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EY Tax Alert

CBDT notifies rule and countries for deferral of taxation of income from retirement benefit account services

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Executive summary

This Tax Alert explains Notifications[1] dated 4 April 2022 issued by the Central Board of Direct Taxes (CBDT)[2] to operationalize the provision introduced by Finance Act, 2021 (FA 2021) [new section (S.) 89A] in the Indian Tax Laws (ITL) for relief from taxation of income from retirement benefit account (RBA) maintained in a notified country by a specified person.

The Notifications insert new Rule 21AAA (Rule) and Form 10EE (Form) to enable a resident person to exercise the option for deferral of taxation of income from such foreign RBA to the year of withdrawal/redemption from such RBA and also notify Canada, UK and USA as eligible countries in respect of which such option can be exercised.

The Notifications come into effect from the date of their publication in the official gazette i.e., 4 April 2022.

[1] Notification Nos. 24 and 25/2022 [F. No. 370142/7/2022-TPL]
[2] Apex direct tax administrative tax body in India

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Background

- There are instances where non-residents (NR) located outside India contribute to RBAs in a foreign country. Typically, such RBAs operate on exempt-exempt-tax (EET) basis of taxation where contributions and accruals are exempt, but withdrawals are taxable. Tax issues arise when such withdrawals are made when the taxpayers are resident in India.
- Taxpayers made representations to the government that there is a mismatch in the year of taxability of withdrawal from RBAs by residents who had opened such accounts when they were NR in India and resident in foreign countries. The withdrawals may be taxed on receipt basis in such foreign countries under their domestic tax laws, while the accruals in the RBAs may be taxed in India on year-on-year basis. This creates challenges for claiming foreign tax credit (FTC) in India and leads to double taxation despite availability of benefit under the Double Taxation Avoidance Agreement (DTAA).
- To illustrate, Mr. A worked in the US from Years 1 to 10 when he was NR in India and resident in the US. During his employment in the US, he contributed to RBA in the US, which is taxable in the year of withdrawal in the US. The accruals in US RBA during Years 1 to 10 are not taxable in India since Mr. A is NR in India. Mr. A returned to India in Year 11 and became a resident of India. Mr. A made withdrawal from US RBA in Year 15. The issue was if the accruals in US RBA during Years 11 to 14 were taxable in India. If so, since no tax was paid in the US during those years, Mr. A was unable to claim FTC against Indian tax liability.
- In order to address this mismatch and remove this genuine hardship, FA 2021 introduced a new S.89A in the ITL with effect from tax year (TY) 2021-22, which provides that:
  - Income of a **specified person** from a **specified account** shall be taxable in the manner and in the year **as prescribed by the central government (CG).**
  - **Specified person** means a person resident in India who has opened a specified account in **a notified country** while being NR in India and a resident in that country.
  - **Specified account (RBA)** means an account maintained in a notified country by the specified person in respect of their retirement benefits and the income from such account is not taxable on accrual basis but is taxed by such country at the time of withdrawal of income or redemption.
  - **Notified country** means a country as may be notified by the CG.
- While S.89A became effective from TY2021-22, the rules prescribing the manner and the year in which income from specified RBA will be taxed and the countries whose RBA will qualify for the benefit, were yet to be notified by the CG.
- Incidentally, the income tax return (ITR) forms for TY2021-22 notified on 1 April 2022 also require reporting of relief claimed under S.89A, but the aforesaid rules were yet to be notified to operationalize the relief under S.89A.
- The CBDT has now notified the requisite rules for operationalizing S.89A and the countries whose RBA will qualify for the relief.
- Notification No. 24/2022 inserts the Rule in the Income Tax Rules to provide for the manner and the year in which income from qualifying RBA will be taxed. Notification No. 25/2022 notifies the following countries whose RBA will qualify for such relief:
  - Canada
  - United Kingdom of Great Britain and Northern Ireland
  - USA

The Rule and the Form

- The Rule provides an option to the specified person for the income accrued in a specified RBA or RBAs from TY2021-22 to be included in their total income for the TY in which such income is taxed in the notified country at the time of withdrawal or redemption.
- Where the specified person has exercised the option provided under this Rule, the total income of the specified person for the year in which income is taxable shall not include the following incomes:
  - The income which has already been included in the total income of such specified person in any of the earlier TYs during which such income accrued and tax thereon has been paid in accordance with the provisions of the ITL;

    OR
  - The income was not taxable in India, in the TY during which such income accrued, on account of:

    (a) Such specified person being an NR or not ordinarily resident (RNOR)[3] during that TY;

    OR

    (b) Application of the DTAA[4], if any.

[3] As per S. 6(6) of the Income Tax Act during the TY

[4] Which is possible where a taxpayer qualifies as a resident of both India and the other country, but the tie to the other country breaks on application of residency tie-breaker clause under the DTAA

The foreign tax paid on such income, if any, shall be ignored for the purposes of computation of FTC under Rule 128 of the Income Tax Rules.

- The option shall be exercised by the specified person in respect of all the specified RBAs maintained by the specified person (i.e., all or nothing approach).
- The option to be exercised by the specified person for any TY (beginning from TY2021-22 onwards) shall be in the Form which shall be furnished electronically under digital signature or electronic verification code on or before the due date specified under the ITL for furnishing the original return of income[5].
- The relief, by way of deferral to the year of withdrawal/redemption, ceases when the specified person becomes NR subsequent to the TY in respect of which they have exercised the option (relevant TY).
- In a case where the specified person becomes an NR during any relevant TY, then:
  - (a) The option exercised by the specified person shall be deemed to have never been exercised with effect from such relevant TY.
  - (b) The income which has accrued in the specified RBAs during the period, beginning with the TY in respect of which the option under the Rule was exercised and ending with the TY immediately preceding the relevant TY, shall be taxable during the TY immediately preceding the relevant TY and tax shall be paid on or before the due date for furnishing the return of income for the relevant TY.
- Subject to the specified person becoming an NR in a subsequent TY, the option once exercised for a specified RBA in respect of a TY shall apply to all subsequent TYs and cannot be subsequently withdrawn for the TY for which the option was exercised or any TY subsequent to that TY.
- The procedures, formats and standards for ensuring secure capture and transmission of data shall be specified by the relevant tax authority[6] which shall be responsible for evolving and implementing appropriate security, archival and retrieval policies in respect of Form 10EE.
- The Form requires the specified person to furnish basic details such as name, address, Permanent Account Number (PAN), year of exercising the option and relevant details of the specified RBAs maintained by the specified person and details of the option exercised by the specified person. The specified person is also required to furnish the following information and/or documentary evidence:
  - (i) How the income from the specified RBA is taxable in the notified country (i.e., accrual basis, receipt basis or any other basis).
  - (ii) The TY in which the income from the specified RBA is eligible to be withdrawn.
  - (iii) Nature of income (i.e., salary, interest, dividend or any other income).
  - (iv) Amount of income from the specified RBA, which has already been included in the total income of any earlier TY during which such income accrued when the specified person was resident and the TYs in which it was so included.
  - (v) Amount of income from the specified RBA which was not taxable in India when the specified person was NR/NOR/treaty resident of the other country, the TYs in which it was so exempt and acknowledgement numbers of returns filed in India for such TYs, if any.
- The Notes to the Form require furnishing of the following documents:
  - (i) Copy of statement of the specified RBA as evidence of the account number of all the specified RBAs, notified country in which such RBA has been opened and the balance in the specified RBA as on last date of the TY prior to the TY in which the Form is submitted.
  - (ii) Documentary evidence to show how the income from the specified RBA has been taxed or is taxable in the notified country (relevant statutory provision of the notified country or any other relevant document may be attached).
  - (iii) The computation of income for all the TYs in which the income from the specified RBA has already been included in the total income. The computation has to be reconciled with the return of income for the said TYs. A reconciliation statement of the computation of income has to be furnished along with the Form.

[5] S.139(1)

[6] Principal Director General of Income Tax (System) or Director General of Income Tax (Systems)

Illustration on the operation of the Rule

- Mr. A worked in the US from Years 1 to 10 when he was NR in India and resident in the US. During his employment in the US, he contributed to RBA in the US which is taxable in the year of withdrawal. The accruals in US RBA during Years 1 to 10 (INR5m) are not taxable in India since Mr. A is an NR in India.
- Mr. A returns to India in Year 11 and becomes resident of India. He offers accruals in Years 11 and 12 (aggregating INR1m) to tax in India.
- Mr. A furnishes the Form on or before due date for furnishing return of income for Year 13.
- Mr. A makes withdrawal from US RBA in Year 15, which includes income accruals of INR8m.
- The amount of accruals to be taxed in India in Year 15 shall be computed as follows:

Particulars	Amount (INR)
Aggregate of income from specified RBA (accruals) taxable in the US in Year 15	8m
Less: Income from specified RBA already taxed in India in earlier years on accrual basis (Years 11 and 12)	1m
Less: Income from specified RBA not taxable in India in earlier years when Mr. A was NR (Years 1 to 10)	5m
Net income from specified RBA taxable in India in Year 15 due to relief under S.89A	2m
Note: Mr. A can claim FTC of US taxes relatable to 2m against Indian tax liability for Year 15 subject to limitations of Rule 128	

Illustration on cessation of relief on turning NR subsequent to furnishing the Form

In the above referred illustration, instead of withdrawal from US RBA in Year 15, Mr. A shifted to Canada in Year 15 and became NR for Year 15. The income accruals in US RBA was INR8m up to end of Year 14.

On a literal interpretation of relevant sub-rule[7] of the Rule, Mr. A shall be deemed to have never exercised the option under the Rule with effect from Year 15. Furthermore, the income accruals in US RBA from Years 13 to 14 (INR2m) shall be taxable in Year 14 and tax shall be paid on or before due date for furnishing the return of income for Year 15.

This will pose the following practical challenges for Mr. A in Years 14 and 15:

- The income of INR2m is taxable in Year 14, but tax is to be paid by due date for furnishing return of income for Year 15. It is not clear whether such deferred payment of tax will trigger interest liability for Mr. A.
- If the time limit for filing return for Year 14 has already expired by the time Mr. A realizes that he has become NR due to his shift to Canada, the issue arises as to how Mr. A will offer the income to tax in Year 14. The other issue that arises is whether Mr. A will need to avail of the facility of updated return recently made available by Finance Act, 2022 (with effect from 1 April 2022) to file return beyond the due date with payment of additional taxes of 25%/50%.

[7] Sub-rule (4)

Comments

The term "accrual" has a specific connotation as per settled jurisprudence under the ITL. It means that there is perfected entitlement and enforceable right in favor of the taxpayer and corresponding obligation on the other party to pay the taxpayer[8].

Relief under S.89A becomes relevant when test of "accrual" of income is met in case an individual is resident in India but taxation in foreign country happens only in subsequent year when it is withdrawn.

While the Rule and the Form operationalize the relief by way of deferral of taxation on income accrued on the specified RBA and may be welcomed by taxpayers, it raises certain peculiar issues which require clarity from the CBDT.

The Rule is made effective from notification in the official gazette i.e., 4 April 2022. A well-settled proposition under the ITL is that the law to be applied for a particular TY is the law as prevailing on the first day immediately succeeding the relevant TY i.e., law as prevailing on 1 April 2022 will apply for TY2021-22 and the Rule cannot generally have retrospective effect[9]. Hence, the issue may arise whether the benefit of the Rule can be availed of for TY 2021-22. It is significant to note that the parent S.89A is effective from TY2021-22, that the ITR forms notified for TY2021-22 also permit taxpayers to avail relief under S.89A and that the Rule itself permits furnishing the Form beginning from TY2021-22 onwards. Hence, taxpayers may seek to rely on the Supreme Court (SC) ruling in the case of S.A.L. Narayan Row v. Ishwarlal Bhagwandas[10], where the SC applied a rule to the benefit of the taxpayer on retrospective basis from the effective date of the parent provision. A specific clarification to that effect from the CBDT may avoid unnecessary litigation on the issue.

The benefit is presently restricted to RBAs in three countries viz., Canada, UK and USA. Taxpayers having RBAs in other countries with similar features may need to approach the CBDT to notify such other countries as well.

[8] Refer, for instance, CIT v. Excel Industries Ltd ([2013) 358 ITR 295 (SC)]
[9] Refer, illustratively, CIT v. Essar Teleholdings Ltd [(2018) 401 ITR 445 (SC)] which held that Rule 8D notified on 24 March 2008 will apply from TY2007-08 and not retrospectively
[10] [(1965) 57 ITR 149 (SC)]

The Form is a one-time compliance and once furnished for a particular TY applies to all subsequent TYs (unless the specified person becomes an NR). However, it is significant to note that the compliance could be made on or before the due date for furnishing the return of income of the first year for which the benefit is to be claimed. If the taxpayer misses this date, then specific application may need to be made to the CBDT to condone the delay and permit belated filing.

In this regard, recently, based on representations made by corporate taxpayers for availing concessional tax rate for TY2019-20 where similar compliance of furnishing Form 10-IC was required but inadvertently missed by several corporates, the CBDT issued Circular No. 6/2022 dated 17 March 2022 providing a general condonation till 30 June 2022[11]. But the circumstances in which such general condonation was granted were peculiar and, hence, taxpayers will do well to comply with furnishing of the Form by the due date, instead of relying on condonation by the CBDT.

The documentary evidence required to be furnished with the Form, prima facie, appear to be onerous and, hence, taxpayers will do well to prepare for compliance well before the due date.

The consequences of the specified person turning NR in subsequent TY after having furnished the Form are peculiar and may pose certain practical challenges (refer illustration provided earlier). It may be better for the CBDT to clarify how taxpayers can make the tax compliances without facing interest, penalty or other adverse consequences. This is particularly because of the possible scenario where the due date for filing return for the TY in which the income becomes taxable may expire before the taxpayer realizes that they will turn NR in the subsequent TY.

[11] Refer EY Tax Alert dated 18 March 2022 titled Central Board of Direct Taxes condones delay in filing Form 10-IC for tax year 2019-20

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