

EY Tax Alert

CBDT to examine cases of double taxation to provide relief to individuals stranded in India during the COVID-19 pandemic

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Executive summary

Due to the Novel Corona Virus (COVID-19) outbreak and consequent fallout like lock down, quarantine, cancellation of international flights, limited operation of evacuation flights, many individuals coming on visit to India were stranded in India. The forced stay in India impacts the residential status of individuals, as the residential status is generally based on physical stay in India.

Accordingly, to avoid genuine hardship for the tax year 2019-20, the Central Board of Direct Taxes (CBDT) vide Circular 11/2020 dated 8 May 2020 provided relaxation by announcing exclusion of period of overstay in India from 22 March 2020 to 31 March 2020 for determining the residential status in India.

As the COVID-19 outbreak continues even for the tax year 2020-21, the CBDT received various representations from individuals who had come on a visit to India during the tax year 2019-20 and intended to leave but could not do so due to the suspension of international flights. Such individuals requested for relaxation in determining residential status on the lines of relaxation announced for tax year 2019-20.

Pursuant thereto, the CBDT has issued Circular 2/2021 (Circular) dated 3 March 2021 (accompanied with a press release) in the light of changed circumstances of prolonged disruption. The Circular explains how there are lesser chances of double taxation risk for such individuals in view of the interplay of Indian domestic tax rules with Double Taxation Avoidance Agreements (DTAA/treaty) entered with other countries. But it also provides opportunity to impacted individuals to provide relevant information to the CBDT by 31 March 2021 on the risk of double taxation faced by them in order to enable the CBDT to announce a general or case-by-case individual relief.

Residential status and scope of taxable income for individuals

- ▶ Under the ITA, the scope of income taxable in India is dependent on the residential status of a taxpayer. In case of individual, the residential status is primarily determined on the basis of period of stay of such individuals in India during the relevant and earlier tax years.
- ▶ In case of individuals, there can be three categories of taxpayers and the scope of taxation in India with reference to the residential status is provided below:
 - ▶ Resident (R) individual - Worldwide income is taxable in India
 - ▶ Resident but Not-Ordinarily Resident (NOR) individual - Only India- sourced income is taxable in India but at tax rates and slabs as applicable to residents. India-sourced income includes (a) incomes accruing or arising in India including those deemed to accrue or arise in India as per the domestic source rules (b) incomes received in India or deemed to be received in India and (c) income accruing or arising outside India derived from business controlled in or profession set up in India.
 - ▶ Non-resident (NR) individual - Only India-sourced income is taxable in India at special tax rates. Unlike NORs, India-sourced income excludes income accruing or arising outside India derived from business controlled in or profession set up in India.

COVID-19 residency relief announced for tax year 2019-20

- ▶ Due to Novel Corona Virus (COVID-19) outbreak and consequent fallout like lock down, quarantine, cancellation of international flights, limited operation of evacuation flights, many individuals who were on visit to India were stranded in India. The elongated physical stay in India was likely to convert their tax residential status in India as R or NOR.
- ▶ Accordingly, to avoid genuine hardship, for the tax year 2019-20, the CBDT vide its Circular 11/2020 dated 8 May 2020 announced relaxations to individual who had come on a visit to India before 22 March 2020. The relaxation announced was the exclusion of the period from 22 March 2020¹ to 31 March 2020² for determining the residential status in India.
- ▶ Interestingly, the CBDT Press Release dated 9 May 2020 clarified that for determination of residential status for the tax year 2020-21 a similar circular for excluding the period of stay of such individuals up to the date of normalization of international flights shall be issued after normalization.
- ▶ However, the COVID-19 pandemic disruption continues till date and international flights are not normalized in India till 31 March 2021.

Considerations for COVID-19 residency relief for tax year 2020-21

- ▶ As the COVID-19 outbreak continues even for the tax year 2020-21, the CBDT received various representations from individuals requesting for relaxation in determination of residential status for those who had come on a visit to India during the tax year 2019-20 and intended to leave but could not do so due to suspension of international flights.
- ▶ However, in light of the changed circumstances of prolonged disruption, the CBDT has deviated from its earlier announcement of blanket exclusion of period of forced stay in India. The CBDT has issued

¹ Or date of quarantine after 1 March 2020

² Or date of departure before 31 March 2020 on evacuation flight

Circular 2/2021 dated 3 March 2021 (accompanied with a press release) which explains how there are lesser chances of double taxation risk for such individuals in view of the interplay of Indian domestic tax rules with DTAA entered with other countries. But it also provides opportunity to impacted individuals to provide relevant information to the CBDT by 31 March 2021 on the risk of double taxation faced by them in order to enable the CBDT to announce a general or case-by-case individual relief. The factors analyzed by CBDT are explained below:

Factors mitigating risk of double taxation for stranded individuals

Based on the examination of provisions of domestic tax rules, DTAA and international literature, the Circular explains that there are less likely chances of double taxation for stranded individuals.

- ▶ **Individual likely to be resident of only one country due to domestic tax rules and tie breaker rules under treaty**
 - ▶ Short stay in India on account of COVID-19 may not result in an individual qualifying as resident in India because, generally a person will become Resident in India only if his/her stay in India is for a period of 182 days or more.
 - ▶ The exceptions to the above rule are as follows:
 - In case of individual being citizen of India or person of Indian origin, if his/her income from Indian sources exceeds INR 1.5m in tax year 2020-21 and he/she stays in India for 120 days or more and has also stayed in India for 365 days or more in preceding four tax years.
 - In case of other individuals, if he/she stays in India for 60 days or more during tax year 2020-21 and has also stayed in India for 365 days or more in preceding four tax years.
 - ▶ Due to 182-day rule (out of 365 days), which is also prevalent in most of other countries, the individual is likely to be resident in only one country and may not be regarded as resident of more than one country. On the contrary, if a general relaxation for stay exceeding 182 days in India is provided, there are chances of individual not being resident of any country (double non-residency) resulting in double non-taxation or non-payment of tax in any country.
- ▶ However, in certain exceptional scenarios, where a shorter duration of less than 182 days can also result in an individual being resident of India, it is quite possible that such individual will also be resident in other country which has DTAA with India. Such dual residency is addressed by the “tie breaker test” in the DTAA’s, due to which such person shall qualify as resident in only one of the countries. The tie breaker test provides certain objective tests to determine the stronger connect of individual between the two countries in terms of his/her permanent home, center of vital interest, habitual abode, nationality or as last resort, resolution through Mutual Agreement Procedure (MAP).
- ▶ **No double taxation of income and income is taxable subject to DTAA benefit:**
 - ▶ Where the individual becomes resident on account of exceptional cases, it is most likely that such person will qualify as NOR, and his/her foreign-sourced income would not be subjected to tax in India unless it is derived from business controlled in or profession set up in India.
 - ▶ In case of employees visiting India, who are stranded in India, the DTAA provides adequate conditions for taxation of income. Income from employment exercised in India is taxable in the hands of person resident of other country only if he/she is present in India for more than 183 days or the foreign employer is a resident of India or foreign employer has a permanent establishment (PE) in India which bears such remuneration. Illustratively, if a US resident under employment of US corporation has got stranded in India and performs employment from India, his/her salary will not be taxable in India during tax year 2020-21 unless he/she is present in India for 183 days or more during tax year 2020-21 or if his/her salary is borne by Indian PE of such US corporation.
 - ▶ In any case, the person qualifying as Resident in India shall be entitled to credit of taxes paid in other countries in accordance with the foreign tax credit (FTC) rules in this regard.
- ▶ **International experience on COVID-19 residency relief:**
 - ▶ International literature and country experiences portray that relaxations for COVID-19 stranded stay are not required as DTAA relieves the double taxation, if any. Illustratively:
 - The Organization for Economic Co-operation and Development (OECD) in

its report³ states that temporary dislocation in host country is unlikely to render a person resident of host country due to the inbuilt tie breaker rules in DTAA.

- The study of world-wide COVID-19 reliefs provided in different countries reveal that while some countries⁴ have gone ahead to extend the relaxation to its taxpayers, some countries⁵ have not provided for any such relaxations in the absence of any double taxation or granted limited relaxations.

Window for availing relief from double taxation

Despite the above considerations, the CBDT acknowledges that there may be possible scenarios of double taxation. Hence, the Circular provides that those individuals who are facing double taxation even after considering the relief provided by the relevant DTAA can furnish the specified information in Form - NR electronically by 31 March 2021⁶. Thereafter, the CBDT will examine:

- ▶ Whether the particular instance warrants any relaxation
- ▶ If yes, whether a general relaxation is required to be issued for class of individuals or specific relaxations to be provided in individual cases

Form - NR requires basic information about the taxpayer, his/her stay in India, whether he/she will become resident in India or dual resident in India and other country, nature and amount of income being subjected to double taxation and reasons for double taxation inspite of DTAA.

Comments

The present Circular is a deviation from earlier announcement on 9 May 2020 that a circular for excluding the period of stay of stranded individuals up to the date of normalization of international flights, for determination of residential status for the tax year 2020-21 shall be issued after normalization. The deviation is in the light of prolonged disruption due to COVID-19 where international flights have not yet normalized.

The Circular also explains the policy rationale of not announcing a general relaxation which has the inherent risk of some individuals avoiding becoming resident in any country during tax year 2020-21. It explains how there is a lesser risk of double taxation in view of tie breaker rules of treaties, treaty conditions for source taxation and FTC rules (if there is double taxation). But the Circular also demonstrates the pragmatic and accommodative approach of the Government by not ruling out the practical cases of double taxation. The individual taxpayers, who are impacted by forced stay in India, should utilize this opportunity to communicate their concerns on or before 31 March 2021 in the specified form electronically.

The Circular rightly points out that a forced stay in India in most cases will make an individual NOR in India and not liable to tax on foreign-sourced incomes. But one has to note that NOR has to pay tax on India-sourced incomes at higher rates applicable to residents and not at special rates applicable to NRs. The general relaxation as announced for tax year 2019-20 by excluding the period of forced stay in India would have granted relief in such circumstances. But in view of the changed policy, individual taxpayers can only expect relief from double taxation. However, if they tie break to other country as per treaty, they can still claim lower treaty rate on India-sourced incomes.

³ OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis

⁴ USA, UK and Australia subject to fact-specific evaluation.

⁵ Germany has clarified that in the absence of a risk of double taxation, there is basically no factual inequity if the

right to tax is transferred from one contracting state to another due to changed facts.

⁶ https://nicforms.mp.nic.in/nicforms_designer/nic_form_selector.php?form_id=enRhYmxlNjAzZWY2NmIzZGI3NjIwMjEwMzAzMTg=

One important development which those individuals seeking to claim treaty relief must consider is the proposal in the Finance Bill 2021 introduced on 1 February 2021 to define the term "liable to tax" with effect from tax year 2020-21. It is proposed to define "liable to tax" to mean, in relation to a person, that there is a liability of tax on such person under any law for the time being in force in any country and shall include a case where subsequent to imposition of tax liability, an exemption has been provided. When this is enacted into law, the residency article in most treaties will need to be read in the light of new definition creating uncertainty on treaty residency in countries (like Middle East countries⁷) where there is no personal income tax.

Individuals based in non-treaty countries may face the risk of double taxation, but Indian domestic tax rules provide FTC for taxes paid in foreign country by a resident.

The risk of double taxation generally arises in cases where there is mismatch in tax year between India and foreign country and due to reduced time lines to file revised/belated returns as proposed in Finance Bill 2021 for tax year 2020-21 onwards, there may be difficulties faced by taxpayers to claim FTC.

The extended stay can also create permanent establishment (PE) risk, especially service PE, for foreign enterprises with respect to employees' presence in India. One may note that the scope of present Circular is restricted to tax implications in the hands of the individual and it does not appear to address concerns with reference to taxation of foreign enterprises due to elongated presence of employees in India as also consequential salary taxation in hands of the employee due to PE trigger.

⁷ Barring countries like UAE and Kuwait where treaty residency in those countries is not based on "liable to tax" condition but on physical stay condition

