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PAPER IV RESIDENCE FOR TREATY PURPOSES

NALSAR – MA INTERNATIONAL TAX

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SCOPE OF THE SESSION

- Residence of individuals
- Tie Breaker rules for individuals-
- Determination of residential status in gig economy

RESIDENCE OF INDIVIDUALS UNDER DTAA

Text of Article 4, defines Residence for the purposes of eligibility of the Treaty

OECD Model Convention

For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and (*omitted as does not relate to individual*) …….. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

UN Model Convention

For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and (*omitted as does not relate to individual*) …….. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

RESIDENCE OF INDIVIDUALS UNDER DTAA

- Most DTAAs have adopted this definition with small modification for the purposes of residence of a person, who is eligible to the benefits of the DTAA
- There is only one difference in the definition between the UN Model and the OECD Model. UN Model recognises "incorporation" leading to 'residence' of a corporation whereas OECD Model only recognises 'place of management'.

- **The limbs of the definition for individual as "Resident":**
  1) Must be a "person" as defined in the DTAA Definition of Person under MC & Treaties.docx
  2) Must be covered by the laws of the relevant State – either of the two contracting States
  3) Under the laws of the State, he must be liable to tax therein
  4) For the reason of that State's laws to make him taxable in that State by virtue of either being domiciled there, resident there, having a place of management there, being incorporated there or a criterion of a similar nature
  5) "criterion of a similar nature" refers to other than by virtue of having source of income in the State, e.g. in case of the US, because he is citizen of US – whether he is resident under the US Tax Code or NOT

RESIDENCE OF INDIVIDUALS UNDER DTAA

Applying the above limbs to an individual to determine whether he is resident in a State :

Limb 1 – An individual would satisfy this limb as he would be considered a 'person'
Limb 2 – He must submit himself to the laws of the State where he proposes to be regarded resident
Limb 3 - Further, being subject to the laws of that State, he must be liable to tax therein
Limb 4- His taxability must be because he is either domiciled there, or is a resident there, or has a place of management therein (e.g. he has his profession in that State and by virtue of his profession having the seat of management in that State) or because he is a citizen of that State or another similar criterion; **BUT**
Limb 5 - **NOT** simply because he has source of income in that State

RESIDENT – LIMB 4 – DOMICILE

- While a person can have residence in more than one State, he can be domiciled only in one State.
- Individuals have domicile of their parents, given to them by birth – Domicile of Origin
- Upon becoming adult, the individual can decide to acquire another domicile by undertaking many steps to demonstrate to acquire 'Domicile of Choice'
- Unless a person acquires Domicile of Choice and declares giving up Domicile of Origin, he continues to be domiciled in the State where he acquired Domicile of Origin.

Very Broad meaning of Domicile :
State that a person treats as his permanent home, or lives in and has a substantial connection with.

One can be without a residence, and one may not be tax resident in any country, but one will always be domiciled in the Domicile of Origin unless one has acquired Domicile of Choice.

One may not be tax resident in the State where he has Domicile of Origin, but that is because he does not satisfy the criteria of being tax resident there.

RESIDENCE OF INDIVIDUAL UNDER S.6 OF THE IT ACT

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Category	Rule	Conclusion
Any individual	• 182 days or more in relevant PY **OR** • 60* days or more in the relevant PY and 365 days or more in the 4 preceding years	If yes, 'Resident'.
***Citizen of India who leaves India in any PY as a member of the crew of an Indian ship or for the purposes of employment or profession outside India**	• 182 days or more in the year of leaving India for employment; and • 365 days or more in the preceding 4 years	If yes, 'Resident'.
Citizen of India (who has been living outside India) or a PIO coming on a visit to India in any PY	• If income from Indian sources < INR 15 lakh and present in India 182 days or more; OR • If income from Indian sources >INR 15 lakh and present in India 120 days or more	If yes, 'Resident'.
Citizen of India with following facts : • **Total non-foreign source income > INR 15 lakhs in FY; and** • **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**	Even without any presence in India	Shall be deemed to be resident in India in that FY. But will be eligible to DTAA benefit subject to the tie braker clause to determine residential status as per the DTAA.

LIABLE TO TAX

Defined under Section 2(29A) of the IT Act :

"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.

Elements of the Definition :

- Applies to a 'person' (as defined in the IT Act)
- The taxability is with reference to a particular country, i.e. to determine whether a person living in UAE is "liable to tax", his taxability is to be considered in UAE for applying the deeming residence provision under section 6 (1A)
- There should be income tax liability on the person under the law of that country which is in force. In our example, in UAE
- While the law prescribes tax liability on the person, it may subsequently exempt the person from such liability and may not collect tax from the person . E.g. Mauritius levies tax on capital gains but then under the law, it exempts NRs from paying such capital gains tax hence, the NR is said to be 'liable to capital gains tax' in Mauritius

Impact of "Liable to Tax" in the IT Act

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Several impacts :

(1) A person who has been residing in countries which do not levy tax on individuals, such as UAE, Qatar, Saudi Arabia and could not acquire citizenship of those countries, he is exposed to being regarded 'deemed resident' in India

(2) Several of the DTAAs with India use the term "liable to tax" in the definition of Residence – refer **Annexure 1**. Article 4 - comparison for determining residence to claim DTAA benefit.docx

(3) There is a risk that since "liable to tax" is not defined in the DTAAs the definition in the IT Act may apply. However, there are 2 schools of thought here

(4) Before introduction of this definition, the Indian courts interpreted that 'liable to tax' does not mean actual liability or payment of tax by a person in the other country and they thought it sufficient if the country has sovereign powers to tax irrespective of actual exercise of such power.

(5) Would Article 26 of the VCLT come to rescue for application of DTAA if the definition under IT Act is invoked for denying benefits of the DTAA?

All in all, this opens up dispute in applying DTAA and leads to uncertainty.

Determination of Levy of Tax on a Person

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- This is a question of Fact and Law of the State where the person is residing

- Hence for the purposes of applying Section 6(1A) read with Section 2(29A), the following inquiry would be required in case of any jurisdiction, say UAE
  - Does the UAE law have a provision under which it levies tax on a person living in UAE?
  - Does it subsequently have a provision that the person is exempt from paying such tax? – No reason may be provided for such exemption since that is a sovereign right

- While it is understood that there is no tax on income in UAE, there is Social Security regime under which non GCC Nationals pay 17.5%. The question is, what would this levy be regarded for the purposes of Indian definition of 'liable to tax' under 2(29A)?

- Similar investigation would be required in case of all Indian citizens who live in countries where no income tax is paid by them : are they not paying because of exemption (as in case of territorial tax in Singapore) or because there is no law in the country for levy of income tax?

DUAL RESIDENT & TIE- BREAKER CLAUSE

Article 4 of DTAA :

Based on Article 4, the individual can be resident in both the Contracting States :

Example to Explain

1. An individual who leaves India in 2021-22 , could well be resident in India under Section 6(1)(c)Section 6.docx
2. If the person went to say US, and due to the complex definition of residence in the US under the US tax laws, becomes resident in the US.
3. Then the question arises :
   - Which state has the first right to tax the individual, i.e. which State would claim tax on all her income, i.e. where is her EA?
   - Which State will give credit for taxes in the Source State?
4. Here is where Tie- Breaker clause in Article 4(2) is applied

ARTICLE 4(2) – TIE BREAKER PROVISION

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India-US DTAA

Where, by reason of the provisions of paragraph 1 (of Article 4), an individual is a resident of both Contracting States, then his status shall be determined as follows :

(a)	he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;
(b)	if the State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode ;
(c)	if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
(d)	if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Article 4(2) – Tie Breaker Provision

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- Each of the above criterion has considerations which are both subjective & objective
- The individual would need to have all the supporting paperwork and facts to submit for consideration.
- Even after this resolution is made at the level of the individual, he would need to convince the tax authorities of both the jurisdictions
- Where the tie-breaker resolves in favour of say USA (in this case), that establishes his EA in US
  - This gives primary right of taxation to the US on his worldwide income
  - However, his income from India can still be taxed in India on source base, applying the provisions of the DTAA or the IT Act, whichever is more beneficial.
  - US will then need to relieve double taxation as provided in the DTAA read with the domestic law provisions

GIG ECONOMY CONSIDERATIONS

What is GIG Economy

Traditional Economy - in a traditional economy, people become employed by a company to carry out work for that one company. They work for prescribed time in the day each day. The labour laws apply to such permanently employed individuals. There is a benefit of certainty and stability both from the employer's perspective and the employee's perspective

Gig Economy : A labour market characterized by the prevalence of short-term contracts or freelance work as opposed to permanent jobs. It is characterized by the following elements :

- The worker is essentially self employed, free lancer, independent professional
- Most of the service industry as well as traditional commerce & trade can benefit from this arrangement and such benefits can include the following :
  - They do not need to be on the payroll in slow times
  - No social security or other responsibilities
  - Can be entirely performance based
  - Cost is commensurate with the need and reward to the principal- employer
  - Worker can work from anywhere and needs to be self motivated to perform
  - In cross border situation, where the work needs to be performed on-line, the restrictions due to visas and local laws pertaining to engaging foreign workers can be overcome

WHERE IS GIG ECONOMY WORKER LIABLE TO TAX?

- His EA needs to be established to determine his taxability
- In a situation where the individual is resident in India, the EA is in India
- However, if he is performing his professional services to a NR, say a co from US, it needs to be considered whether the US Domestic law establishes his EA in the US
- Even if his EA can be established in the US, his taxability will be in the country of residence
- Examine whether he is resident in India under section 6 of the IT Act
- Examine if he also becomes resident in the US under the US Tax code
- If he is, then apply tie breaker clause.
- If not, then India has the right to tax all his income
- For the purposes of India-US DTAA, his income would fall either under Article 15 – Independent Personal Services if his services fall within the meaning of "Professional services" under this article
- If Not professional services, then it is his income from Business or Profession, under Article 7 and would need to be examined for taxability in the US if he has a PE in the US.

CAN GIG WORKER EXPOSE HIS PRINCIPAL TO TAX IN HIS HOME COUNTRY?

- This needs to be examined carefully with the following elements :
  - His contract with the Principal – the terms would determine whether he is regarded as employee or independent worker
  - E.g. If he is guided and directed for his work constantly by the US enterprise, is responsible for his time, is subject to the work hours and holiday and leave rules applying to employee, the US enterprise is liable for his work, the IP created by him is automatically assigned to the US enterprise, then he is likely to be treated as employee of the US enterprise in India.
  - If he is employee of US enterprise, then the risk that his work and his relationship with the US enterprise may expose the latter to PE in India needs to be examined in facts of the case
  - If he is regarded PE of the US enterprise – either as fixed base or dependent agent – depending on the facts of the arrangement, then the income of the US enterprise, allocable to his activities could be taxable in India. Payment to him would be a deductible expense

Equity Based Compensation & GIG Workers

- Equity based compensation in the form of ESOPs are regulated by :
  - The Companies Act, 2013 when given by Indian companies
  - FEMA and Regulations thereunder when given by foreign companies.

- Companies Act and Companies (Share Capital and Debentures) Rules, 2014 ("Share Capital Rules")require that ESOPs are granted to permanent employees of the Indian company or its subsidiary
  - GIG worker may not benefit from this variable compensation

- FEMA Regulations also require ESOPs to be given to its own employee or to employees of Indian company in which it holds equity.
  - However, no restriction if the options are given on a cashless basis.

- **Taxation :**
  - Perquisite taxation attracted when the worker receives the shares, being difference between FMV and exercise price. Employer is required to deduct payroll taxes
  - Cashless where the GIG worker is not employee, will have to bear his own taxes and make compliances.

CASE LAW ON DETERMINATION OF RESIDENCE FOR ELIGIBILITY OF DTAA

1. [**2010] 38 SOT 95 (MUM ITAT) Meera Bhatia v IT Officer**

Tax officer had denied Treaty eleigibility on the basis that there was no tax in UAE, relying on AAR Ruling in case of Eugene Perreira (1999)

Tribunal, while granting the releif to taxpyaer, said the following :

The issue involved in the instant case was covered by the Tribunal's decision in the case of Asstt. DIT *v.* Green Emirate Shipping & Travels *[2006]* 100 ITD 203 *(Mum.) wherein the Tribunal has held that actual payment of tax in one of the Contracting States is not a condition precedent to avail the benefits of the DTAA in the other Contracting States because the tax treaty prevents not only 'current' taxation but also 'potential' double taxation. Once the right to tax the UAE residents in specified circumstances vests only in Principal State of the UAE under a tax treaty, that right, whether that right is exercised or not, continues to remain exclusive right of that State.*

2. **[2013] 33 taxmann.com 23 (Mumbai - Trib.)- KPMG v Jt Commissioner**

Again a case where tax officer denieed DTAA benefit becasue person was not taxed in UAE, Tribunal relied on Green Emirate Shipping and held that the UAE resident was eligible to DTAA benefits.

3. [2014] 50 taxmann.com 415 (Pune - Trib.) - Prashant Kumar Gulati *v. IT Office (Int'l Taxation) - Nagpur*

Benefit of DTAA was denied on the basis that UAE resident was not liable to tax in UAE and the Tribunal

- Tribunal held that the AAR decision in case of C.E. Perreira by the TO has been considered and explained by the Tribunal, which held that *Emirates Shipping & Travels* (*supra*) was eligible to DTAA benefits .
- That being 'liable to tax' in the Contracting State does not necessarily imply that the person should actually be liable to tax in that Contracting State by virtue of an existing legal provision but would also cover the cases where that other Contracting State has the right to tax such persons irrespective of whether or not such a right is exercised by the Contracting State.

CASE LAW ON DETERMINATION OF RESIDENCE FOR ELIGIBILITY OF DTAA-TIE BREAKER CLAUSE

4. **[2019] 104 taxmann.com 183 (Bangalore - Trib.)- DCIT v Shri Kumar Sanjeev Ranjan**

India-US DTAA, application of Tie Breaker rule – Article 4 (1)(b). Though the individual was present in India and had a permanent home available to him in India as well as US, he was able to show that his centre of Vital interest was in the USA and hence the tie-breaker caluse was resolved in favour of USA. Taxability of his US income in the year of his return was held to be in the US, not in India.

Thank you

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