

International Taxation -1

Residential Status –Act and DTAA Expatriate Taxation Tax issues on cross border employment

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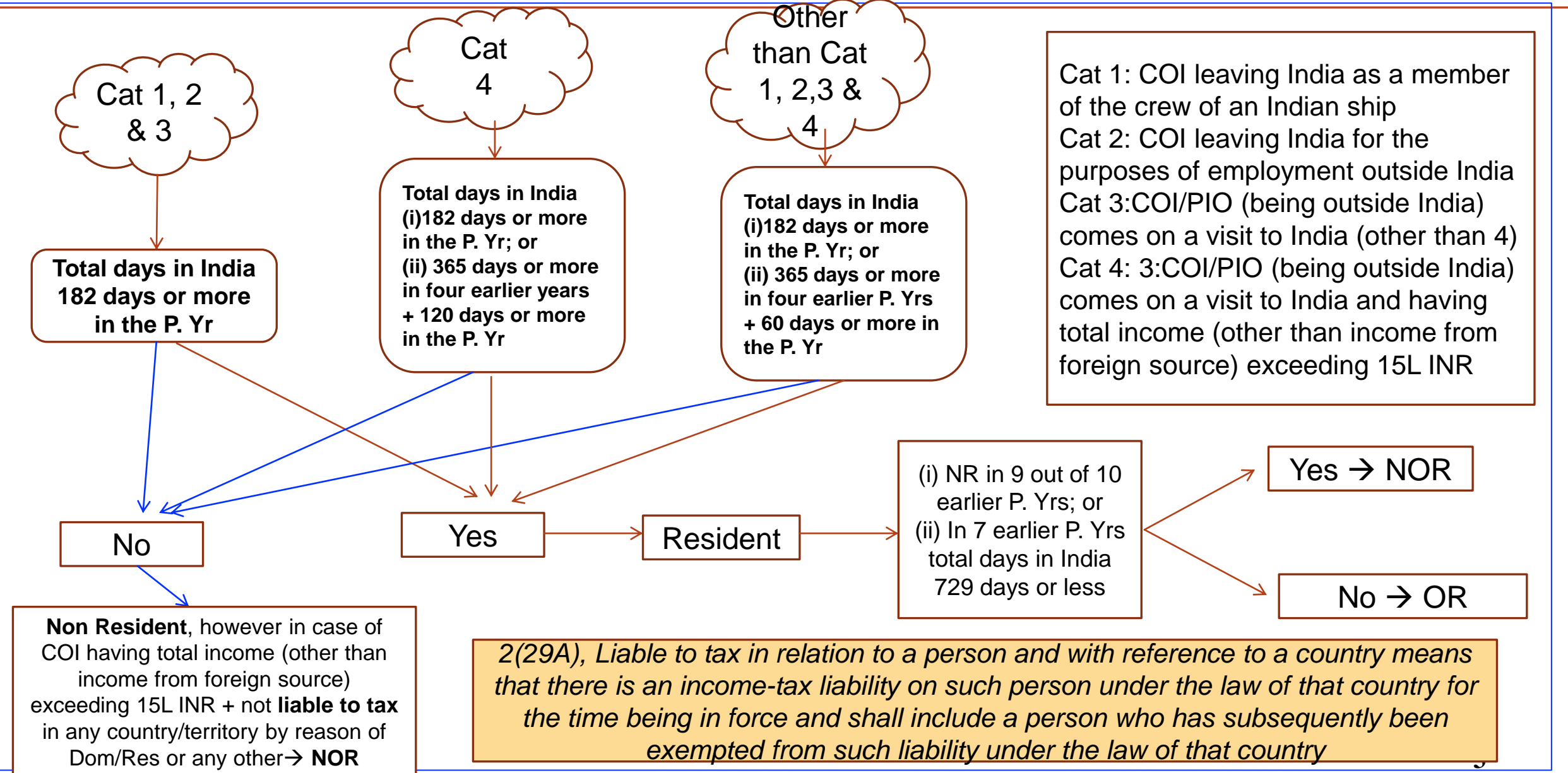
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Scope of Total Income

Particulars	Resident-Ordinary	Not Ordinary Resident	Non-resident
Received in India/deemed to be received in India	Yes	Yes	Yes
Accrues or arise in India/deemed to accrue or arise in India	Yes	Yes	Yes
Accrue or arise outside India	Yes	No (unless derived from business controlled or profession set up in India)	No

- Section 9(1)(ii): Salary income earned in India + Salary for service rendered in India (including leave/rest period preceded/succeeded and forming part of service contract of employment) → is deemed to accrue or arise in India
- Sets to rest the controversy about where salary income accrues – where service rendered (Shoorji Vallabhdas & Co SC, or (ii) where employment contract is enforced, whether the visit to India is for employment or in connection with employment
- Receipt means first receipt after accrual. Control test. CIT v Diwan Bahadur S.L. Mathias (SC)
- However, there are various judgments where salary received in India was not held taxable. CBDT circular no 13/2017 for seafarer on foreign going ships (Indian flag or foreign flag) salary credited in NRE account would not be taxable if accrue outside,

Residency test of Individuals under section 6 of ITA



Cat 1: COI leaving India as a member of the crew of an Indian ship
 Cat 2: COI leaving India for the purposes of employment outside India
 Cat 3: COI/PIO (being outside India) comes on a visit to India (other than 4)
 Cat 4: COI/PIO (being outside India) comes on a visit to India and having total income (other than income from foreign source) exceeding 15L INR

Non Resident, however in case of COI having total income (other than income from foreign source) exceeding 15L INR + not **liable to tax** in any country/territory by reason of Dom/Res or any other -> **NOR**

2(29A), Liable to tax in relation to a person and with reference to a country means that there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country

Important points to determine residency for individuals

- Residential status is determined on the basis of number of days present (except deemed residency for Indian citizens)
 - Under The Citizenship Act a person could be a citizen of India by birth, by descent, by registration and by naturalization.
 - Citizen means those individuals who under the Constitution of India are guaranteed civic rights and who can hold public offices and elect their representatives to Parliament/assemblies (STC v CTO AIR 1963 SC 1811)
 - OCIs are registered under section 7A of The Citizenship Act as OCI cardholder and thus, they cannot be regarded as citizen generally and also for section 6(1A) although the nomenclature might suggest so
 - Explanation to section 115C(e), a Person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand parents, was born in undivided India
 - Explanation to section 6, Income from foreign source means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India.
 - A claim of stay in Nepal/Bhutan will not lead to conclusion (without evidence) that the person is non-resident (Ram Kumar Dhumka v UOI 2001, 118 Taxmann 535 Rajasthan HC)
 - Leaving job outside India permanently and coming to India is not a visit
 - Visit for the **purpose of employment** vs visit **in connection with the employment**. But need not be an unemployed person when leaving India for the purpose of employment (outbound on deputation)
 - Employment include self employment
 - For a member of crew of a foreign bound ship leaving India, period of stay as per Rule 126.
 - Day of arrival to be counted? Yes AAR, No Bang ITAT (Manoj Kumar Reddy)-section 9 of GCA
 - Involuntary stay Delhi HC in Suresh Nanda, general applicability?
 - “Liable to tax” back ground, Azadi Bachao, AAR in Mohsinaaly Rafik, Cyril Eugene Pereira, Abdul Razak Meman
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Tie breaker test for Dual residency for Individuals under DTAA

- Dual residency could be based on stay or could also be based on deemed residency (for those treaties that do not have “liable to tax” requirements like UAE and Kuwait)

General tests for tie breaker for dual residency for individuals under DTAA (hierarchical):

1) Permanent Home

- Individual must have arranged and retained it for his permanent use.
- May not be owned, could be rented.
- Stay should not be intended of short duration.

2) Centre of Vital Interest

- Based on facts, to which State has personal and economic relations are closer
- See family, social relations, occupations, place of business, place from where properties are administered, from where he conducts political, cultural or other activities.

3) Habitual Abode

- To determine where individual live habitually, presence in one State to the exclusion of other State.
- Compare the presence over sufficient length of time to determine where does he live habitually more.
- Consider frequency, duration and regularity of stays.

4) Nationality

Mutual Agreement Procedure: If above tie breaker fails, CAs of two countries to meet under MAP and decide. Canada and Estonia have something special → In the absence of CA agreement, resident of neither countries

Expatriate taxation/Tax issues in cross border employment

- **Whether expatriate is employee** (dependent services) or performing independent services.
- **What is employer – employee relationship:** It is true that HC/SC judges have no employer, but that ipso facto, does not mean that they do not receive salary (Justice Deoki Nandan Agarwal vs UOI SC). Important factors:
 - ✓ Right to control the **manner** in which work is to be done, and not just final output, Control need not be day to day but could be through article of association (In case of MD, in case of Ram Prashad, SC)
 - ✓ Right of establishment to dismiss or suspend, Delhi HC in Centrica India Offshore Pvt Ltd – right to terminate secondees' employment is with foreign entity hence foreign entity is employer of secondees
 - ✓ Ultimate authority on performance of worker, SC in Morgan Stanley observed that person responsible for the work of deputationists is the employer
 - ✓ Obligation of payment of salary or right to recover salary: In Centrica Delhi HC observed that responsibility to pay salary was on foreign company and no legal recourse was against Indian company
 - ✓ Contribution to social security benefits like PF: In Centrica
 - ✓ Lien on employment: In Morgan Stanley SC observed that as long as Lien remains with the overseas entity, the deputed employees cannot be considered to be the employees of Indian entity

Expatriate taxation/Tax issues in cross border employment

- **Tax equalisation**

- ✓ Section 2 (24)(iii), 17 (2)(iv) – any sum paid by the employer in respect of any obligation, which but for such payment, would have been payable by the assessee
- ✓ Section 10(10CC), tax on income (in the nature of non monetary perquisite) paid by employer on behalf of employee, at the option of employer, is exempt – This is to avoid multi stage grossing up. However, no deduction allowed to employer, if claimed exempt [section 40(a)(v)].
- ✓ Delhi HC in Yoshio Kubo and Uttarakhand HC in Sedco Forex International Drilling held it to be non-monetary perquisite
- ✓ Hypothetical tax is not counted as income, Delhi HC in Dr Percy Batlivala, Yoshio Kubo, Bombay HC in Jaydev H Raja, Madras HC in Rajasekaran Balasubramaniam

- **Social security contribution**

- ✓ SC in L. W. Russel held that unless a vested interest in the sum accrues to an employee, contribution by employer is not taxable as it is only a contingent interest depending upon the assessee reaching the age of superannuation, thus need to see if it is compulsory obligation of the employer and employee does not have a vested right and right to claim is only on happening of contingency
 - ✓ Employee's contribution was held to be deductible (though not covered u/s 16) by Mumbai ITAT in Gallotti Raoul on the basis that it was statutory with overriding charge and it never reached the employee. SC decision in Sitaldas Tirathdas diversion by overriding title is important to understand this
 - ✓ It is important to see if it is statutory(compulsory), does employee have vesting rights (like in insurance premium). SC in Navnit Lal Sakar Lal has held that amount utilized for obtaining deferred annuity policy is taxable as salary.
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Expat taxation/Tax issues in cross border employment

- **ESOP**

- ✓ 17(2)(vi). Perquisite includes value of any specified security or sweat equity shares allotted, directly or indirectly, by the employer free of cost or at concessional rate to the employee.
- ✓ Value is FMV on the date of exercise of option less as reduced by the amount paid by employee
- ✓ Taxation is on allotment but value is taken as on date of exercise
- ✓ Tax deferral for eligible start up for max 48 months from the end of taxable year
- ✓ Even allotment by former employer is covered as it is for past employment, Bang ITAT in the case of Chittaranjan A Dasannacharya
- ✓ Share of group company also covered SC in Justice Deoki Nandan Agarwal has held that employer employee relation not essential for salary income followed by Mumbai ITAT in Sumit Batttacharya.
- ✓ Circular no 9/2007 on FBT clarifies that where employee was in India for only part of grant period, a proportion amount of FBT would be liable to tax.
- ✓ ITAT Delhi in the case of Robert Arthur Keltz and ITAT Hyd in the case of Anil Bhansali restricted the taxation to proportion of service rendered in India.
- ✓ In case of lock in period there is SC judgment in Infosys. However, that judgment spoke about lack of legislative provision which we now have. The fact of lock in could influence the FMV as on the date of exercise but still the amount would be taxable.
- ✓ The period of shareholding is counted from date of allotment and not date of exercise

Expatriate taxation/Tax issues in cross border employment

• Short stay of Expats

- ✓ 10(6)(vi). Remuneration received by a non Indian citizen, who renders service during his stay in India as employee of a foreign enterprise, is exempt if
 - (i) the foreign enterprise is not engaged in any trade or business in India; and
 - (ii) his stay in India does not exceed in aggregate 90 days in the previous year; and
 - (iii) such remuneration is not liable to be deducted from the income of the employer under ITA.
 - ✓ Condition (i) not satisfied when fee for deputed employee received by foreign enterprise under direct agreement between foreign company and Indian company. ITAT Hyd in Nagarjuna Coated Tube Ltd and ITAT Delhi in Pace Education(P) Limited. However, when employees are deputed to Indian concern and service rendered by those employee to Indian concern this condition is satisfied even if for convenience amount paid to foreign company. Delhi HC in BHEL
 - ✓ Condition (iii) is not satisfied if income earned by foreign company is chargeable to tax on gross basis like under section 115A
 - ✓ In case of NR crew of foreign ship, short stay exemption of salary income upto Indian stay of 90 days is there without any condition 10(6)(viii)
 - ✓ Under the tax treaty, in general, source country (India) loses its right to taxation under dependent personal service Article if
 - (i) the stay is upto 183 days in aggregate in any 12 months period (this differs from treaty to treaty); and
 - (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of source state (India); and
 - (iii) the remuneration is not borne by a PE or fixed base which the employer has in source state (India)
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