Longer version – 9,000 words.

Residential Status
Long version of the article
meant for professionals & academicians

Finance Act 2020 – changes affecting NRIs.

Date: 20th April, 2020

Preface:

P.1 Genesis of Section 6 Amendments:

This article discusses last **thirty years' history** of developments in Section 6. Legal history considered with developments in economy explains why Finance Bill 2020 proposed some anti-avoidance provisions. An **anti**-avoidance provision causes harm to unintended persons also. GOI has to balance "the revenue loss due to tax planning" against unintended difficulties to genuine tax payers. This exercise is on display in Finance Act, 2020.

Government of India believed that (i) NRIs based in Tax Havens and (ii) "Stateless Persons" were abusing some reliefs given to them under S. 6. Hence on 1st February 2020 The Finance Bill proposed two amendments in S. 6. Proposals: (i) Reducing number of days' stay in India from 181 to 119 under Explanation 1(b); and (ii) Deeming a Stateless Person to be Indian Resident U/s. 6(1A). These amendments were strongly protested by NRI community – especially from UAE. In the Finance Act instead of dropping the amendment proposal, Government amended S. 6(6) and considered the affected persons to be Not Ordinarily Resident (NOR). Hence most of the NRIs will not be affected adversely. The purpose targeted under the Finance Bill - will not be served. Revenue benefit to GOI will certainly be far less than the harm caused by controversies created by these amendments. Ideally the Finance Bill Proposal to amend S.6 should have been completely dropped. Stability in law should have been maintained.

Tug of War between Tax Payer & Government is well known and exists in almost all countries. But what is not clearly seen is – the **Tug of War within the Government.** There is a section within the Government that wants to curb Tax Evasion and Tax Planning – both. They bring in Anti-Avoidance provisions. There is another section within the same Government that wants more Foreign & NRI investments coming in. This section is worried about Balance of Payments & foreign exchange reserves. It does not want to antagonise NRIs & foreign investors.

The vested interest lobbies know which nerves to press when. Whenever an anti-avoidance provision for non-residents comes in, they make a hue & cry. The front is taken by absolutely bonafide investors.

Government buckles in. Makes anti-anti–avoidance provisions. At this stage the tax officers as well as tax professionals find it difficult to clearly interpret the law. Result is – A Grand Chaos, controversies & litigation.

Indian Taxation is a Grand Opera worth watching.

P.2 Short Forms used in this article:

DTA:	Double Tax Avoidance Agreement.
GOI:	Government of India.
Exp:	Explanation
IR:	Indian Resident.
IC:	Indian Citizen.
ICIR:	Indian Citizen as well as Indian Resident.
ICNR:	Indian citizen, Non-resident of India.
ITA:	Indian Income-tax Act.
NR:	Non - Resident of India
NOR:	Not Ordinarily Resident of India.
ROR:	Resident & Ordinarily Resident.

Stateless Person is a person who is not liable to pay income tax in any country because of his residential status. Popular term for this purpose is: "**Tax Nomad**".

P.3 Non-professionals may find this article difficult. Too many controversies arise because of amendments in section - 6. I have discussed only some of the controversies. In case of each controversy there can be several different views. I am submitting my views and giving reasons for my views. Finality on these issues may be achieved after a long time.

P.4 Four Changes: The amendments made by The Finance Act 2020 regarding residential status may be divided into four major parts. These will affect mainly the NRIs and will also affect non-resident foreigners.

1. **Anti- Avoidance:** 119 days (less than 120 days) for NRIs. S. 6(1) Explanation 1(b). Paragraph I below.

2. **Anti- Avoidance:** Stateless Citizens deemed to be Indian Residents. Section 6(1A). Paragraph II below.

   In the month of February 2020 – between the presentation of Finance bill & publication of Finance Act, a few controversies were publicly discussed. These are discussed in Paragraph III.

3. **Anti- Anti- Avoidance:** NOR. Section 6(6) gives relief to the assessees covered by earlier two amendments.

4. **Anti-Anti-Anti-Avoidance:** Income from Foreign Sources. S. 6 (1) Exp (1) (b), S. 6(1A) & S. 6(6) (d).

I. Residential Status:

I.1 The text of the amended law – Section 6(1) & (1A) is given below *in italics*. Amendments are given in blue colour. Matter which is not directly relevant for this discussion is deleted.

Indian Income-tax Act, Section 6:

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, ……

*(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;'.*

(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.

Extract of Section 6 (1) & (1A) completed.

I.2 119 days: Section 6(1) (Explanation) (1) (b).

Residential Status for NRI visitors:

An NRI can now come to India for 119 days (instead of current 181 days) during a financial year to remain a Non-Resident of India. If his stay is 120 days or more, he will become an Indian resident. This provision is applicable only if the concerned person has "Indian income" (simplified phrase) of more than Rs. 15 lakhs. This is an anti-avoidance provision planned to curb a tax avoidance scheme.

I.3 Brief History:

It was almost 30 years back in the **year 1991** that India started **liberalisation of the economy**. Government started attracting investment from both – NRIs and foreigners. However, as the law then stood, there were difficulties. If a non-resident individual visited India even for 60 days, he would be considered an Indian Resident under S. 6(1)(c). When a person would invest in a business in India, naturally, he would like to visit India and would like to supervise the business. If he is considered as Indian tax resident and his global income becomes taxable in India, he would not invest in India. NRIs made representations before GOI to increase the number of days for which they could stay in India. By Finance Act 1994, the law was amended and the number of days was increased from 60 to 182.

The implication of this amendment (of year 1994) is that NRIs can visit India as many times as they want. However, total number of days in India should be **less than 182 days.** All investors were satisfied. 181 days is sufficient for a normal investor who wants to remain non-resident and at the same time wants to look after his Indian investment.

The relief of 182 days was convenient for many people. In these days of globalisation while foreigners are investing in India, lot of Indians also invest abroad. Such investors find it convenient to look after the businesses in India as well as abroad and remain non-resident. Prima facie, there is nothing wrong in an Indian resident becoming non-resident and still looking after both the businesses.

I.4 Relief given in 1994 was abused:

India had till the accounting year 2003-04, a provision that a person, who had been non-resident for two years out of preceding 10 years, would be treated as a Not Ordinarily resident (NOR) for subsequent 9 years. This provision was abused by people becoming tax residents of UAE or other tax haven. They could physically go to UAE for a period of 13 months (15th September of one year to 15th October of the next year.) and claim to be non-residents for two financial years. These people would return to India in the 14th month. They would claim that in the two years of their NR

status and in the subsequent 9 years of their NOR status, they earned millions of dollars and were not liable to pay tax in India. Their genuine foreign incomes were free from Indian tax. But if they remitted Indian black money abroad & showed the same as genuine foreign income, how would GOI know? This "**Conversion Scheme**" of black money into white money was possible only because the restriction of 59 days under S. 6(1)(c) was suitably amended.

I.5 Anti-Avoidance Provision for above Conversion Scheme:

Because of this Conversion Scheme Government amended Section 6(6) and reversed the position with effect from accounting year 2004-05. Under the amended law, a person would have to stay as a non-resident for at least 10 years to get the NOR status for two years. (The other test of 730 days is ignored for this article.) This amendment made the Conversion Scheme unworkable. GOI objective was achieved.

Simultaneously Income-tax commissioners **aggressively scrutinised** the records of every person returning to India from a tax haven and claiming to have saved money abroad. Earlier, such non-residents were claiming that it was not compulsory for them in UAE to maintain books of accounts or to get the books of accounts audited. So they have not maintained any accounts. Such arguments worked in the past. Now Income-tax Assessing officers refuse to accept such argument. Their stand has been that if a person introduces substantial capital into his Indian accounts, then it is for him (assessee) to establish that the source of his income is legitimate. The **burden of proof lies on the assessee**. It is not for the department to prove that the wealth is Indian black money converted into white. If the assessee cannot establish genuineness of his foreign savings, Assessing Officer can tax the amount as **unexplained investment etc. U/s. 68 to S. 69D.** Legal controversies on this subject go on. While the "Conversion scheme" is dead, genuine NRIs returning to India are now facing difficulties. We have a long way to go before striking balance.

I.6 Another Tax Planning:

Now instead of 'remaining NR for 2 Financial years & NOR for nine years', people planned to 'continue staying NR for much longer periods'. Indian Residents (IR) would become non-residents. Getting Residence permit from USA, UK etc. is very difficult. And they levy substantial income-tax. Getting it in UAE was comparatively easier. And UAE imposes no income-tax. Hence people would obtain resident permit of UAE. SPVs incorporated in the UAE would earn substantial incomes. GOI felt that some of these SPVs were actually converting Indian black money into white. These NRIs could still manage their Indian and their foreign business activities because of short air-distance between India & UAE.

And Law permitted them to "Visit" India for 181 days every year. They can continue to be NR for very long period. Earn incomes in & outside India. Pay Indian tax on Indian income. But get all foreign incomes tax free. If foreign incomes are tax free, Conversion Scheme goes on.

See the Tug of War that goes on.

I.7 Anti-Avoidance provision in Finance Bill 2020:

Finance Bill proposed to amend the Explanation 1(b) and reduce the number of days from 181 days to 119 days. Hence, now if an NRI wants to remain NRI and yet look after the Indian business, he must ensure that his stay in India is for less than 120 days. This will affect all NRIs – whether they are coming from a normal taxed country like USA, UK; or from a tax haven. NRIs were worried. They protested. See Paragraph IV below for the relief from this anti-avoidance provision.

II. Stateless Indian citizens deemed to be Indian Tax Residents. Section 6(1A).

II.1 Proposal in brief: S. 6(1A):

Under this sub-section a non-resident will be deemed to an Indian Resident if he is subject to the three conditions given below:

(i) He is an Indian citizen; and
(ii) His total income for the previous year, other than the income from foreign sources (Indian income) is more than Rs. 15 lakhs; and
(iii) He is not liable to Income-tax in any country other than India by the nexus of "Residential Status" (Stateless Person).

This provision is stricter compared to amendment in Explanation 1(b). Under this provision, a Stateless Indian citizen will be deemed to be an Indian resident even if he has not stayed in India for a single day in the relevant previous year.

II.2 Reason for this proposal:

So far, under Indian Income-tax Act, citizenship was totally irrelevant. Residential status was determined purely by physical stay in India or outside India.

Global law on Residential status in brief:

In USA, a person is considered to be US tax resident if he is a US citizen or a US Green Card holder. This position applies even if the person may not be personally present in USA for a single day during the accounting year. In Britain, Canada, etc. provisions for residential status are very complex.

In tax planning, there is a popular tool called "**Tax Nomad**". HNIs wanting to avoid tax would plan in such a way that they would be non-residents of all the countries imposing income-tax. Assuming that for determining residential status - several nations have similar criteria (181 days' stay) – it is practical to become a tax non-resident. An HNI would stay in two main countries for about five months each; and for two months he would be travelling globally. He would not be tax-resident of any country. His family would continue to stay in India. His Indian businesses would continue in India. Indian income would be taxable in India. But the foreign incomes would be free from taxes in India. Which probably means, the Conversion Scheme can go on.

Government of India (GOI) realised that considering citizenship as the criteria for tax residence, makes tax planning very difficult. Hence, by the Finance Bill they proposed to add sub-section 1A after Section 6(1). This amended version was directed mainly towards Tax Nomads and people staying in tax havens. Hence, the wording was such that an Indian citizen staying in a country like US, UK etc., and paying normal taxes in those countries would not be covered. They would be liable to income-tax in those countries qua the Connecting Factor of Residence and hence not covered by S.6(1A). However, a tax nomad or a person staying in tax haven like UAE would be covered by S.6(1A). Such a person would be deemed to be an Indian tax resident. He would face serious consequences as listed in paragraph II.3 below.

II.3 Implications of Finance Bill Proposal: The implications would be:

(i) The Stateless Person/ Tax Nomad would be considered Tax Resident of India.

(ii) His global income would be taxable in India. (After becoming ROR).

(iii) Hence, he would be liable to file his income-tax returns in India.

(iv) He would be liable to disclose his global income and wealth in his Indian Income-tax return.

(v) He would be liable to comply with the normal tax procedures like – submitting **tax audit reports**; deducting Income-tax at source from payments made by him, etc.

(vi) Consider a case where a non-resident of India became a tax resident in India. He did not realise his duty for filing Indian Income-tax return and paying Indian Income-tax on his global income. To such a person, the **Black Money Law (BML) could be applied**. The BML provides for 120% of the undisclosed wealth as tax & penalty. In addition, there can be prosecution.

II.4 We need to note that a non-resident does not become liable to Indian tax on his foreign income in the very first year of his becoming Indian resident. A person may be **NOR for two or three years** depending upon his earlier stay in India. Under the Finance Bill, there was a proposal to amend S. 6(6) (a) & (b) so that such a person could be NOR for four years. In the Finance Act this proposal is dropped. As long as a person is NOR, all the implications listed above (Paragraph II.3) do not apply to him.

II.5 There was strong protest - especially by NRIs from UAE - against explanation 1A. Government was taken aback by this unexpectedly huge protest. If NRIs are unhappy, their investment flows into India would be adversely affected. To placate the NRIs CBDT issued a press note on 2nd February, 2020. However, the press note was not clear. Once the Finance Act has been passed, this Press Note has no legal significance. Hence it is not discussed here. Finance Act has made significant changes so that the adverse consequences discussed in this paragraph would largely not apply to NRIs.

II.6 Two Way Relief:

Government has provided relief to NRs in two ways.

6.1 **Rs. 15 Lakhs threshold.** It is said that there are a few lakhs of Indians working in UAE. A large number of them are poor labourers or middle class employees. They are not into any sophisticated tax planning. By providing a threshold of "Indian income" of Rs. 15 lakhs, GOI has exempted all these people. This issue is also controversial. But that controversy is not discussed in this article.

6.2 **NOR Status:** Even HNIs are given a relief. They are considered to be NORs. Hence their foreign incomes remain tax free. This issue is elaborated in paragraph IV below.

II.7 Discussion on S. 6(1A):

Query: Some professionals have asked: "What is the significance of S.6 and the amended S. 6 (1A)?"

Response: For a Government to tax the income of any person, it should have a **jurisdiction**. The jurisdiction is available if there is a connection between the Government and the assessee or his income. This connection is also referred to as – a **Connecting Factor** or a **Nexus**. There are two kinds of connecting factors:

(i) Qua the **assessee**, his **residential status**.
(ii) Qua the **income** – the **country of source (COS)**.

Country of Residence: 'An assessee is liable to tax' or 'the Government of a country has jurisdiction to tax an assessee' if the assessee is resident of the concerned country. The country where the assessee is resident is called "Country of Residence" or COR. Importance of S. 6 lies in specifying the provisions for the Connecting Factor of Residence.

Country of Source – If an income is sourced from a country, then that country has the jurisdiction to tax the income. The country from where the income is sourced is called the "Country of Source" or COS. The COS can tax an income irrespective of the residential status of the assessee. Section 5 provides the "Scope of Total Income" that is taxable in India.

Each connecting factor (Residence & Source) is independent of the other connecting factor.

To illustrate: Mr. Patel is resident of India and earns British pounds (BP) 1,000 as interest income from a bank account maintained in UK. For Mr. Patel, India is COR. He is liable to tax in India by reason of his residence. The interest income has been sourced from UK. Hence, the Country of Source is UK.

The proposed amendment in S. 6 (1A) emphasises liability qua the connecting factor of residence. By deeming an Indian citizen to be an Indian resident, his global income can be taxed in India. Indian tax provision would be somewhat comparable to US tax provisions.

To explain further – another illustration: Mr. Iyer is a resident of Dubai. He has Tax Residency Certificate (TRC) as well as a work permit (residence permit) from Dubai. However, Dubai does not impose any Income-tax. Hence, qua the status of residence, he has no liability to tax. Mr. Iyer is earning income of dividend, interest and capital gains from – (i) UK, (ii) India & (iii) Singapore. He pays Income-tax in all these three countries. These taxes are paid qua the source of income. The proposed amendment has nothing to do with the source of income. Hence, irrespective of the amount of taxes paid by Mr. Iyer in all the three countries, he will be considered to be a person covered under Section 6(1A). While Dubai does not impose Income-tax, it imposes several other taxes like **Municipal Tax**, etc. These taxes are irrelevant for Income-tax consideration.

II.8 Impact of the amendments for the first year.

We may note the structure of Section 6(1) providing for residential status in India. Under Section 6(1)(a), an individual becomes tax resident in India, if he stays in India for 182 days or more. There is a single

condition. If this condition is fulfilled then only the person becomes Indian resident.

Now consider Section 6(1)(c). This section provides for two cumulative conditions: (i) The individual should be in India for 365 days or more during the preceding four previous year; AND during the relevant previous year, he should be in India for 60 days or more. If any one of these two conditions is not applicable, then that individual is not subject to Section 6(1)(c). He will be subject to only Section 6(1)(a). Hence, he will become Indian resident only if he stays in India for more than 181 days.

Consider an illustration. Mr. John is a resident of UK. Since birth he has never entered India. Now in the year 2020, he is deputed to India. He will travel between India & UK for his job. In the preceding four previous years – 2016-17 to 2019-20, he was not in India for a single day. Hence, he did not complete the condition of 365 days under Section 6(1)(c). Hence, Section 6(1)(c) is not applicable to him. Under Section 6(1)(a), he will be Indian resident only if he physically stays in India for more than 181 days. If he plans his stay in such a way that in the first year – 2020-21, his stay in India is for 181 days or less; then he will not be considered to be an Indian tax resident. Thus, it is important to note that a person does not become Indian resident straight away in the first year itself.

Even if he becomes an Indian resident in the first year itself, he will become resident and ordinarily resident (ROR), only when he completes two years of being Indian resident [S. 6(6)(a)]. Thereafter, his global income will be taxable in India.

III. Technical Issues: Dual Residential Status:

III.1 India – UAE DTA: "Liable to Tax": A history of case law development.

There has been considerable controversy on the issue of "Liability to tax". UAE does not impose Income-tax on individuals residing in UAE. Can they be considered to be liable to Income-tax in UAE?

Many NRIs from the UAE were making personal investments in India even before liberalisation of Indian economy in the year 1991. After liberalisation they started investing even in business. When they started having substantial interest, dividend, capital gain incomes and even business income, they wanted the **DTA relief**. Income-tax department was giving treaty reliefs to investors from Dubai. NRIs would earn incomes from India and file a CA certificate and claim relief under treaty. Hence, capital gains earned by them were going totally tax free. (Note: India UAE DTA has been amended by protocol in the year 2007. Now capital gains

are not exempt under this DTA.) Other incomes were taxed at lower rates as per the treaty. In cases where assessees applied to Indian Income-tax assessing officers for a no TDS certificate, they could easily get such certificates. In other words, department was not raising an issue that "when there is no Income-tax in Dubai, there is no double tax and hence there is no question of double tax avoidance relief".

In the year 1993 India started the process of **Authority for Advance Rulings** (AAR) giving its ruling on international taxation (Chapter XIX-B of the ITA). Foreign investors could obtain advance rulings to avoid future controversies. When there was no controversy for UAE resident, there was no need for them to apply to AAR ruling. However, many people wanted a certainty in their tax matters. Hence, they started making applications for rulings from AAR. In the case of Mr. M. A. Rafik, AAR gave a ruling that individuals resident in Dubai can get DTA relief. After some years, in the case of Cyril Pereira, the AAR raised the issue: "there is no Income-tax in Dubai. Hence, there is no double taxation. Hence, there is no question of providing relief under Double Tax Avoidance Agreements" and a whole controversy started.

Government of India recognised that if UAE residents were not provided treaty relief, their investments into India could go down. Hence, Government amended Section 90 (1)(a)(ii) and made a provision that Government of India could sign a treaty purely to promote mutual **economic relations, trade and investments**. In other words, Government could sign a treaty not necessarily for avoiding double taxation but simply for developing economic relations. After the amendment, the issue of liability to tax died. In other words, Dubai residents were given treaty relief, even though it amounted to double non-taxation.

In the last thirty years, Indian economy has passed through severe ups and downs. In the year 1990, India was on the brinks of serious economic crisis. Dr. Narsimha Rao as the Prime Minister of India and Dr. Manmohan Singh as finance Minister of India started liberalisation of Indian economy. Dr. Manmohan Singh had to physically pledge 100 tonnes of gold to get a loan from IMF. This was a situation when India was ready to sacrifice Income-tax revenue for the purpose of attracting foreign investment. Hence, in the case of **India-Mauritius treaty**, Government took a clear stand of providing treaty relief even if it amounted to "**Double Non-taxation" and "Treaty Shopping**". GOI went out of its way to facilitate investments coming in from tax havens like **Mauritius, UAE, Cyprus etc.**

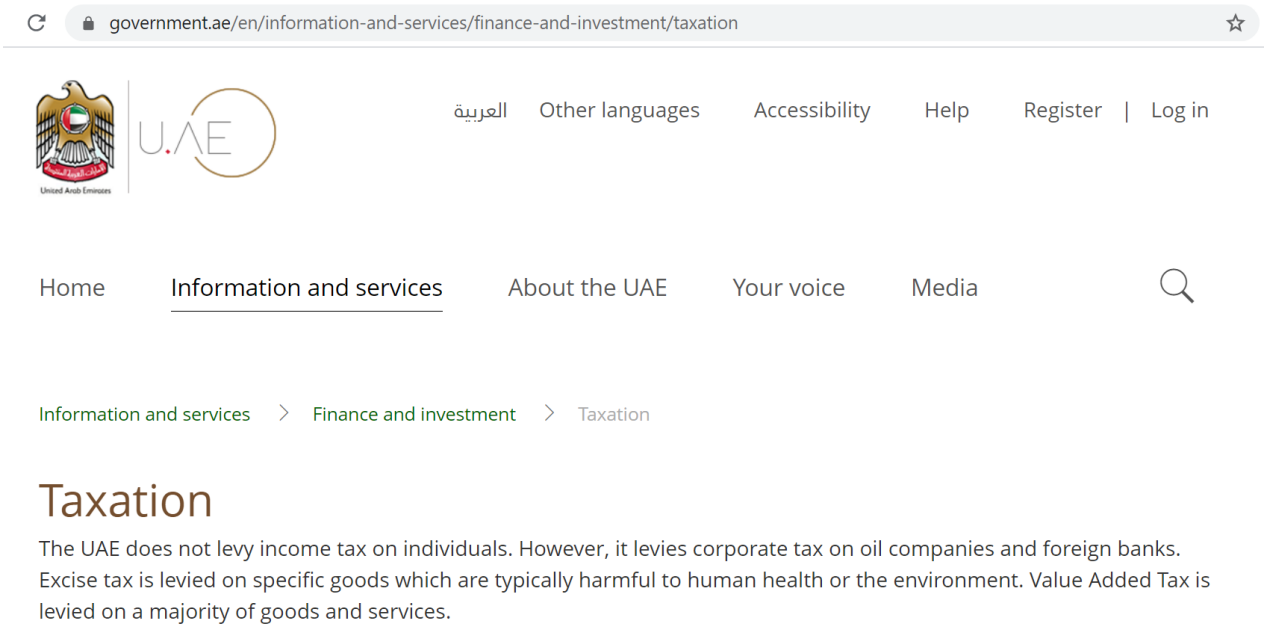
In the year 2020, Indian economy has improved considerably (as compared to 1991). Global views have changed. Double non-taxation and Treaty Shopping are considered as 'Not Acceptable'. G20 and OECD **BEPS** programme has declared clearly that double non-taxation will not be

acceptable and a treaty cannot be used to achieve double non-taxation. In this changed environment, all Governments are trying to ensure that an income is taxed atleast in one country. **We need to view Finance Bill proposals in the light of this changed global atmosphere.**

III.2 Consider the illustration of an individual who is resident of UAE. UAE Income-tax law is called: "**Dubai Income-tax Decree 1969".** Under the decree only a corporation is liable to Income-tax. **Individuals are not liable to Income-tax**. Only banking and oil mining corporations are asked to pay the Income-tax. All other corporations (companies / FZCs) doing business in Dubai are not asked to pay Dubai Income-tax. Can an individual who is resident of Dubai claim that he is **liable to tax in Dubai** and hence he will not be covered by S. 6(1A)? Further, can he make following claim? "He has a **Tax Residency Certificate** from UAE government. Hence, if, in **future**, UAE government imposes income-tax, he will be liable to tax in UAE. He has a **potential tax exposure**. Hence he should be considered Liable to Tax in UAE."

III.3 In my view, this claim would not be tenable. Income-tax law is applicable **qua a previous year** (accounting year or financial year). All the circumstances present during a previous year determine the assessee's liability to tax. Thus, for example, for the accounting year 2020-21, a person would be liable to tax in Dubai only if – (i) Dubai makes a law levying Income-tax on him & (ii) he actually becomes liable to pay such a tax for accounting year 20-21. **A potential tax liability has no place under Income-tax**.

A snap shot of UAE Government's website taken on 6th February, 2020. Website address is : https://u.ae/en/information-and-services/finance-and-investment/taxation .



III.4 Similarly, the argument that an individual holding "**Residence Permit**" in Dubai is "**Subject to Dubai Income-tax**" is also not correct. In reality, the current Dubai Income-tax Decree does not cover individuals as "Taxable Persons".

Similarly, if a person holds TRC – **Tax Residency Certificate** of Dubai, it does not mean that he is liable to tax in Dubai. While UAE does not levy any Income-tax on its resident individuals; it does give TRC. The TRC is issued pursuant to the India-UAE DTA so that a person can claim the DTA relief. It does not mean the person becomes "liable to tax" in UAE.

III.5 Buying Citizenship Abroad: GAAR:

Consider the illustration of the person who has been Indian citizen and is now a resident of Dubai for last few years. He wants to avoid the applicability of Section 6 (1A). Hence, he pays appropriate price and obtains the **citizenship of a tax haven -** say, St. Kitts Island, situated in the West Indies. Can **GAAR** provisions be applied to his purchase of citizenship? (Sections 95 to 102 of ITA.)

If the person continues to do his business in Dubai, continues to stay in Dubai and almost never visits St. Kitts Island – it can be said that he has changed his citizenship to avoid Indian taxes. He has no commercial or even personal purpose for acquiring citizenship of an island situated 12,000 kilometres away from Dubai. Hence, Income-tax department may, in appropriate cases invoke GAAR; ignore his citizenship of the tax haven & consider him as an Indian citizen & Indian resident.

IV. Not Ordinarily Resident (NOR) Section 6(6):
Amendments in S. 6(6) nullify the anti-avoidance provisions made in S. 6(1) & (1A).

IV.1 Section 6(6) as amended by Finance Act, 2020 is reproduced below.

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.

(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).

Explanation.- For the purposes of this section, the expression "income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

Extract of Section 6 (6) completed.

IV.2 Indian Finance Act - 2020:

Two clauses have been added to NOR status - clauses 'c' & 'd' giving permanent reliefs. Interrelationship between S. 6(1) and S. 6(6) and their implications are discussed below:

2.1. A person who is subject to three conditions given under Section **6(1A) will be deemed to be an Indian Resident.** These conditions are given in paragraph II.1 above. **He will also be considered to be Not Ordinarily Resident** (NOR) for the relevant year. **S. 6(6)(d).** Under S. 6 (6) (c) even PIOs – who are not Indian citizens are covered.

2.2 As an NOR, he will not be liable to Indian tax on his foreign income; and will not be liable to disclose his foreign assets & incomes in India. With this important change in S. 6(6), GOI has nullified the effect of amendments in S. 6(1). While the NR may be treated as IR under S. 6(1A), he will also be treated as NOR and hence he will not be liable to Indian tax on his foreign income. All non-residents were always liable to Indian tax on their Indian sourced incomes. So the Finance Act 2020 amendment achieves almost nothing. But it does create some avoidable controversies as discussed below.

IV.3 Permanent relief:

Clauses (c) & (d) provide a permanent relief. The concerned person will remain an NOR for as long as he continues to satisfy conditions of these clauses. It will be practical for NRIs to satisfy these conditions for

very long periods. We consider following provisions to understand how these are permanent reliefs.

Section 6 sub section 6 starts with following sentence: *"A person is said to be "not ordinarily resident" in India in any previous year if such person is— ...."*

In simple terms - any assessee who can satisfy any one of the four conditions given below the sentence will be an NOR as long as he continues to satisfy those conditions. There are four separate and independent clauses given below this sentence: clauses a, b, c & d. Please note the term "OR" at the end of each clause – a, b & c. This term signifies that each clause is independent of all the other clauses in S. 6(6). It is only in clauses a & b that the NOR status has been restricted to two or three years. In clauses c & d such a condition is not made. Hence clauses c & d provide permanent relief.

IV.4.1 Implications of Combined operations of S. 6 - (1),(1A) & (6):

Let us examine section 6 as a whole for its implications. Consider the illustration of an **ICNR**. He is Indian citizen but non-resident of India. He has been settled in UAE for last several years. He has business in UAE as well as in India. UAE business is his main business. Indian business is either investment or subordinate. He has homes in UAE as well as in India. His income in India exceeds Rs. 15 lakhs. But his income outside India is far more. His family stays with him in UAE. Hence "**The Centre of His Vital Interests**" is situated in UAE. He comes to India for 180 days in every financial year. Hence U/s. 6(1) (a) he will be a NR for every year. But to be a NR, he should be NR under S. 6(1) clauses (a) & (c) both.

4.2 Let us examine **S. 6(1)(c)**. Under this clause the person will become IR if both of the following conditions are cumulatively applicable to him:

(i) He has been in India for **365 days** or more in preceding four previous years. The ICNR in illustration would satisfy this condition.
(ii) He has been in India in the relevant previous year for more than **59 days**. Even this condition will be satisfied by the ICNR. Hence prima facie he will be an IR.

However, **explanation 1(b)** grants a relief to him. Instead of 59 days as per S. 6(1)(c), he will get **181 days** if he fulfils **all** of the following conditions:

(i) He is an Indian **citizen** or a **PIO**; and
(ii) He has been "**Outside India**"; and
(iii) He comes **on a visit** to India.

Note that the condition in (ii) above is that he should be "outside India". Condition is not that he should be a "Non-resident". Since the ICNR's "Centre of Vital Interests" is situated outside India, he can easily claim that – every year he has been "Outside India"; and that he "Comes on Visits" to India. Hence he is entitled to the relief of 181 days U/S 6(1), Explanation 1(b) as it stood before amendment. Some tax officers take a view that only a NR can claim the benefit of explanation 1(b) as a visitor to India. If a person is Tax Resident in India, he is returning to India; not visiting India. This interpretation is contrary to the clear language of law.

With the **amendment**, the number of days are reduced to **119 days.** Since he is coming to India for more than 119 days, he will become an IR U/S 6(1) (c). However, U/S **6(6) (c)** he will be an **NOR**. Hence he will not be liable to Indian tax on his foreign income and will not be liable to disclose his foreign assets & incomes in his Indian return of income. This is the final effect.

The **chain of provisions** considered in paragraph IV.4 is as under:

S. 6(1) (c) read with **Explanation 1(b):** ICNR becomes IR as per amended provision.
S. 6 (6) (c) he becomes NOR.
Hence he is not liable to tax in India on his foreign income. S. **5(1)(c).**

In the next paragraph we consider another Chain of provisions.

IV.5 State less Person: NOR status, Permanent Relief.

5.1 S. 6(6) is reproduced above in paragraph 1.1. Same sub-section is broken up into its clauses:

(i) Notwithstanding anything contained in clause (1)
(ii) an individual, being a citizen of India,
(iii) having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year

(iv) shall be deemed to be resident in India in that previous year,
(v) 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.

IV.5.2 Discussion:

(i) Sub-section 1A starts with a non-obstante clause. Which means Sub-section 1 and sub-section 1A are independent. Under S.s 1A, number of days stay in or outside India is irrelevant. A person may be in India for all

the 365 days in a year; or may be outside India for all the 365 days in the year. It does not matter.

(ii) The assessee in question should be an Individual and should be a citizen of India.
(iii) He should have "Indian income" of more than Rs. 15 lakhs per year.
(iv) In UAE, he is not liable to Income-tax based on his residential status.

All the above conditions are satisfied by the ICNR in our illustration. Hence he will be considered to be an IR. No need to go to S. 6(1) (c) and to explanation U/s. 6(1). We are not concerned with that chain of provisions. The ICNR is now considered to be an IR. This is the effect that the Finance Bill targeted.

But this was protested. Hence to exempt such ICNRs from its consequences, clause (d) has been added to S. 6 (6). Under this clause he shall be an NOR. Hence he will not be liable to Indian tax on his foreign income and will not be liable to disclose his foreign assets & income in his Indian tax return.

V. "Income from Foreign Sources":

V.1. Preliminary:

1.1 Extracts of amended provisions with separated phrases:

S. 6(1)(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 ……

S. 6(6) explanation:
"**income from foreign sources**" means
income which accrues or arises outside India
(except income **derived from** a business **controlled in** or a **profession set up in** India).

1.2 The term "Income from Foreign Sources" has been used in following provisions:

(i) S. 5(1) (c) Proviso. NOR's **Scope** of Taxable Income. Wording is different.

(ii) S. 6 (1) (Exp. 1)(b) NRI **Visitor's** Residential status.
(iii) S. 6(1A) IC **Stateless** person's Residential Person.
(iv) S. 6(6)(d) **NOR** status-6(1) exp(1)(b). Relief from anti-avoidance provisions.

1.3 Amended provisions of S. 6(1) & S. 6(6) use age old phrases: "Controlled in India" and "Set up in India". They don't use the term "Place of Effective Management" used in S. 6(3). For Business, the term used is: "Controlled in". For Profession the term used is: "Set up in". Why the difference? All these three terms will cause their own independent litigation. Totally avoidable litigation.

V.2. Purpose of the provision in Section 5 (1) (c) Proviso:

This is an age old provision. In "good old times" under section 4A(a)(ii) of 1922 Act – parallel to S. 6(1)(b) of 1961 Act - a person maintaining a dwelling place in India and being in India for a single day in a previous year was considered IR. Being an NR was tough. Once a person was NR for even two years, he was considered to be NOR for nine years. The circumstances then justified some provisions which are now just history. Irrelevant for today's circumstances.

V.3. Chain of Purposes under amended S.6:

The chain of purposes for using this term "income from Foreign Sources" in this section is as under:

3.1 As we have seen above, amendments in **S. 6 (1) exp. (1)(b); and 6(1A)** are **Anti-avoidance provisions.**

3.2 These amendments hit genuine NRs also. They need to be given relief. Hence these amendments are restricted to people having Indian income in excess of Rs. 15 lakhs. While computing the Indian Income, Foreign Income is to be excluded. This gives **relief** from Anti-avoidance provision. Hence this can be called **anti-anti-avoidance provision.**

3.3 However, people may abuse this threshold of Rs. 15 lakhs. CBDT considered it necessary to stop such anticipated abuse. Hence, instead of saying "Indian **income exceeding** Rs. 15 lakhs", the provision uses a lengthy term: "total income, other than income which accrues or arises outside India (except **income derived from** a business controlled in or a profession set up in India)." This definition makes S. 6 in lines with S. 5. It can be called **anti-anti-anti-avoidance provision.** By this time, it stops making any meaning and invites controversies. Some of the controversies are discussed below with illustrations.

V.4. Illustrations:

First illustration is such that the anti-anti-anti-avoidance provision should apply to it. For illustration purposes clear facts are given. Controversies are discussed only for legal implications.

4.1: Indian Professional firm, British Branch:

Facts:

M/s. XYZ is an Indian partnership **firm of lawyers**. It is **set up in India**. The firm has five partners. Four partners look after Indian practice and are normally in India. One partner – Mr. ICNR advises firm's foreign clients and as such he is normally outside India for more than 183 days every year. Mr. ICNR comes to India for more than 120 days every year. The firm has set up a **branch in London**. 5th partner –ICNR carries on his practice from the London branch office. Firm's income from this foreign source is Rs. Five crores. Firm's Indian income is Rs. 2 crores. All partners share profits equally.

Legal implications: General implications:

(i) Query: For considering Mr. ICNR's status under this amendment – should we consider **exclusively Mr. ICNR's own**, sole **proprietary incomes;** or should we consider even **income derived by him from the partnership firm** also? There are two views on this query.

My view is as under: we have to consider only the individual's income. However, it may be derived from any business or profession. That business may be conducted by himself or anyone else. It may be a partnership firm as in this illustration; or a company as in the next illustrations; or even a proprietary concern run by someone else. As long as the business is controlled in India; or the profession is set up in India; the income derived from such a business by the individual will be considered for these amended provisions.

(ii) There are two separate considerations. (a) Income to be computed for the threshold of Rs. 15 lakhs. (b) Income to be considered for taxability U/s. 5.

(a) The language of the law is clear that while computing the threshold of Rs. 15 lakhs, we need to consider only the concerned individual's income. Not the income of other firms or companies with which the individual may be associated. In fact association is not relevant.

(b) Even for taxability U/s. 5, we can consider only the income of the individual only.

(iii) We are considering the individual's residential status under S. 6(1) & (1A) read with S. 6(6). We are not considering the residential status of the firm or company which is controlled in or set up in India. That would be a legal issue under S. 6(2) or (3). A foreign company if controlled from India may be considered to be an Indian resident under S. 6(3). Its global income may be

taxable in India. We are not concerned with that issue in this article. We are exclusively looking at the income derived by an individual from any business or profession.

Legal implications for this illustration:
(i) For the firm XYZ global income is taxable in India. Firm's British income does not become Indian sourced income. It is just taxable in India. This is old established position & nothing changes because of the amendment.

(ii) Mr. ICNR earns Rs. 40 lakhs as his share of profits from Indian source; and earns a salary of Rs. 50 lakhs from the London branch. The share of profits from Indian firm including the British income is not taxable in partner's hands. Firm would pay full tax on its profits after deducting partners' salaries. Hence this share of profit is not considered in more details. The British sourced salary income of Rs. 50 lakhs is foreign sourced income. But it is earned from a firm set up in India. Amendment to clause 1(b) is applicable. Since ICNR comes to India for more than 120 days, he will be treated as an Indian resident. Relief provided in S. 6(6)(c) will be available to him and he will be NOR. Yet, his British income would be taxable in India U/s. 5(1)(c) Proviso. If he has other independent foreign incomes, such independent incomes would not be taxable in India.
(iii) The London branch will be a **permanent establishment** (PE) in Britain and as such its British income will be taxable in Britain as per the British law. There will be double taxation. Relief under DTA will be applicable.

(iv) Mr. ICNR's British salary also will be subject to double taxation – British income tax & Indian Income-tax. DTA relief will be available.

4.2 Illustration of a British Subsidiary Company:

Facts:

Consider ABC Pvt. Ltd., an Indian company. It has incorporated a 100% subsidiary in London which is controlled from India. Mr. Iyer is a senior manager under the subsidiary. He stays in London for about 240 days and visits India for about 125 days every year. His salary from the British subsidiary crosses Rs. 15 lakhs. His Indian income is Rs. 2 lakhs.

Implications of amended provisions:
(i) Mr. Iyer is a British tax resident. His global income is taxable in Britain. He derives salary from a business controlled in India. Hence his entire salary will be considered "Indian Income" for the threshold. The anti-avoidance provision will apply to him and he will be considered to be Indian resident U/S. 6(1) (c) read with amended exp. 1(b). Relief U/s 6(6)(c) will be available to him – he will be considered an NOR. But because of the anti-anti-anti-avoidance provision his **salary will be taxable in India U/s. 5(1)(c) Proviso.**

(ii) However, India-UK **DTA will override ITA**. Assume that under Article 4 (2) – Tie Breaking provision, he will be treated as a British resident. Hence under Article 16 of the DTA, his British salary will not be taxable in India.

(iii) Controversy: ICNR's British salary is taxable in India under ITA. But due to DTA it becomes not taxable in India. Can he apply the DTA at the stage of computing the threshold of Rs. 15 lakhs? If for threshold itself the British income is not to be considered, then rest of the law will not be applicable. Note that there are two independent issues: (a) DTA application for computing income subject to threshold – which is applicable for determining residence under S. 6; and (b) DTA application for taxability under S. 5.

There are two views:
(iiia) Function of DTA is only to give relief from double taxation. As far as computation of income and all compliance provisions are concerned, only ITA applies. Hence in this illustration the British salary will be considered for threshold computation. It crosses Rs. 15 lakhs. Hence Mr. ICNR will be considered to be an IR. There after his income is not liable to tax in India – is a matter of application of DTA for providing relief from double taxation. That issue comes up after computing the income.

(iiib) Another view: DTA should apply at every stage for anything relating to the British salary income. Hence British salary will not be counted for threshold computation. Hence Mr. ICNR will not be considered to be an IR.

I agree with the first view expressed above and the illustration is dealt with accordingly.

4.3 Illustration of a UAE Company.

Facts:

Shah family, Indian residents have incorporated a company in a Free Zone in UAE namely Shah FZE. The family holds 100% equity in the UAE company and controls it from India. There are a hundred employees of the UAE company. Most of them are not related with Shah family. All of them earn annual salaries from Shah FZE in excess of Rs. 15 lakhs. Some of them visit India for more than 120 days a year.

Implications of amended provisions:

The employees visiting India for more than 120 days will be considered to be Indian residents under S. 6(1) Exp. 1(b). They will also be considered NOR U/s. 6(6)(c). Since salaries are derived from an Indian controlled business, they will be considered "Indian Income" for the purposes of the threshold. These salaries will also be **taxable in India under ITA** – S. 5(1)(c). However, India – UAE **DTA will prevail over ITA**. Under Article 16, such salary will not be taxable in India.

V.6 Pandora's Box:

(i) Issue: If a NR earns interest income from a totally **unrelated foreign concern** which is controlled from India; will such interest income be considered for the threshold of Rs. 15 lakhs?

Response: Under plain interpretation of law such income will be considered for application of amended provisions. Section nowhere requires that the assessee individual and the business or profession from which he derives income should be associated. It seems that Parliament never intended to tax unrelated persons' incomes. But plain interpretation of law supports the view that the two need not be associated.

(ii) What is the meaning of the phrase "Derived from" used in explanation at the end of S. 6(6)? There are controversies about this term under different provisions. Consider an illustration: Mr. NR conducting his business outside India is selling his services to a UAE company which is controlled from India. Mr. NR's business profits are "derived from" this UAE company. Will his income be considered for the threshold of Rs. 15 lakhs? Response will be same as in V.6.(i) above.

V.7. Circular Calculations:

7.1 "Income from foreign sources" is a phrase that determines or affects the "Scope of Total Income" taxable in India. This scope is dependent upon residential status of the assessee. Such a phrase in S.5 is fine. However, use of this phrase in S. 6 means, the residential status will be determined by the person's "Total Income". Now it becomes a Circular Calculation. To repeat: "Scope" depends upon "Residence" which depends upon "Scope".

There are several kinds of incomes which are exempted from Indian tax U/s. 10 for NRs. Hence such incomes do not form part of "Total Income". Hence they would not constitute the threshold of Rs. 15 lakhs. An illustrative list of incomes that are exempt U/s 10 for non-residents is given below in paragraph 7.2. For individuals having such incomes, what does one consider first – the residential status or exempt income? Based on what logic the sequence will be determined? Can a CBDT circular decide such matters?

7.2 Exemptions U/s 10 dependent upon residential status:

- 10(4D) – income from transfer of units in IFSC
- 10(6)(viii) – salary from employment on foreign ship
- 10(6BB) – tax on income certain incomes from Indian airline companies
- 10(6D – specific royalty income
- 10(8A) – specific consultancy income
- 10(15)(iv)(fa) – interest on foreign currency deposits
- 10(15)(viii) – interest on deposit with Offshore Banking unit
- 10(15)(ix) – interest from a unit in IFSC

7.3 Relief in computation of capital gain U/s. 47:

- 47(via) – GDR
- 47(viiaa) – Rupee denominated bond
- 47(viiab) – capital asset in IFSC
- 47(viib) – Govt security

V.8 Conclusion on Income from Foreign Sources:

It is clear that too many unintended cases will be covered under this anti-anti-anti-avoidance provision. Real cases of sophisticated tax planning may be very few. And for those few cases involving HNIs, it may be fairly easy to escape this provision by ensuring that the income is derived from a separate foreign business which is not controlled from India or a profession which is not set up in India. Language used is prone to litigation. It will unsettle a section which has been well settled. Damage caused by these amendments will be many times more than the possible revenue that the department may get.

VI. Conclusion of the article as a whole:

GOI tried to plug a tax avoidance mechanism. However, the proposal would also hurt genuine non-residents. On realisation of this unintended consequence, GOI decided to provide relief to NRIs by considering them as NORs. In the process, the law has become unnecessarily complicated. Ideally, the Finance Bill proposal to amend S. 6 should have been dropped. It would help stabilise the law.

Thanks.

Rashmin Chandulal Sanghvi