with the country in which the income originates. Given the above two principles of taxation there is often a scenario where a person would be taxed twice on the same income in different jurisdictions. In order to avoid such double taxation, countries have entered into Double Tax Avoidance Agreement (DTAA) with other countries.
- Objective of DTAA
 - i. To prevent double taxation on the same income
 - ii. To improve the co-operation between two different taxing authorities
 - iii. To attract foreign investments by providing relief from dual taxation
 - iv. To promote exchange of goods and services, movement of capital and person
 - v. To provide further reduction in the applicable tax rates on certain incomes.
- There are two popular Model treaties adopted by the countries:
 - i. OECD (Organization for Economic Cooperation and Development) Model
 - ii. UN (United Nations) Model

There is one more Model Treaty known as US Model Income Tax Convention

DTAA Provisions

➤ Scope Provisions

Article No	Particulars
1	Personal Scope
2	Taxes Covered
30	Entry into Force
31	Termination

➤ Definition Provisions

Article No	Particulars
3	General Definitions
4	Residence
5	Permanent Establishment

➤ Substantive Provisions

Article No	Particulars
6 to 22 (except Article 9)	Applies to Particular categories of income, capital gains. Capital and allocation of taxing jurisdictions, etc

DTAA Provisions

➤ Provisions for Elimination of Double Taxation

Article No	Particulars
23	Elimination of double taxation
25	Mutual Agreements

➤ Anti Avoidance Provisions

Article No	Particulars
9	Associated Enterprises
26	Exchange of Information

➤ Miscellaneous Provisions

Article No	Particulars
24	Non Discrimination
27	Assistance in collection of taxes
28	Diplomats
29	Entitlement to Benefits

Applicability of DTAA

Steps	Particulars
1	Determine the nature of the income
2	Determine the tax liability under Income Tax Act
3	Check if the treaty applies
4	Determine which treaty article applies. If the NR has a Permanent Establishment (PE) in India then general articles for taxation would be applicable
5	Check how are the taxation rights assigned
6	Determine the tax liability under DTAA
7	Check whether provisions under IT Act or DTAA are more beneficial
8	Final tax liability to be calculated as per the provisions more beneficial

Tax Treaty and Business Connection

- One of the most important aspects of a treaty-based law or Double Taxation Avoidance Agreement (DTAA) is the existence of Article 5 in the Tax Treaty, a Permanent Establishment (PE).
- As per general parlance, a non-resident taxpayer is not required to pay income tax on its business profits unless it has a Permanent Establishment in the source country and the profits are attributing from such PE.
- Usually, as per Section 90(2) of the Income Tax Act, while ascertaining the tax liability of a non-resident, the provisions of the Income Tax Act and the DTAA are taken into consideration and whichever is more beneficial shall apply. Business connection equivalent in a tax treaty is the Permanent Establishment concept though the depth and degree of threshold could vary.

Section 9(1)(ii) (iii) - Salary

- Income from salary will be considered to arise in India:
 - i. If the services are rendered in India irrespective of the place of receipt of salary
 - ii. Salaries payable by the Government to a citizen of India for service outside India
- All components of salary including allowances, perquisites and non-cash benefits are taxable unless specifically exempted
- Section 15 deals with the basis of charge as under.
 - a. Salary is chargeable to tax either on a 'due' basis whether paid or not
 - b. Any salary, paid or allowed in advance, (though not due)
 - c. Any arrears of salary paid or allowed, not charged to tax in earlier year/s

Section 9(1)(ii) (iii) - Salary

Analysis of the Charging Provisions: Interestingly following will emerge from the above

- Even if the salary is accrued it will be not be taxable until it is due but not received
- If salary is earned outside India by a Non Resident i.e. employment is exercised outside India, it may not be taxable in India even if the same is received in India.
- Any arrears of salary received for the past services rendered outside India has accrued outside India and hence may not be taxable again on due basis or on the basis of it being received in India even for the person who is Resident of India at the time of it's receipt.
- Support to the propositions as above may be found in the case of Ranjit Kumar Bose Vs. ITO [(1986) 18 ITD 230 (Calcutta)] it was held that as the assessee was a non-resident in service with a foreign employer, the salary income could not have been brought to tax on accrual basis for the simple reason that it accrued outside India. **The provisions of section 5(2)(a) are subject to section 15, which, inter alia, says that salary is chargeable to income-tax on due basis irrespective of the fact whether it has been received or not. So, salary income is not liable to be taxed in India on receipt basis under section 15.**

Article 15 - DTAA

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

- a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
- b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
- c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

Economic Employer

- The economic employer is defined as a company that has control and management of the employee's work regardless of who the formal employer of the employee is, or who is paying the employee's salary.
- In 2010 the OECD revised its commentary relating to Article 15 and introduced the concept of the economic employer. The commentary plays an important role in this context, as it indicates that the "employer" of a globally mobile employee may not necessarily be the legal employer. In determining who the employer is, other factors such as the following should be considered:
 - who has the authority to instruct the individual regarding the manner in which the work has to be performed;
 - who controls and has responsibility for the place at which the work is performed;
 - the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided;
 - who puts the tools and materials necessary for the work at the individual's disposal;
 - who determines the number and qualifications of the individuals performing the work;
 - who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;
- Based on this approach, substance should prevail over form. This means that the term "employer" should be considered in a broader sense and the whole context of the employment should be reviewed to determine which entity is the economic employer of the employee under the provisions of the treaty to be able to decide whether exemption under Article 15 can be granted to avoid host country taxation.

Expatriate Taxation

- ITA provides an inclusive definition of the term salary and perquisites. The term 'salary' includes wages, any annuity or pension, gratuity, any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages, advance salary, leave salary, etc. Thus, essentially salary includes all consideration in money or money's worth (cash or kind) for services rendered arising out of an employer-employee relationship. The definition is wide enough to cover all types of payments whether in cash or kind; whether immediate or lump sum and whether from or on behalf of current or past employer.
- In addition to the normal components included in salary structure of any employee, some typical components of the remuneration package of an expatriate employee/inbound deputation will cover a complex remuneration arrangement as follows:
- **Provident Fund:** It is mandatory for international workers i.e. non-Indian passport holders working in India and Indian employee going for work in a foreign country with which India has entered into a Social Security Agreement (SSA), who are employed with an establishment to which the provisions of the Provident Fund Act apply, to contribute to Provident Fund in India.
- An international worker, who is contributing to a social security programme of his/her country of origin, either as a citizen or resident, with whom India has entered into a social security agreement on reciprocity basis and enjoying the status of detached worker for the period and terms as specified in such agreement are excluded from contributing to Indian social security schemes.

Expatriate Taxation

- The balance held in the provident fund (i.e., employer's contribution plus employee's contribution plus accrued interest thereon) can only be withdrawn on retirement or after the expatriate reaches 58 years of age or on incapacity to work and not at the time of repatriation to home country.
- **ESOP** :An Employee Stock Option (ESOP) is a common component of remuneration especially in multinational companies that provide the workforce with an ownership interest in the company. Currently, ESOP is specifically included within the definition of perquisite.
- ITA does not specifically provide for apportionment of stock-based income in relation to mobile employees. However, guidance may be drawn from the Delhi Income Tax Appellate Tribunal (ITAT) in the case of Robert Arthur Keltz (represented by United Technologies International Operation), according to which if an employee is based in India only for a part of vesting period (i.e. period beginning with the date of grant of the stock options and ending with the date of vesting of the stock options), then proportionate amount of the value of benefit will be liable to tax in India. The proportionate value shall be determined by applying to the value of benefit, the proportion which the length of the period of stay in India by the expatriate during the vesting period bears to the length of the total vesting period. This proposition is supported by CBDT circulars in the erstwhile Fringe Benefits Regime. Hence, in case of NRs and RNORs, only that benefit which is attributable to the period of services rendered in India during the vesting period shall be taxable in the financial year in which taxable event occurs
- In case of Bharat Financial Inclusion Ltd (ITA No 237/Hyd/2017), dated 3 August 2018), the Hyderabad Tribunal held that allotment of shares by the employer is relevant for taxation of ESOP perquisite and not on exercise of option by employee. Accordingly, tax withholding obligation arises on allotment of shares.

Exemptions - Expatriate Taxation

- Allowances and perquisites paid or provided abroad by the Government to a citizen of India for rendering service outside India are fully exempt – Sec 10(7)
- Expatriates coming into India and working in various companies generally demand ‘tax equalization’ i.e., the tax payable in India on their salary and perquisites is borne by the employer. This is to ensure that they remain tax neutral in respect of their Indian assignment.
 - The expatriate employees are assured net-of-tax salary income.
 - The Indian taxes in respect of income from employment in India would be borne by the employer and not by the employee

Notwithstanding Section 200 of the Companies Act, 1956 the employer could, at his option pay taxes on the non-monetary perquisites provided to employees, and such taxes need not be grossed up i.e. shall not be included in the taxable income of the employee. The downside of such relief is that the employer is not eligible to claim corporate tax deduction for such tax – Sec 10(10CC)

- Daily allowances specifically granted by third party customer to the expatriate, to meet necessary expenses exclusively incurred in the performance of the duties of an office are exempt to the extent to which such expenses are actually incurred for that purpose – Sec 10(14)

Taxation of Non Residents – Computation of Income

- Section 9(1)(iv)

- Dividend paid by Indian company outside India

Article 10 of DTAA may reduce tax on dividend under applicable DTAA. Tax credit will be available in Resident Country

- Section 9(1)(v) – Source rule for interest:

Definition Of Interest S.2(28A) and Art 11 of Art.11

- Income by way of interest payable by (a) Government, (b) Resident, (c) Non Resident
- Provisions of Article 11 of DTAA may reduce the burden of taxation on interest income of the Non Resident

Definition: Royalty – S.9(1)(vi)

- S 9 (1)(vi): Royalty: Consideration for the transfer of all or any rights (including the granting of a license) and information, use and imparting of skill, use of equipment, copy rights and services as defined
- Therefore, Income by way of 'royalty' payable by a person who is a resident of India is deemed to accrue or arise in India (except when the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India)
- Consideration for transfer of rights (including granting of a license) in respect of a trade mark or similar property or for use of a trademark or transfer of rights (including granting of a license) in respect of any copyright, literary, artistic or scientific work, falls under the definition of 'Royalty' under the IT Act

Definition: Fees for Technical Services – S.9(1)(vii)

- FTS defined under the Act as any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head “Salaries”

[Explanation 2 to Section 9(1)(vii)]

Taxability of Reimbursement of Expenses as FTS?

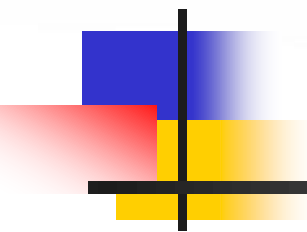
- Where in terms of 'secondment agreement' entered into by assessee with overseas companies, employees of those companies used their technical knowledge and skills while assisting assessee in conducting its business of quality control and management, amounts reimbursed by assessee to overseas companies towards salaries of seconded employees amounted to 'fee for technical services' liable to tax in India – HC of Delhi in case of Centrica India Offshore (P.) Ltd vs. CIT [2014]
- Where employees were seconded to assessee by group overseas entity, assessee was service recipient for manpower recruitment and supply services; assessee would be liable to pay service tax - SC in case of C.C.,C.E. & S.T. Bangalore vs. Northern Operating Systems

Taxation of Non Residents – Computation of Income

- Specific provisions Vs general provisions
 - CIT Vs Copes Vulcan Inc. [167 ITR 884 (MAD.)]
- Exclusion from income of each type
- Gross basis of taxation Vs net basis of taxation
- Scheme of the ITA – Gross basis, Net basis, Tax rates & TDS
- Simultaneous operations of the provisions are normally avoided
- Circular No. 333 dt. 2nd April, 1982 & S.90(2): If provisions of the DTAA are beneficial, then that shall prevail
 - CIT Vs Vishakhapatnam Port Trust [144 ITR 146 (SC)]

Computation of income of NR in India

- Normal computation procedure of S. 15 to 27 in case of salaries, income from house property and S. 28 to 44C for business income is applicable
- Business income sec 9(1), Business connection in India, attribution as per rule 10 if
 - there is presence of Permanent Establishment of NR & income in India
 - Prominent example is Branch of a Foreign Bank
 - Other income of S. 9 is taxed on a gross basis
- Presumptive taxation in India S.115 applicable strictly as per the conditions of each of subsection, S.44 to S.44BBB etc. & S.172 of ITA (a code by itself as distinguished from S.44B).Provisions of S.172 are notwithstanding the Act where as S.44B makes exception to S 28 to 44C
- MAT, surcharge & Education cess [S. 2(37A), on rates in force] on income in India
- Double Tax Avoidance Agreements [S. 90(2)]
- Advance Rulings u/s 245 of ITA
- Tax is deducted on most of the income either u/s 192 or u/s 194 or 195 and 196
- Income can be taxed on a net basis also. Tax rates are different for net basis of taxation. Sec 9(1), S.44DA, S.172 and in a case where accounts are maintained and lower tax option is available under the provisions of S.44BB and 44BBB.



Thank You