Taxation of an individual as a resident and a non-resident of India

- *Vivek Newatia, S Jaykishan (vnewatia@sjaykishan.com)*
- *Shreya Jain, S Jaykishan (shreyajain@sjaykishan.com)*

Introduction

A general confusion exists between citizenship and residential status of an individual. In fact, there are instances wherein both the terms are used alternatively. However, citizenship and residential status are two independent concepts.

The key difference between the two terms is –

- An **Indian citizen** enjoys all the political and civil rights (voting, holding agricultural land of the country), the same is not available to an overseas citizen and
- Taxation of an individual is based on her **residential status and not on her citizenship.**

Thus, citizenship deals with an individual political and civil rights and based on the Citizenship Acts of the respective country. Residential status are prominently used for the purpose of determining the taxation of an individual.

In this write-up, the authors have, to the best of efforts detailed out the difference amongst two and simultaneously analysed the taxation status of an individual in the UK and India.

Residential status –

I. India

The concept of residential status differs as per the Income Tax Act, 1961 and as per the FEMA provisions. Residential status under FEMA has been covered in the later part of this note.

Position under the Income Tax Act, 1961 –

As per the provisions of Section 6 of the Income Tax Act, 1961 an individual is said to be resident in India in any previous year, if she—

a. Is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or
b. Having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to **sixty days** or more in that year.

   The period of 60 days shall be substituted for 182 days in case of a citizen/ person of Indian origin who leaves India for employment during a FY. However, from the financial year 2020-21, the period is reduced to 120 days where the total income (excluding income from foreign sources) exceeds Rs 15 lakhs.

Concept of deemed resident under Section 6(1A) of the Income Tax Act, 1961

Irrespective of the conditions as stipulated above, an individual, **being an Indian citizen**, not being a resident as per the conditions mentioned above, shall be deemed to be an Indian resident, if

(i) total income (excluding income from foreign sources) exceeds Rs. 15 lakhs during the relevant year; and

(ii) if she is not liable to pay tax in any other country or territory by reason of her domicile or residence or any other criteria of similar nature.

Thus, an Indian citizen having India-sourced taxable income exceeding Rs. 15 lakhs during the relevant tax year will be deemed to be a resident of India if she is not liable to tax in any other country by reason of domicile or residence or any other criteria of similar nature.

Once the status of the individual is determined to be the resident of India for the relevant year, the next step is to analyse whether the said individual is as an ordinarily resident (ROR) or not ordinarily resident of India (RNOR).

The status of the individual as ROR or RNOR is important to determine the scope of income which shall be taxable in India.

Summarising the above –

Where an individual, being a citizen or a person of Indian origin, leaves India for the purpose of employment, she shall be treated as a resident of India for tax purposes for the relevant year in the following scenarios:

Total income (Excluding income from foreign sources)	Stay in India	Status
< Rs. 15 Lakhs	182 days or more in the relevant FY	Refer note below
> Rs. 15 Lakhs	120 days or more (and less than 182 days) in the relevant FY and 365 days or more in the preceding four years.	RNOR
> Rs. 15 lakhs subject to her being a citizen of India and not liable to pay tax in any other country	NA	RNOR

Not ordinarily resident in India (RNOR) –

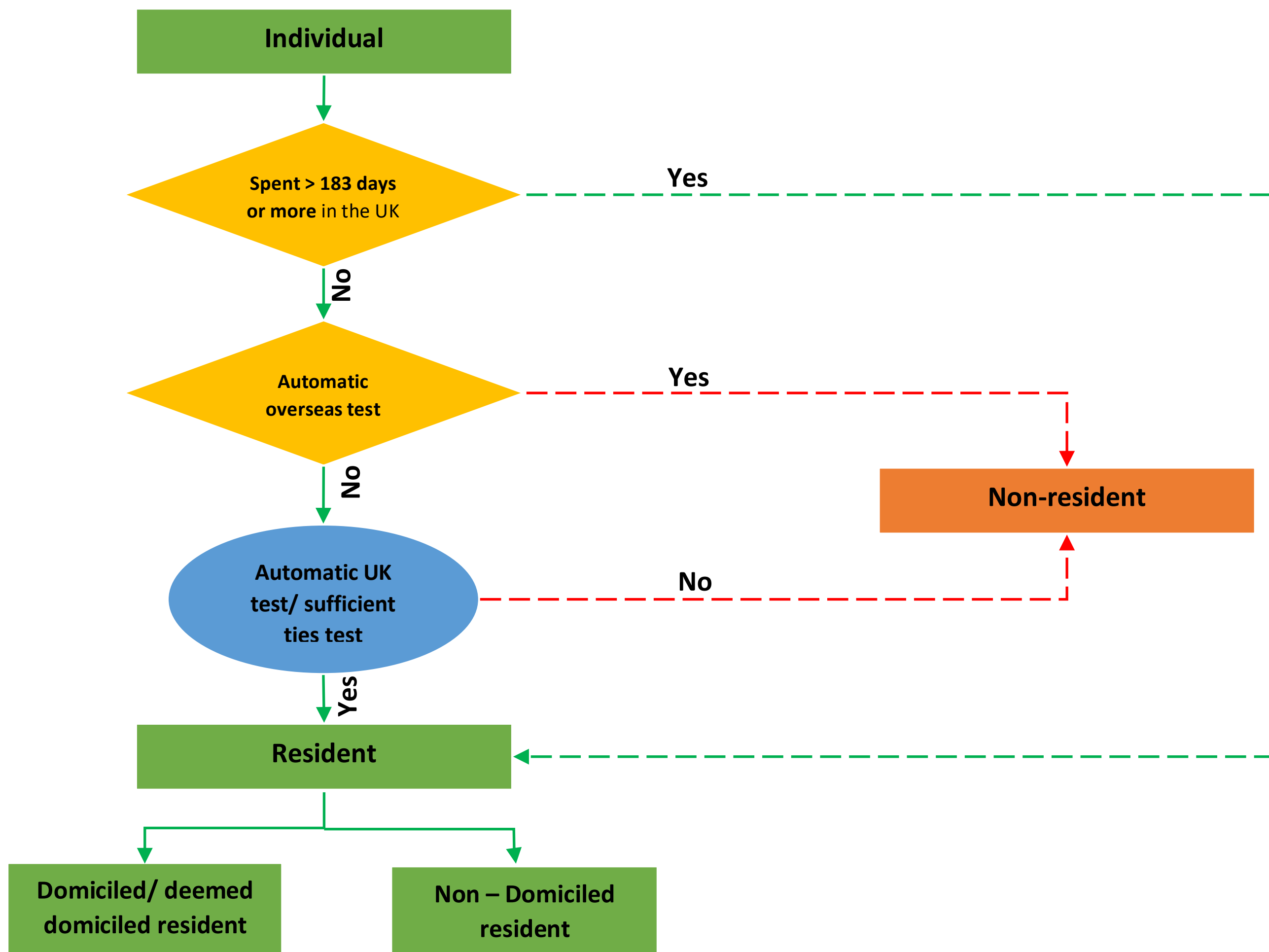
An individual who has been a non-resident in India –

- in nine out of the ten previous years preceding that year, or
- has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less;

Scope of income taxable in India -

Particulars	Non-resident	Resident	
		ROR	RNOR/ Deemed Resident
Salary	Income earned and accrued in India shall be taxable in India.	Taxable on the worldwide income irrespective of the source of income	Income earned and accrued in India shall be taxable in India.
Dividends from companies resident outside of India	Not taxable.	The individual shall be taxed on her worldwide income, thus, this nature of income shall also be taxable.	Not taxable.
Dividends from Indian companies	A dividend paid by a company which is a resident of India to a resident of the UK may be taxed in the UK. The dividend may also be taxed in India but the Indian tax so charged shall not exceed 15 per cent of the gross amount of the dividend.	Dividend income will be taxable in the hands of the shareholders or unit holders at the applicable rates (without any exemption threshold).	Dividend income will be taxable in the hands of the shareholders or unit holders at the applicable rates (without any exemption threshold)

II. UK



Tests mentioned in the flowchart above have been enumerated below –

A. Automatic Overseas Test

If any of the following conditions are satisfied:

- *If the individual were resident in the UK for one or more of the 3 tax years before the current tax year and spent less than 16 days in the UK in the tax year or*

- *If the individual were a resident in the UK for none of the 3 tax years before the current tax year and spend less than 46 days in the UK in the tax year or*

- *If the individual for the tax year if she **works full-time overseas** over the tax year and:*
    - *Spent less than 91 days in the UK in the tax year*
    - *The number of days on which she works for more than 3 hours in the UK is less than 31*
    - *There is no significant break from the overseas work*

    A significant break is when at least 31 days go by and not one of those days is a day where:
    1. *She worked for more than 3 hours overseas*
    2. *would have worked for more than 3 hours overseas, but did not do so because she was on annual leave, sick leave or parenting leave*

    If a significant break from overseas work is availed, she will not qualify for full-time work overseas.

B. Automatic UK Tests

If any of the following are satisfied:

1. *If spent 183 days or more in the UK;*

2. *Have or have had a home in the UK for all or part of the year and –*
    1. *there is or was at least one period of 91 consecutive days when she had a home in the UK;*
    2. *at least 30 of these 91 days fall in the tax year when she has a home in the UK and she has been present in that home for at least 30 days at any time during the year and*
    3. *at that time, she had no overseas home, or if she had an overseas home, she were present in it for less than 30 days in the tax year*

3. *She will be considered as a UK resident for the tax year **if all the** following apply:*
    1. *She works full-time in the UK for any period of 365 days, which falls in the tax year;*
    2. *more than 75% of the total number of days in the 365 day period when she does more than 3 hours work in the UK and*
    3. *at least one day which has to be both in the 365 day period and the tax year is a day on which she does more than 3 hours work in the UK*

C. Sufficient ties test

If the individual does not satisfy the following:

1. *Automatic overseas tests*
2. *Automatic UK tests*

The individual shall have to consider her connections to the UK, known as 'ties', taken together with the number of days she spends in the UK, which will make her resident in the UK for that particular tax year.

If the individual was not UK resident in any of the 3 tax years before the one in consideration, she must check if she has any of the following-

1. *a family tie*
2. *an accommodation tie*
3. *a work tie*
4. *a 90 day tie*

If she was resident in the UK in one or more of the 3 tax years before the year of consideration, she shall also have to check whether she has a country tie.

Therefore,

- The individual shall be a UK resident in case she spends 183 or more days in the UK or
- In case the individual does not satisfy the UK overseas test, the chances of her meeting either the Automatic UK Test or the Sufficient Ties Test are significantly high (in light of her intention to buy a residential house in the UK). Thus, the individual in such circumstance shall become a UK resident.

Similar to India tax laws (ROR and RNOR), UK tax provisions also categorises the residential status in the following -–

1. Domiciled/ deemed domiciled resident and
2. Non-Domiciled resident.

Domiciled and Non-domiciled resident

A resident of the UK is usually taxed on her worldwide income. Thus, even if the foreign income has been taxed in that country, the same shall still be taxable in the UK subject to relief under the DTAA entered between the two countries and such declaration must be stated in the tax return of the individual.

In case the individual is a UK resident but not domiciled in the UK, the individual has an option of availing another scheme known as remittance-based scheme. Thus, the determination of her domicile status shall be relevant.

Domicile status of an individual is distinct from the nationality, citizenship. The intention of the individual of remaining in the UK is also important to determine the domicile status of the said individual[1].

Once an individual has been resident in the UK for 15 out of the previous 20 tax years they are deemed UK domiciled and the remittance basis is no longer available.

In case the individual satisfies the condition of a non-domiciled resident, she may have the benefit of availing an alternate option of taxation – **remittance-based tax (RBT),** wherein tax is only due on overseas investment income, capital gains, and certain offshore earnings to the extent that those are remitted to the UK. Overseas income and gains not remitted to the UK shall not be subject to the UK tax. The said option, however, is not available to a domiciled UK resident.

[1] Refer https://www.gov.uk/government/publications/residence-domicile-and-remittance-basis-rules-uk-tax-liability/guidance-note-for-residence-domicile-and-the-remittance-basis-rdr1 for other key points

The table below enumerates the comparison between a UK resident and non-resident

Particulars	**Non-resident**	**Resident**	
		Domiciled/ deemed domiciled/ non domiciled and not opted for RBT	**Non – domiciled and opted for RBT**
Personal allowance	Taxes are only paid on the UK sourced income.	The resident in this case is allowed tax exemption on taxable income upto GBP 12,570.	Not entitled to Personal allowance and annual capital gains exemption
Charges for availing the Remittance based tax (RBT)	NA	NA	*Refer Note 1*
Earning Salary abroad	Not taxable	Taxable on the worldwide income irrespective of the source of income, subject to benefit under the relevant DTAA	Taxable in case the same is remitted to the UK, except where the individual is entitled to overseas workday relief[2]
Dividends from companies resident outside of UK	Not taxable	Taxed on the worldwide income, hence any dividend that is received shall be taxable irrespective of its source. Tax credit under the relevant DTAA shall be available	Liable to UK tax w.r.t. dividend remitted to the UK at the normal tax rates (currently 20%, 40% and 45%)
Dividends from UK companies	The dividend income shall be taxed in India (Article 11 of DTAA), if she is an Indian resident. She shall be entitled to the tax credit in respect of that dividend which an individual resident in the UK would have been entitled. Tax may also be charged in the UK and according to the laws of the UK on the aggregate of the amount or value of the dividend and the amount of the tax credit, not exceeding 15 per cent.	Shall be charged as per the UK tax rates and shall be allowed with entitlements, if any	Shall be charged as per the UK tax rates and shall be allowed with entitlements, if any

Note 1: If an individual has been resident in the United Kingdom. A remittance based charge has to be paid by the individual in case her foreign sourced income exceeds GBP 2000.

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[2] Overseas workday relief is an option available exclusively to foreign domiciled UK tax residents wherein, part of the earnings of the individual from her UK employment is treated as if it were foreign income and the same is not taxed in the UK unless remitted to the UK. The option is subject to the following –

a. The individual is not domiciled in the UK throughout the year;
b. RBT has been availed;
c. The duties of employment are carried out wholly or partly outside the UK, and that year is **either**:
    - the first tax year immediately after 3 consecutive tax years when she was not resident in the UK
    - one of the next 2 tax years after such a year

The individual will have to pay

GBP 30,000 a year – have been resident in at least 7 out of the previous 9 years,

GBP 60,000 a year - have been resident in the United Kingdom for 12 out of the past 14 years

It is essential that clean capital is maintained in a separate account before opting for RBT. Clean capital means income or gains realised before an individual becomes UK tax resident under the statutory residence test. Clean capital can be brought into the UK without triggering income tax or capital gains tax.

The following points should also be noted:

- No income, interest, dividends or gains of any kind can be paid into the account holding clean capital. Interest cannot be first paid into the account and then transferred on to another account. The interest must not be paid into the account in the first instance.
- Interest (or any other type of income or gain) must not be paid into the account holding clean capital.
- Account segregation should aim to separate where clean capital is deposited, where income is deposited and where gains are deposited.
- As a general guide, the following is a suggestion of the six offshore accounts that should be maintained:
    - Clean capital account
    - Foreign interest account
    - Foreign capital gains account
    - Foreign capital loss account
    - Foreign income account
    - Employment income account
- Remittances can be made tax-free from the clean capital account and generally from the capital loss account.
- Tax will arise on remittances from the foreign interest, capital gains or foreign income accounts.
- Mixing clean capital with post-arrival foreign income or gains will create a "mixed fund". Remittances from mixed funds are subject to the statutory ordering rules. The mixed fund rules are complex. It is advisable to avoid remitting any income or gains to the UK without a full understanding of these complex rules.

III. Dual Residence

It is possible for an individual to be the resident of both India and the UK which is termed as 'dual residence'. The Double Tax Avoidance Agreement ('DTAA') between the two nations provides for tie breaker rule where the individual is treated as a tax resident of both the countries as per taxation laws of both the countries. As per Article 4 of the DTAA between India and the UK, the individual shall be–

a. deemed to be a resident of the Contracting State in which she has a permanent home available to her. **If the permanent home is available to her in both Contracting States, she shall be deemed to be a resident of the Contracting State with which her personal and economic relations are closer (centre of vital interests);**

b. if the Contracting State in which she has her centre of vital interests cannot be determined, or if she does not have a permanent home available to her in either Contracting State, **she shall be deemed to be a resident of the Contracting State in which she has an habitual abode**;

c. if she has a habitual abode in both Contracting States or in either of them, she shall be deemed to be a resident of the Contracting State of which she is a national;

d. if she is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

The UK provides reliefs to an individual who is a dual resident (if, as per the tie-breaker test, she is treated as a resident of India) –

- **Full relief**
  Full tax may be paid in India and the entire relief may be claimed in lieu of such taxes being paid in India.
- **Partial Relief**
  A hypothetical example may be taken say - if the UK's basic rate is 20%, and India's double taxation agreement with the UK is 15%, a relief of 5% may be claimed.
- **Credit Relief**
  The individual may claim credit relief if her income is taxable in both the UK and India. The country of residence will give the credit for the tax paid on UK income, against its own tax. She may need to claim back the tax paid from India.

Residential status under FEMA

As per Section 2(v)–
"person resident in India" means—
(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—
(a) for or on taking up employment outside India, or
(b) for carrying on outside India a business or vocation outside India, or
(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;"

(B) a person who has come to or stays in India, in either case, otherwise than—
(a) for or on taking up employment in India, or
(b) for carrying on in India a business or vocation in India, or
(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

Residential status under FEMA for a particular financial year is examined with respect to the period of stay in India during the preceding financial years. However, the exceptions carved out in sub-clauses (A) and (B) of clause (v) of Section 2 of FEMA stipulates exceptions to the general rule. **Reading of the three clauses or exceptions indicate that the intention to stay for an uncertain period is an essential factor for the individual to be considered as a person resident in India.**

As per the exception, an individual shall become a "person resident outside India" from the date she leaves India for the purposes of employment outside India.

Foreign exchange laws of India, therefore, determines the residential status at a point of time rather than for the entire year. The residential status, thus, needs to be evaluated at the point of time when a cross-border transaction is entered into by the individual.

Such cross-border transactions are evaluated **on the basis of residential status** and in light of the **relevant FEMA provisions** – inference –

a. FEMA provisions shall be applicable when the individual is an Indian resident, and the transaction is w.r.t. her assets and liabilities outside India, or with a person resident outside India.

b. When the individual is a resident outside India, and the transaction is w.r.t. assets and liabilities in India, or with a person resident in India.

Applicability of Inheritance Tax in UK

Inheritance Tax (IHT) is a tax on the estate of someone who has died, including all property, possessions and money. Analysis of the same has been dealt below in three categories –

i. Domiciled resident
ii. Deemed domiciled resident and
iii. Non domiciled resident.

The standard inheritance tax rate is 40% on part of the income exceeding the threshold specified above.

i. Domiciled resident –

If the individual is a domiciled resident of the UK then her global asset shall come under the ambit of inheritance tax (IHT).

In case of UK domiciled and estate is valued at over GBP 325,000 the estate will be subject to IHT – either 40% or 36% on the amount over the threshold. Since 2007, this threshold has increased to GBP 650,000 for married couples and civil partners, providing the executors transfer the first spouse/partners unused IHT threshold to the second partner when they die.

ii. Deemed domiciled resident–

Inheritance tax rate for a deemed domicile is similar to that of a domiciled resident.

A deemed domicile is typically acquired by a non-UK domiciled individual once she has been UK resident in 15 of the 20 preceding tax years. It follows that an individual with a foreign domicile typically becomes deemed domiciled for IHT purposes at the beginning of her 16th tax year of residence in the UK. For instance – if the individual became a UK resident partway in a tax year, the whole tax year must be counted for the purpose of deemed domiciled test.

The effect of being deemed domiciled in the UK is that the scope of IHT extends from UK assets to all assets on a worldwide basis.

Three year rule –

The "three year rule" applies to individuals previously actually domiciled in the UK. Such an individual is deemed to remain UK domiciled **for three calendar years after she has in fact lost her UK domicile**. Thus, the individual shall be treated as a deemed domiciled in such situation as well.

iii. Non domiciled resident

Non-domiciled individual has the advantage of beneficial treatment for UK IHT purposes. Only assets situated in the UK are subject to UK IHT for such individual. Non-UK assets are excluded. Hence,

- Inheritance tax shall only be applicable on the assets located in the UK while the said individual remains to be non-domiciled.
- In case of domiciled resident of the UK – inheritance tax shall be applicable on the global income of the individual.
- For a non-resident having assets in the UK – she shall be taxed based on the assets located in the UK

Concluding remarks

In this article, the authors have made their best efforts in analysing the taxability of an individual based in India and the UK. However, one would need to evaluate if there are any additional key matters that should be determined in scenario dealing with the UK provisions.

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