Resident and Non-Resident (Concept of Residence)

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Synopsis

- Importance of Residential status
- Role of Tax treaties


  Section – 5 – Incidence of Tax
  Section – 6 - Residential status

- Treaty Law
  Article – 4 (1) – Definition of Resident
  Article – 4(2), 4(3)- Tie – Breaker Rules
Importance of Residential status

- Residential status of a person is one of the major criteria which gives the Country the right to levy tax on the income/wealth of that person
  - a) Residence Jurisdiction
  - b) Source Jurisdiction

- Determines the incidence tax on income/wealth of a person

- Person is either an individual or a legal entity other than individual (Company)

- Countries use objective test or subjective tests or a combination of both for determining person’s residence in their domestic law.

Objective Tests methods: Individuals

- Minimum fixed period of time of physical presence in a country
- Visa and Immigration status
- Citizenship
- Nationality

Subjective Test – Individuals

- Based on fiscal presence, i.e., economic/business connection in the country
- “Facts and circumstances” test
- Unable to apply the physical presence test effectively
Importance of Residential status ...

**Objective Test – Companies**

- Place of Incorporation – For eg: Company incorporated in India is resident in India as per Income Tax Act
- Place of registered office – “legal seat”

**Subjective Test – Companies**

- Place of management (For eg: Germany, Portugal, Switzerland)
- Place of head office of company (For eg: Japan, Slovenia)
- Place of main activity of company (For eg: Israel)
- Place of effective management (For eg: France, Norway)

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Role of Tax Treaties

- **Elimination of double taxation**
  - a) Juridical Double Taxation
  - b) Economic Double Taxation

- **Resolves**
  - a) Source – Residence conflict
  - b) Residence – Residence conflict
  - c) Source – Residence conflict

- Once residence is determined under the treaty, residence under the domestic tax law becomes irrelevant. [CIT vs. P.V.A.L. Kalandacan Chettiar [2004] 267 ITR 654. (SC)]
### Domestic Law - Residential Status

<table>
<thead>
<tr>
<th>For Individual and a Hindu undivided family</th>
<th>All other assesseees (a firm, an association of persons, a joint stock company &amp; every other person)</th>
</tr>
</thead>
</table>
| • Resident and ordinarily resident in India | • Resident in India; or
| • Resident but not ordinarily resident in India; or | • Non-resident in India. |
| • Non-resident in India.                    |                                                   |

### Domestic Tax Law ....Residential Status and Tax Liability:

- **Resident & Ordinarily Resident**
  - World wide Income Taxable.

- **Resident But Not Ordinarily Resident**
  - Income accruing or arising in India OR
  - Received OR
  - Deemed to be received in India OR
  - Arising out of business controlled from India

- **Non Resident**
  - Only Income accruing OR
  - Arise in India OR
  - Received OR
  - Deemed to be received in India.
### Basic conditions to test as to when an individual is resident

<table>
<thead>
<tr>
<th>Basic condition (a)</th>
<th>Basic condition (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>He is in India in the previous year for a period of 182 days or more</td>
<td>He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year</td>
</tr>
</tbody>
</table>

### Additional Conditions to test as to when a resident individual is ordinarily resident in India

<table>
<thead>
<tr>
<th>Additional Condition 1</th>
<th>He has been resident in India in atleast 2 out of 10 previous years immediately preceding the relevant previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional Condition 2</td>
<td>He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant previous year</td>
</tr>
</tbody>
</table>
Residential status of an individual [sec 6 (1), sec 6(6)(a)]

<table>
<thead>
<tr>
<th>Resident and ordinarily resident</th>
<th>Resident and not ordinarily resident</th>
<th>Non Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; Satisfies one of the basic conditions</td>
<td>&gt; Satisfies one of the basic conditions</td>
<td>&gt; Satisfies none of the basic conditions</td>
</tr>
<tr>
<td>&gt; Satisfies both of the additional conditions</td>
<td>&gt; Satisfies at least one/none of the additional conditions</td>
<td></td>
</tr>
</tbody>
</table>

Residential status of firm and association of person [sec 6 (2)]

<table>
<thead>
<tr>
<th>Place of Control</th>
<th>Residential Status Of Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholly in India</td>
<td>Resident</td>
</tr>
<tr>
<td>Wholly Out of India</td>
<td>Non-Resident</td>
</tr>
<tr>
<td>Partly in India and partly outside India</td>
<td>Resident</td>
</tr>
</tbody>
</table>
## Residential status of a Company [sec 6 (3)]

<table>
<thead>
<tr>
<th>Place of control</th>
<th>An Indian Company</th>
<th>A Company other than an Indian Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholly in India</td>
<td>Resident</td>
<td>Resident</td>
</tr>
<tr>
<td>Wholly out of India</td>
<td>Resident</td>
<td>Non- Resident</td>
</tr>
<tr>
<td>Partly in India &amp; Partly outside India</td>
<td>Resident</td>
<td>Non - Resident</td>
</tr>
</tbody>
</table>

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## Treaty Law - Article – 4

- Principles for determination of a person’s residential status as per the Tax Treaties between countries (contracting states)
- Resolves the cases of double taxation due to residence – residence conflict between the countries (contracting states)
- Allocates the residence based taxing rights to one of the countries (contracting states)
Treaty Law - Structure of Article 4

- Article 4(1) – Definition of a “Resident of a contracting state”
- Article 4(2) – Tie-breaker rule for individuals
- Article 4(3) – Tie-breaker rule for persons other than individuals

Article 4(1) – Definition of a “Resident of a Contacting state”

“Resident of a Contacting state” means:

- any person who, under the laws of the State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature and also includes that State, and any political subdivision or local authority thereof.

- This does not include any person who is liable to tax in that State in respect of only of income from sources in that State or capital situated therein.
Article 4(1)…

- **Any person: Article 3**

“Person” for the purpose of a DTA is generally defined to include “an individual”, “a company” and any other “body of persons”. If a country specifically does not recognize an entity as a “person” in its domestic tax laws, it may wish to specifically exclude that entity from the application of the DTA to that entity.

- **Liable to Tax**

This means the person who is a resident as per the domestic laws of the country should be liable to tax in that country.

‘Liable to Tax’ is not the same as ‘pays tax’

(Azadi Bachao Andolan [2003] 263 ITR 706 (SC))

“Liability to Tax is a legal situation and ‘payment of tax’ is a fiscal fact

Various case laws and AAR rulings with different interpretation of “Liable to Tax” provision.
Article 4(1)...

- Cyril Eugene Pereira [1999] 239 ITR 650 (AAR)
- Azadi Bachao Andolan [2003] 263 ITR 706 (SC)
- Abdul Razak’s case[2005] 276 ITR 306 (AAR)
- Asst.DIT v Green Emirates Shipping & Travels [2006] 286 ITR (AT) 60 (Mum.)

- **domicile, residence, place of management or any other criterion of a similar nature**

  - **domicile** – is a person’s legal place of residence. It could be his place of origin or nationality or citizenship. Residence implies some degree of permanence.

  - **place of management** – is where the control is located and key decisions as a whole are taken. – (for persons other than individuals)

  - any other criterion of a similar nature.
Exclusion:

The term 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.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mr. A</th>
<th>Mr. B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Status as per domestic tax laws</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) India</td>
<td>Resident &amp; Ordinary resident</td>
<td>Resident but not ordinary resident</td>
</tr>
<tr>
<td>b) United States</td>
<td>Resident</td>
<td>Resident</td>
</tr>
<tr>
<td>Taxability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) India</td>
<td>World wide income</td>
<td>Income from sources in India</td>
</tr>
<tr>
<td>b) United States</td>
<td>World wide income</td>
<td>World wide income</td>
</tr>
</tbody>
</table>
Dual Resident – Tie Breaker rules

- If based on the above definition of a “Resident of a Contracting State” as per the provisions of Article 4(1) of Treaty, a taxpayer becomes resident of more than one country, the taxpayer is known as “dual resident”.

- In such circumstances, Treaty provides resident “Tie-breaker” rules to ensure that the person is a resident of only one of the contracting states (countries) that claim his resident status, and thereby assign the resident based taxing rights to that country.

Article 4(2) Tie – breaker rule for Individuals

- Availability of a Permanent home

- Centres of vital interests (closeness of personal and economic relations with a State)

- Habitual Abode

- Nationality

- Mutual Agreement Procedure

Should exist of the period for which taxation is an issue.
**Article 4(2) - Tie breaker rule – Permanent Home**

- Should be **continuously available**

- Should be **permanent** as opposed to short duration

- To be determined on a case to case basis based on the facts of the case

- The onus to prove the existence of permanent home to the assessing officer is on the assessee

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**Article 4(2) - Tie-breaker rule – Centre of Vital interests**

- To be applied when Permanent home is available for the tax payer in both the States

- Presence of family or other domestic ties

- Existence of business or investments

- Personal conduct of an individual is important

- The onus to prove the existence of centre of vital interest to the assessing officer is on the assessee
Article 4(2) - Tie-breaker rule – Habitual Abode

- Applicable when a Permanent home is available, but the Centre of vital interests cannot be determined;
  OR
- When no Permanent home is available.

- “Habitual” implies repeatedly and persistently and “An abode” is a place of residence

Article 4(2) - Tie-breaker rule – Nationality

If the individual has an habitual abode in both the states or in neither of them, then;

- The state of which the individual is a national is considered as the resident state

- All citizens are nationals of a particular country but all nationals may not necessarily be citizens of the country
**Article 4(2) - Tie-breaker rule – Mutual Agreement Procedure**

- Last resort when all other tests fail
- To seek expert opinion of the Competent authorities of the Contracting states
- Settle issue of by mutual agreement between the countries
- Assign the residence based taxing rights to one of the Contracting states

**Article 4(3) Tie-breaker rule for persons other than individuals**

- If a person other than an individual can be considered as resident of both the contracting states, the tie-breaker rule provides that the “place of effective management” will be considered as the resident state. - Article 4 (3).

- **Place of effective management (POEM)** is the place where:
  - Key management and commercial decisions that are necessary for entity’s business are taken in substance.
  - The most senior person or the group of persons make its decisions
  - Factually and effectively, the day to day affairs of the Company is carried on (AAR P.No.9 of 1195{1996} 220 ITR 377 Affirmed in DLJMB Mauritius Investment Company {1997}228 ITR 268
Article 4(3) Tie - breaker rule for persons other than individuals …

- Possible to have more than one place of management but can have only one place of effective management

- “Effective management” means the actual conduct of business, where the brain of the business is located.

- This is to be determined based on the facts on a case to case basis.

Case Study – 1

Li Ping was born in Hong Kong. He is 42 years old and has lived in Vancouver (Canada) since he was 6 years old. His employer sent him to Dublin (Ireland) to work in its Irish branch for 2 years. Li Ping moved to Dublin together with his family. However, he maintained his house in Vancouver and returned to Vancouver many times during the 2 years. He stayed in his Vancouver house on those visits. Under Canadian Law, Li Ping is tax resident of Canada if he resides in Canada or is ordinarily resident in Canada.
Case Study – 1

Under Irish Law, Li Ping is a tax resident if he is in Ireland for more than 183 days in a tax year, or more than 280 days in 2 tax years. The concept of residence is not applicable to Hong Kong tax law. Only Hong Kong sources income is subject to Hong Kong tax. Article 4(2) of the Canada-Ireland DTA (2003) states that the following residence tie-breaker tests are to be applied sequentially:

- the place at which a permanent home is available
- the place at which the person’s personal and economic ties are closer
- the place in which the person has an habitual abode; and
- citizenship

There is no DTA between Canada and Hong Kong or Ireland and Hong Kong.

Where is Li Ping resident for tax purposes during his 2 year period Dublin, if, at the end of it, he:

(a) returns to Vancouver?  (b) moves to South Africa?

Opinion:

During the 2 years period: In the case of Canada: He has maintained a permanent house in Vancouver, Canada hence he is tax resident of Canada.

In the case of Ireland, - As per Irish Law, Li Ping is a tax resident since he was in Dublin for more than 183 days, he is a resident of Ireland.

Hence applying the tie breaker test as per Article 4(2) of the Canada – Ireland DTA (2003)

Li Ping is a resident of Canada since a permanent home is available for him in Canada.

If he moves to South Africa, even then he is a resident of Canada since the condition is availability of permanent home and not the actual utilization of permanent home.
Case Study – 2

Thornco Limited (Thorco) is a company that provides consultancy services worldwide. It has offices in a number of countries. Thornco was originally incorporated in State C, where all the records required by corporate law (e.g., the register of shareholders and the minutes of board of directors and shareholders meetings) are maintained. However, its two main offices are in States A and B. Thornco’s shareholders are its senior consultants. Each of them works in one of the offices where he supervises a number of employees who provide consultancy services to local clients. Approximately 30% of the shareholders work and live in State A and 40% in State B.

Case Study – 2 …

Management decisions that apply to the whole company like changes to the legal structure, to set up an office in a new country, determining the salary and dividends of each employee-shareholder etc. are taken by management committee on which the shareholders serve for periods of 5 years. A shareholder is elected for a period of 5 years to serve as the chief executive. The current chief executive works and resides in State A. Meetings of committee through video conference calls (which usually originate from the office of the chief executive)

The domestic law of State C provides that a company is a resident of State C if it was incorporated there.

In the domestic law of State A, the relevant criteria for determining the residence of a company are factors that indicate an economic link with the country, such as the place of management, the place where the board meetings take place or where the accounting records are kept.

State B’s domestic law provides that a company is resident where its registered office or principal establishment is located.
Case Study – 2 …

There is a complete network of DTAs between States A, B and C, which are identical to the OECD model DTA.

Where is Thornco resident for the purpose of those DTAs?

**Opinion:**

**Facts:**

1. Incorporated in State C – satisfies test of residence – Resident of C
2. In State B neither the registered office of the Company is situated nor the principal establishment is located.
3. In State A, there is economic link, i.e. place of management since the Chief executive works and resides in State A – so as per domestic law – the Company is resident of State A. The management committee takes decisions which apply to the Company as a whole. The meetings of the management committee usually originate from the office of the chief executive who is residing and working from State A. Hence the place of effective management criteria is satisfied for State A.

**Analysis**

**Tie-Breaker rules - test**

Since the Company is resident as per the domestic law of State C and State A, the place of effective management has to be considered as the state of residence for assigning taxing rights. In this case the place of effective management is State A since:

1. Chief executive is working and residing in State A
2. 30% of share holders live and work in State A
3. Meeting of management committee is usually originated from State A since the chief executive resides and works from State A
4. Management committee takes decisions for the company as a whole

**Conclusion:**

For the purpose of DTA Thornco is resident of State A.
Thank you

Questions

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