IMPLICATIONS FOR NON-RESIDENTS STRANDED IN INDIA

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1. INTRODUCTION

The Coronavirus (COVID-19) pandemic has been devastating and has a profound impact globally. We can all agree, *"One cannot predict or control the future but only adapt to it."* The rapid spread of the virus has strained local medical infrastructure, led to restrictions on travel and social contact and created unprecedented disruptions to the global economy. Many of the countries have urged their citizens to stay at home as much as possible and practice social distancing to limit face-to-face interactions with others. This not only has an impact on individuals but has also impacted countries as a whole from an economic standpoint, bringing an array of economic sectors to a standstill. Before the pandemic, the idea of Work From Home (WFH), virtual meetings and gatherings were just a fantasy to most of the people which turned out to be the "New Normal" in the COVID-19 times.

Such unique and almost unprecedented restrictions arising from government responses to COVID-19 have led to practical challenges for businesses and employees. Where the movement of people have been significantly restricted, the issue of residential status has thrown novel challenges. In the current Covid times, the concept of residential status and its impact on people stranded in India has attracted focused attention. This article intends to throw insights on tax and regulatory implications for individuals as well as business organizations on account of forced stay in India.

2. IMPLICATIONS ON INDIVIDUALS DUE TO UNINTENDED STAY IN INDIA

2.1. RESIDENTIAL STATUS OF AN INDIVIDUAL

The tax incidence and imposition of tax is dependent upon the residential status of a person. The residential status of a person must be ascertained with reference to each financial year. Therefore, the identification and classification of the residential status of a person is one of the first steps to be carried out for assessing the total income chargeable to tax in India. The provisions for determining the residential status are primarily based on the number of days of physical presence/absence in India as provided under section 6(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act). An individual is classified into three broad categories based on their period of stay in India viz. i) Resident and Ordinary Resident (ROR) ii) Resident but not Ordinary Resident (RNOR) iii) Non-Resident (NR).

As per section 6(1) of the Act, an individual shall be resident in India in any previous year if such individual fulfils any one of the below mentioned conditions:

a. Is in India for 182 days or more in the previous year or

b. Is in India for 60 days or more in the previous year and has been in India for a total period of 365 days or more in the 4 years preceding the respective previous year

The second condition mentioned above is the one that is most worrisome for individuals who are stranded in India.

2.2. RELAXATIONS PROVIDED BY THE GOVERNMENT

2.2.1. Relaxations for Previous Year 2019-20

The unplanned extended period of stay in India, due to the declaration of the lockdown and suspension of international flight sat end of March 2020 could have changed the residential status of many non-residents affecting the taxability of their income under the Act. In order to address the genuine hardship faced by these stranded individuals, CBDT issued Circular No. 11/2020 dated 8th May, 2020, to exclude the period from 22nd March, 2020 (or date of quarantine after 1st March, 2020) to 31st March, 2020 or date of departure before 31st March, 2020 on evacuation flight for determining the residential status.

2.2.2. Specific Relaxations for Previous Year 2020-21

As the COVID-19 outbreak continued even for the previous year 2020-21, various representations were made to CBDT requesting relaxations in the determination of residential status for those who came to visit to India and intended to leave but could not do so due to the COVID-19 pandemic. The Circular No. 11/2020 and tweet from the official handle of Income Tax (@IncomeTaxIndia) on 8th May, 2020 along with the Press release dated 9th May, 2020 clarified that **a similar circular for excluding period of stay of such individuals up to the date of normalization of international flights shall be issued after normalization**. This created an impression that similar relaxations would be provided for the previous year 2020-21.

However, CBDT vide Circular No. 2 of 2021(accompanied with a press release) deviated from its earlier stand of blanket exclusion of period of forced stay in India at fag end of the year where limited options would have been available to individuals. The circular required the impacted individuals to furnish relevant information in Form NR electronically to CBDT by 31st March, 2021 for the risk of double taxation faced by them in order to enable CBDT to evaluate such genuine hardships and announce a general or case specific relief to individuals as the case maybe. The circular justifies how there are lesser chances of double taxation risk for such individuals in view of the interplay of Indian domestic tax rules and Double Taxation Avoidance Agreements (DTAA) entered with other countries. The deviation from the blanket exemption stand could possibly be to give benefit only in genuine cases and not to individuals who would have left the country in recent years to avoid implications under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (commonly referred to as "the Black Money Act"). Writ petition has been filed for quashing this circular and related official memorandum with the Hon'ble Supreme Court on the grounds of constitutional validity.

Several countries such as UK, Singapore and others did not allow persons travelling from India to enter their country for quite some time. In such cases, Taxpayers can refer to the decision of ***CIT v. Suresh Nanda [2015] 57 taxmann.com 448(Del)***, wherein the Hon'ble Delhi High Court held that while determining the residential status of an individual under section 6(1)(a) of the Income Tax Act, 1961, any period of "involuntary stay" must be excluded. In the said case,the passport of the taxpayer was impounded illegally by the authorities which resulted in a forced stay in India.

The High Court stated that "*The Income Tax Act leaves the choice to the citizen to be in India and be treated as a resident for purposes of taxation or be not in India so as to avail the status of a non-resident. The simple test the muster of which is to be passed is the minimum prescribed period of presence in India in a particular financial year. It naturally follows that the option to be in India, or the period for which an Indian citizen desires to be here is a matter of his discretion. Conversely put, presence in India against the will or without the consent of the citizen, should not ordinarily be counted adverse to his chosen course or interest, particularly if it is brought about under compulsion or,* *to put it simply, involuntarily. There has to be, in the opinion of this Court, something to show that an individual intended or had the animus of residing in India for the minimum prescribed duration"*

Similar analogy can be drawn considering the exceptional circumstances for individuals who have been stranded in India due to forced or unintended stay amid the COVID-19 outbreak. However, the decision regarding the same has to be taken after examining the facts and circumstances ona case to case basis considering the litigation involved. Also, it may be noted that the High Court in the aforementioned case has given a caveat that the conclusion reached was on the facts and circumstances and cannot be treated as a thumb rule to invariably exclude each period of involuntary stay.

2.3. DUAL RESIDENCY: TIE BREAKER RULE

An individual may become a resident in India in some cases even if he stays for less than 182 days. In such a situation, there may be a possibility of dual residency for individuals.

The Tie Breaker Rule in the DTAAs generally signed by India provide for some subjective/objective tests to determine a stronger connection of the individual between the two countries. Such individuals will become resident of only one country by applying the Tie Breaker Rule under the relevant DTAA as follows:

- **Permanent Home**

  The first criteria of Tie Breaker Rule is the test of permanent home i.e. an individual would be considered as a resident of the Contracting State where he has a permanent home available to him.

- **Centre of Vital Interest**

  If the above criteria is inconclusive for the reason that the individual has a permanent home available to him in both the Contracting State, the next test is based upon his Centre of Vital Interest. In such a case an individual shall be considered as a resident of the Contracting State where his personal and economic interests are closer. In specific scenarios, where the individual has a permanent home available to him in both the contracting states and it is not possible to determine the Contracting State in which he has a centre of vital interest or where the individual does not have a permanent home available to him in either of the Contracting State, the next determining factor i.e. Habitual Abode has to be applied.

- **Habitual Abode**

  Habitual abode refers to the frequency, duration and regularity of the stays that are part of the settled routine of an individual's life and are therefore more than transient. The determination must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of the stays that are part of the settled routine of the individual's life.

- **Nationality**

  If the individual has a habitual abode in both the Contracting State or neither of them, the next criteria to be looked into is his nationality. He would tie break in favour of the Contracting State of which he is a national.

- **Mutual Agreement Procedure**

  In certain treaties as a last resort, if the individual is a national of both the Contracting States or neither of them, the competent authorities of both the Contracting States need to resolve the conflict of dual residency under the mutual agreement procedure.

In light of the above, where an individual qualifies as a resident of two countries, the Tie Breaker Rule needs to be applied to determine the residential status of an individual to resolve the conflict of dual residency.

2.4. INDIAN TAX IMPLICATIONS ON CHANGE IN RESIDENTIAL STATUS

2.4.1. Change of residential status to ROR

If the status of individual changes to ROR in India, his worldwide income shall be taxable in India. In case the individual has already paid taxes in the country of source of income, he can claim Foreign Tax Credit (FTC) of such taxes paid in foreign jurisdiction subject to satisfaction of the prescribed conditions under Rule 128. It may be noted that tax rates for individuals maybe higher in India and despite the foreign tax credit, there can be an additional tax on such global income in India. In addition to the taxability of global income, such category of residents need to give a disclosure of their foreign assets across the globe while filing tax return in India. India has stringent provisions under the Black Money Act to deal with the menace of black money and imposes huge penalty and rigorous imprisonment on non-disclosure of foreign income and assets.

2.4.2. Change of Residential Status to RNOR

In case an individual is regarded as RNOR, the provisions of the Indian tax laws are relaxed as compared to ROR. RNOR shall not be taxed on its global income except income earned outside India derived from a business controlled from India or professional setup in India. RNOR is not required to provide foreign asset disclosure in their Income Tax Return.

It may be possible that RNOR is not a resident of another country owing to the current situation. In such a case whether an individual can avail treaty benefits will have to be carefully evaluated on a case to case basis based on the specific language of relevant DTAA.

In cases where the residential status of individual changes from NR to ROR/RNOR, certain beneficial provisions under the Act applicable to NR may not be available. [1]An illustrative list of such beneficial provisions which may not be available to ROR/RNOR is:

- First proviso to section 48 providing foreign fluctuation benefit
- 10% tax rate without benefit of first & second proviso to section 48 on Long Term Capital Gains on unlisted securities or shares of a company not being a company in which public are substantially interested.
- 20% tax on Dividend income under section 115A
- 10% tax on Royalty/Fees for Technical services under section 115A

On the contrary, certain beneficial provisions are available to individuals resident in India as per the Act in contrast to non-residents like basic exemption limit, deductions under chapter VI-A, rebate under section 87A, etc.

2.4.3. Concerns related to employment income

The right to tax the employment income under most of the treaties under the OECD model is allocated between the employee's jurisdiction of residence and the place where they effectively perform their

[1] *Tax rates to be increased by surcharge and cess*

employment according to the specific criteria. If a stranded individual begins to exercise their employment in the host jurisdiction, a treaty may allow that jurisdiction to tax the income only if the employee satisfies the day count test (usually 183 days) or the employer is a resident of that jurisdiction (or has a PE that bears the cost).

The OECD guidance on 21st January, 2021 considers the following specific situations:

- Wage subsidy and similar income received by cross-border workers that cannot perform their work due to restrictions should be treated as attributable to the work jurisdiction.
- A worker who is stranded in a jurisdiction where they are not resident but previously exercised employment would otherwise have left that jurisdiction, should reasonably be able to exclude days there for the day count test although the OECD notes that some countries do not support this approach.
- Cross-border workers' may frequently commute for work from their residence jurisdiction to a neighbouring one, with no guidance to follow. The OECD recognizes that some of the jurisdictions have agreed to treat COVID-19 as a force majeure or exceptional circumstance and accordingly the time spent by the employee teleworking in home jurisdiction shall not be included in the calculation of maximum work days outside the work jurisdiction.
- Changes in the jurisdiction where an employee exercises their employment can impact its employment income as payroll taxes are often withheld at source, addressing the change will result in increased compliance and administrative cost for the employer and employees. The OECD calls for an exceptional level of coordination between the jurisdictions to mitigate such additional burden associated with a temporary change of the place where employment is performed.

OECD Guidance would only have a persuasive value and clarification from the Indian government shall help to achieve clarity for such stranded expatriates.

2.5. FEMA IMPLICATIONS ON STRANDED INDIVIDUALS

According to Foreign Exchange and Management Act, 1999 (FEMA), an individual will be treated as a resident in India if such an individual resides for more than 182 days in India but does not include an individual who is coming to India for the purpose of:

a) Taking employment in India

b) Carrying out business or vocation in India

c) Any such circumstances where intention to stay in India is for uncertain period

Unlike the provisions of the Income Tax Act, FEMA emphasis on the intention of a person to stay in India or outside India to determine the residential status. This principle of FEMA law emerges to be of utmost relevance for individuals stranded in India due to the COVID-19 pandemic whose intention was to never stay in India but were forced to stay in India due to subsequent lockdowns and suppression of international flights. Thus it may so happen that an individual may become a resident in India due to his physical presence in India for the said period under the Act but may be a non-resident under the FEMA provisions due to his intention to stay outside India.

Interest earned from Non-Resident External (NRE) Rupee Account and Foreign Currency Non-Resident Depositshall be exempt from tax under section 10 if such interest is earned by a non-resident person under FEMA even though he may be a resident as per the Act.

3. IMPLICATIONS ON FOREIGN ENTERPRISES DUE TO UNINTENDED STAY OF INDIVIDUALS IN INDIA

During the pandemic period, many enterprises have faced curtailment of their operations and have been forced to close offices and other business premises forcing those businesses to change how their business is conducted (i.e. working from home). In many jurisdictions, international travel was either suspended or severely restricted for several weeks, leaving people stranded in a jurisdiction where they might not otherwise be. The temporary dislocation of people can have tax consequences for those individuals and the organization for which they work.

In light of the exceptional circumstances, OECD published updated guidance on 21st January, 2021 providing assistance on the interpretation of tax treaties on the creation of PE, tax residence of companies and individuals and taxation of income from employment amid the COVID-19 pandemic. The guidance indicates the general approach of jurisdictions and illustrates how some jurisdictions have addressed the impact of COVID-19 on the tax situations of individuals and employers. It further clarifies that the guidance seeks to address (and avoid) instances of double taxation but cannot be relied upon to create instances of double non-taxation.

3.1. CONCERNS RELATING TO CONSTITUTION OF PERMANENT ESTABLISHMENT

The business income of a foreign enterprise can be bought to tax in India if such enterprise constitutes a Permanent Establishment (hereinafter referred to as "PE") in India. PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

OECD considers the dislocation of employees to jurisdictions other than the jurisdiction in which they regularly work. In most cases, such employees continue to work from their homes, which consequently might create a PE for their employer in those jurisdictions, triggering new filing requirements and tax obligations for such foreign employers.

The general OECD's output is that exceptional and temporary change of the location where employees exercise their employment because of COVID-19 pandemic, such as working from home, should not create PEs for the employer. Paragraph 18 and 19 of the Commentary on Article 5 of the OECD Model Tax Convention indicates that whether the individual is required by the enterprise to work from home or not is an important factor in this determination. Paragraph 19 notes that where a cross border worker performs most of their work from their home situated in one jurisdiction rather than from the office made available to them in another jurisdiction, one cannot consider the home is at the disposal of the enterprise because the enterprise did not require that home to be used for its business activities. To conclude, individuals' teleworking from home (i.e. the home office) as a public health measure imposed or recommended by atleast one of the governments of jurisdiction would not create a fixed place of business PE for the business/employer.

Similarly, the temporary conclusion of the contracts in the home of employees or agents because of the COVID-19 pandemic should not create PEs for businesses. If the employee was habitually concluding contracts in their home jurisdiction before such measures commenced, or continues to do so afterwards, a different approach may be appropriate. In conclusion, the agent's activity in the jurisdiction should not be regarded as "habitual" if they have exceptionally begun working at home in that jurisdiction due to specific circumstances like the COVID-19 pandemic. This would not constitute a dependent agent PE provided the person does not continue those activities under the normal business environment post pandemic.

Even a construction site PE would generally not be regarded as ceasing to exist when work is temporarily interrupted, but jurisdiction may consider stopping the clock while public health measures are in force in light of the extraordinary circumstances of the COVID-19 pandemic. Thus, such a period should be excluded from the calculation of time thresholds for construction PE.

3.2. CONCERNS RELATED TO CHANGE OF RESIDENCE

The Act provides for Place of Effective Management (POEM), an internationally recognized test, for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognize the concept of 'Place of Effective Management” for determining the residence of a company as a tie breaker rule for avoidance of double taxation.

The OECD guidelines address circumstances in which there is a potential change in the POEM of a company as a result of relocation, or inability to travel, of board members or other senior executives. The concern is that this may as a consequence affect company's residence under the relevant domestic laws of the other country.

The OECD guidance suggests that the COVID-19 situation likely would not create any changes to an entity's residence status under a tax treaty. A temporary change in the location of the board of members or other senior executive is an extraordinary and temporary situation due to the COVID-19 pandemic and such change of location shall not trigger a change in treaty residence.

The guidance also notes that in the case of dual-resident entities, the tie breaker provisions included in a tax treaty should not be impacted when individuals participating in the management and decision making of an entity cannot travel as a public health measure. All the relevant facts and circumstances must be considered as a whole for the determination of POEM in India.

The OECD has sought to provide a degree of certainty for the taxpayers affected by the dislocation of employees as a result of the COVID-19 pandemic. The OECD guidance is in respect of Article 5 of the OECD Model and does not cover a scenario of 'service PE' under the UN Model, but the reasoning in such cases could be the same as in the case of construction PE. However, the employer will need to review carefully and consider the displacements and changes due to COVID-19 may now be the “New Normal”. OECD Guidance is only persuasive in nature and it shall be helpful if the Indian government comes up with similar relaxation or clarification to provide certainty to businesses.

4. CONCLUSION

Alongside creating havoc in human life, the COVID-19 pandemic gave the world an adventurous experience in all possible scenarios one could have ever imagined. Even though the world has slowly started healing itself from the novel coronavirus, working arrangements may never be the same, as before the pandemic, atleast in the immediate near future. The new normal may result in a change in the value chain arrangement and requirement of locational presence. The current uncertainties likely are indicative of the many challenges that may lie ahead. The unpredictable life in today's era only urges all of us to go with the flow and await what the mother nature and tax environment have to offer in such life changing events.