Residence and Scope of Total Income

UNIT – 1: RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

Learning objectives
After studying this unit, you would be able to understand -

- the relevance and significance of residential status in determining total income of a person
- the types of residential status
- the rules for determining residential status for different categories of persons
- the scope of income includible in total income for each residential status

1.1 Residential Status [Section 6]

The incidence of tax on any assessee depends upon his residential status under the Act. Therefore, after determining whether a particular amount is capital or revenue in nature, if the receipt is of a revenue nature and chargeable to tax, it has to be seen whether the assessee is liable to tax in respect of that income. The taxability of a particular receipt would thus depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee’s residential status.

For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status. viz

(1) Resident and ordinarily resident
(2) Resident but not ordinarily resident
(3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice versa. The provisions for determining the residential status of assessees are:

(1) Residential status of Individuals: Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the following conditions:
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(i) He has been in India during the previous year for a total period of 182 days or more, or
(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Note:
(a) The term “stay in India” includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.
(b) It is not necessary that the period of stay must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual.
(c) For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.
(d) The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

Exceptions:
The following categories of individuals will be treated as residents only if the period of their stay during the relevant previous year amounts to 182 days. In other words even if such persons were in India for 365 days during the 4 preceding years and 60 days in the relevant previous year, they will not be treated as resident.
(1) Indian citizens, who leave India in any previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or
(2) Indian citizen or person of Indian origin*1 engaged outside India in an employment or a business or profession or in any other vocation, who comes on a visit to India in any previous year

Thus, under section 6(1), the conditions to be satisfied by an individual to be a resident in India are provided. The residential status is determined on the basis of the number of days of his stay in India during a previous year.

However, in case of foreign bound ships where the destination of the voyage is outside India, there is uncertainty regarding the manner and the basis of determining the period of stay in India for an Indian citizen, being a crew member.

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*1 A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India.
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To remove this uncertainty, *Explanation 2* to section 6(1) provides that in the case of an Individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the prescribed manner and subject to the prescribed conditions.

Accordingly, the CBDT has vide, Notification No.70/2015 dated 17.8.2015, inserted Rule 126 in the Income-tax Rules, 1962 to compute the period of stay in such cases. According to Rule 126, for the purposes of section 6(1), in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, not include the following period:

**Period to be excluded**

<table>
<thead>
<tr>
<th>Period commencing from</th>
<th>Period ending on</th>
</tr>
</thead>
<tbody>
<tr>
<td>the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage</td>
<td>and the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.</td>
</tr>
</tbody>
</table>

**Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Terms</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Continuous Discharge Certificate</td>
<td>This term has the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate-cum Seafarer’s Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1998.</td>
</tr>
<tr>
<td>(b) Eligible voyage</td>
<td>A voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where – (i) for the voyage having originated from any port in India, has as its destination any port outside India; and (ii) for the voyage having originated from any port outside India, has as its destination any port in India.’.</td>
</tr>
</tbody>
</table>

**Illustration 1**

Mr. Anand is an Indian citizen and a member of the crew of a Singapore bound Indian ship engaged in carriage of passengers in international traffic departing from Chennai port on 6th June, 2016. From the following details for the P.Y.2016-17, determine the residential status of Mr. Anand for A.Y.2017-18, assuming that his stay in India in the last 4 previous years (preceding P.Y.2016-17) is 400 days and last seven previous years (preceding P.Y.2016-17) is 750 days:
Solution

In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Chennai port) and having its destination at a port outside India (i.e., the Singapore port). Hence, the voyage is an eligible voyage for the purposes of section 6(1). Therefore, the period beginning from 6th June, 2016 and ending on 9th December, 2016, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Anand, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 187 days [25+31+31+30+31+30+9] have to be excluded from the period of his stay in India. Consequently, Mr. Anand's period of stay in India during the P.Y.2016-17 would be 178 days [i.e., 365 days – 187 days]. Since his period of stay in India during the P.Y.2016-17 is less than 182 days, he is a non-resident for A.Y.2017-18.

Note - Since the residential status of Mr. Anand is "non-resident" for A.Y.2017-18 consequent to his number of days of stay in P.Y.2016-17 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

Not-ordinarily resident - Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesses can be either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

Note: In simpler terms, an individual is said to be a resident and ordinarily resident if he satisfies both the following conditions:

(i) He is a resident in any 2 out of the last 10 years preceding the relevant previous year, and

(ii) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.
Illustration 2

*Steve Waugh, the Australian cricketer comes to India for 100 days every year. Find out his residential status for the A.Y. 2017-18.*

**Solution**

For the purpose of his residential status in India for A.Y. 2017-18, the relevant previous year is 2016-17.

**Step 1:** The total stay of Steve Waugh in the last 4 years preceding the previous year is 400 days (i.e., $100 \times 4$) and his stay in the previous year is 100 days. Therefore, since he has satisfied the second condition in section 6(1), he is a resident.

**Step 2:** Since his total stay in India in the last 7 years preceding the previous year is 700 days (i.e., $100 \times 7$), he does not satisfy the minimum requirement of 730 days in 7 years. Any one of the conditions not being satisfied, the individual is resident but not ordinarily resident.

Therefore, the residential status of Steve Waugh for the assessment year 2017-18 is resident but not ordinarily resident.

Illustration 3

*Mr. B, a Canadian citizen, comes to India for the first time during the P.Y. 2012-13. During the financial years 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17, he was in India for 55 days, 60 days, 90 days, 150 days and 70 days, respectively. Determine his residential status for the A.Y. 2017-18.*

**Solution**

During the previous year 2016-17, Mr. B was in India for 70 days and during the 4 years preceding the previous year 2016-17, he was in India for 355 days (i.e. $55 + 60 + 90 + 150$ days).

Thus, he does not satisfy section 6(1). Therefore, he is a non-resident for the previous year 2016-17.

Illustration 4

*Mr. C, a Japanese citizen left India after a stay of 10 years on 1.06.2014. During the financial year 2015-16, he comes to India for 46 days. Later, he returns to India for 1 year on 10.10.2016. Determine his residential status for the A.Y. 2017-18.*

**Solution**

During the previous year 2016-17, Mr. C was in India for 173 days (i.e. $22 + 30 + 31 + 31 + 28 + 31$ days). His stay in the last 4 years is:

- 2015-16: 46 days
- 2014-15: 62 days (i.e. $30 + 31 + 1$)
- 2013-14: 365 days (since he left India on 1.6.2014 after 10 years)
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2012-13 - 365 (since he left India on 1.6.2014 after 10 years)

Mr. C is a resident since his stay in the previous year 2016-17 is 173 days and in the last 4 years is more than 365 days.

For the purpose of being ordinarily resident, it is evident from the above calculations, that

(i) his stay in the last 7 years is more than 729 days and

(ii) since he was in India for 10 years prior to 1.6.2014, he was a resident in at least 2 out of the last 10 years preceding the relevant previous year.

Therefore, Mr. C is a resident and ordinarily resident for the A.Y. 2017-18.

Illustration 5

Mr. D, an Indian citizen, leaves India on 22.9.2016 for the first time, to work as an officer of a company in France. Determine his residential status for the A.Y. 2017-18.

Solution

During the previous year 2016-17, Mr. D, an Indian citizen, was in India for 175 days (i.e., 30+31+30+31+22 days). He does not satisfy the minimum criteria of 182 days. Also, since he is an Indian citizen leaving India for the purposes of employment, the second condition under section 6(1) is not applicable to him.

Therefore, Mr. D is a non-resident for the A.Y. 2017-18.

(2) Residential status of HUF: A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India. If the control and management of the affairs is situated wholly outside India it would become a non-resident.

The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents. The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated. The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.

If the HUF is resident, then the status of the Karta determines whether it is resident and ordinarily resident or resident but not ordinarily resident. If the karta is resident and ordinarily resident, then the HUF is resident and ordinarily resident and if the karta is resident but not ordinarily resident, then HUF is resident but not ordinarily resident.
Illustration 6

The business of a HUF is transacted from Australia and all the policy decisions are taken there. Mr. E, the karta of the HUF, who was born in Kolkata, visits India during the P.Y. 2016-17 after 15 years. He comes to India on 1.4.2016 and leaves for Australia on 1.12.2016. Determine the residential status of Mr. E and the HUF for A.Y. 2017-18.

Solution

(a) During the P.Y. 2016-17, Mr. E has stayed in India for 245 days (i.e. 30+31+30+31+31+ 30+31+30+1 days). Therefore, he is a resident. However, since he has come to India after 15 years, he cannot satisfy any of the conditions for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y. 2016-17 is resident but not ordinarily resident.

(b) Since the business of the HUF is transacted from Australia and nothing is mentioned regarding its control and management, it is assumed that the control and management is also wholly outside India. Therefore, the HUF is a non-resident for the P.Y. 2016-17.

(3) Residential status of firms and association of persons: A firm and an AOP would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, the firm would become a non-resident.

(4) Residential status of companies: A company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

Explanation to section 6(3) defines “place of effective management” to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

Determination of residential status of a company

<table>
<thead>
<tr>
<th>Is the company an Indian company?</th>
<th>No</th>
<th>Whether POEM of the company is in India in the relevant P.Y.</th>
<th>No</th>
<th>The company is a non-resident for the relevant P.Y.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td></td>
<td></td>
<td>Yes</td>
<td>The company is a resident in India for the relevant</td>
</tr>
</tbody>
</table>
Note – A transition mechanism for a company which is incorporated outside India, which has not been assessed to tax in India earlier and has become resident in India for the first time in A.Y.2017-18 due to application of POEM, has been provided in Chapter XII-BC. The same will be dealt with at the Final level.

(5) Residential status of local authorities and artificial juridical persons: Local authorities and artificial juridical persons would be resident in India if the control and management of its affairs is situated wholly or partly in India. Where the control and management of the affairs is situated wholly outside India, they would become non-residents.

1.2 Scope of Total Income

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

(i) the residential status of the assessee (as discussed earlier);
(ii) the place of accrual or receipt of income, whether actual or deemed; and
(iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assessees would be as follows:

(1) Resident and ordinarily resident - The total income of a resident assessee would, under section 5(1), consist of:

(i) income received or deemed to be received in India during the previous year;
(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
(iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

In simpler terms, a resident and ordinarily resident has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India.

(2) Resident but not ordinarily resident – Under section 5(1), the computation of total income of resident but not ordinarily resident is the same as in the case of resident and ordinarily resident stated above except for the fact that the income accruing or arising to him outside India is not to be included in his total income. However, where such income is derived from a business controlled from or profession set up in India, then it must be included in his total income even though it accrues or arises outside India.

(3) Non-resident - A non-resident’s total income under section 5(2) includes:

(i) income received or deemed to be received in India in the previous year; and
(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

Note: All assessees, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India whereas residents
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alone are chargeable to tax in respect of income which accrues or arises outside India.

<table>
<thead>
<tr>
<th>Resident And Ordinarily Resident</th>
<th>Resident But Not Ordinarily Resident</th>
<th>Non-Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income received/deemed to be received/accrued or arisen/deemed to accrue or arise in or outside India.</td>
<td>Income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India. and Income which accrues or arises outside India being derived from a business controlled from or profession set up in India.</td>
<td>Income received/deemed to be received/accrued or arisen/deemed to accrue or arise in India.</td>
</tr>
</tbody>
</table>
UNIT -2 : DEEMED RECEIPT AND ACCRUAL OF INCOME IN INDIA

**Learning objectives**

After studying this unit, you would be able to understand -

- which are the income deemed to be received in India
- the meaning of income accruing or arising in India
- which are the income deemed to accrue or arise in India.

The taxability of a certain item as income would depend upon the method of accounting followed by the assessee. This is because under the cash system of accounting an income would be taxable only when it is received by the assessee himself or on his behalf. But under the mercantile system it would be taxable once the assessee gets the legal right to claim the amount. However, it has been specifically provided that in the case of income from salaries, the liability to tax arises immediately when the income is due to the assessee irrespective of the method of accounting followed. Likewise, in the case of dividends, the income would be included in total income of the shareholder under section 8 in the year in which the final dividend is declared and, in the case of interim dividend, in the year in which they are made unconditionally available to the shareholders.

### 2.1 Meaning of “Income received or deemed to be received”

All assessee are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of -

(i) their residential status, and  
(ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

**Income deemed to be received** – Under section 7, the following shall be deemed to be received by the assessee during the previous year irrespective of whether he had actually received the same or not -

(i) The annual accretion in the previous year to the balance to the credit of an employee participating in a recognised provident fund (RPF). Thus, the contribution of the employer in excess of 12% of salary or interest credited in excess of 9.5% p.a. is deemed to be received by the assessee.

(ii) The taxable transferred balance from unrecognized to recognized provident fund (being
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the employer’s contribution and interest thereon).

(iii) The contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to under section 80CCD.

2.2 Meaning of income ‘accruing’ and ‘arising’

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g. salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January. Similarly, on Government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates. Example: Interest on Government securities is usually payable on specified dates, say on 1st January and 1st July. In all such cases, the interest would be said to accrue from 1st July to 31st December and on 1st January, it will fall due for payment.

It must be noted that income which has been taxed on an accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation. For example, when a loan to a director has already been treated as dividend under section 2(22)(e) and later dividend is declared, distributed and adjusted against the loan, the same cannot be treated as dividend income again.

With a view to removing difficulties and clarifying doubts in the taxation of income, *Explanation* 1 to section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, *Explanation* 2 to section 5 makes it clear that once an item of income is included in the assessee’s total income and subjected to tax on the ground of its accrual/deemed accrual or receipt, it cannot again be included in the person’s total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

2.3 Income deemed to accrue or arise in India [Section 9]

Certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India. The categories of income which are deemed to accrue or arise in India are:

1. Any income accruing or arising to an assessee in any place outside India whether directly or indirectly (a) through or from any business connection in India, (b) through or from any property in India, (c) through or from any asset or source of income in India or (d) through the transfer of a capital asset situated in India [*Section 9(1)(i)*].

2. Income, which falls under the head “Salaries”, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India. Further, any income under the head “Salaries” payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of
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...employment, shall be regarded as income earned in India [Section 9(1)(ii)].

(3) Income from ‘Salaries’ which is payable by the Government to a citizen of India for services rendered outside India (However, allowances and perquisites paid outside India by the Government is exempt) [Section 9(1)(iii)].

(4) Dividend paid by a Indian company outside India [Section 9(1)(iv)].

(5) Interest [Section 9(1)(v)] (discussed in para 5 below)

(6) Royalty [Section 9(1)(vi)] (discussed in para 6 below)

(7) Fees for technical services [Section 9(1)(vii)] (discussed in para 7 below)

(1) Income not deemed to accrue or arise in India [Explanation 1 to section 9(1)(i)]

Explanation 1 to section 9(1)(i) lists out income which shall not be deemed to accrue or arise in India. They are given below:

(i) In the case of a business, in respect of which all the operations are not carried out in India [Explanation 1(a) to section 9(1)(i)]: In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

(ii) Purchase of goods in India for export [Explanation 1(b) to section 9(1)(i)]: In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

(iii) Collection of news and views in India for transmission out of India [Explanation 1(c) to section 9(1)(i)]: In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

(iv) Shooting of cinematograph films in India [Explanation 1(d) to section 9(1)(i)]: In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is:

(a) an individual, who is not a citizen of India or

(b) a firm which does not have any partner who is a citizen of India or who is resident in India; or

(c) a company which does not have any shareholder who is a citizen of India or who is resident in India.
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(v) **Activities confined to display of rough diamonds in SNZs [Explanation 1(e) to section 9(1)(i)]:** In order to facilitate the FMCs to undertake activity of display of uncut diamond (without any sorting or sale) in a Special Notified Zone (SNZ), clause (e) has been inserted in Explanation 1 to section 9(1)(i) to provide that in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

(1) (a) **Business Connection [Explanation 2 to section 9(1)(i)]:**

(i) ‘Business connection’ shall include any business activity carried out through a person acting on behalf of the non-resident.

(ii) He must have an authority which is habitually exercised to conclude contracts on behalf of the non-resident. However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.

(iii) Where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, a business connection is established.

(iv) Business connection is also established where he habitually secures orders in India, mainly or wholly for the non-resident. Further, there may be situations when other non-residents control the above-mentioned non-resident. Secondly, this non-resident may also control other non-residents. Thirdly, all other non-residents may be subject to the same common control, as that of the non-resident. In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

**Exception:** "Business connection", however, shall not be held to be established in cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident. He will however, not be considered to have an independent status in the three situations explained in (iv) above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (ii), (iii) or (iv) mentioned above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

(1) (b) & (c) **Income from property, asset or source of income**

Any income which arises from any property (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India eg. hire charges or rent paid outside India for the use of the machinery or buildings situated in India, deposits with an Indian
company for which interest is received outside India etc.

1. Income through the transfer of a capital asset situated in India

Capital gains arising from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether (i) the capital asset is movable or immovable, tangible or intangible; (ii) the place of registration of the document of transfer etc., is in India or outside; and (iii) the place of payment of the consideration for the transfer is within India or outside.

The legislative intent of section 9(1)(i) is to cover incomes, which are accruing or arising, directly or indirectly from a source in India. The section codifies the source rule of taxation, which signifies that where a corporate structure is created to route funds, the actual gain or income arises only in consequence of the investment made in the activity to which such gains are attributable and not the mode through which such gains are realized. This principle which supports the source country’s right to tax the gains derived from offshore transactions where the value is attributable to the underlying assets, is recognized internationally by several countries.

Accordingly, Explanation 4 clarifies that the expression “through” shall mean and include and shall be deemed to have always meant and included “by means of,” “in consequence of” or “by reason of”.

Further, Explanation 5, inserted by the Finance Act, 2012, clarifies that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. Circular No. 4/2015, dated 26-03-2015, therefore, clarifies that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would NOT be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 to section 9(1)(i).

Taking into account the concerns raised by various stakeholders regarding the scope and impact of the amendments made by Finance Act, 2012, including, inter alia, Explanation 5 to section 9(1)(i), an Expert Committee under the Chairmanship of Dr. Parthasarathi Shome was constituted by the Government. On the basis of recommendations of the Expert Committee, Explanations 6 & 7 were inserted to clarify the provisions of Explanation 5 to section 9(1)(i).

Explanation 6 provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets,-

(a) exceeds the amount of ₹ 10 crore; and

(b) represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;
### Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of an asset</td>
<td>The <strong>fair market value as on the specified date</strong>, of such asset <strong>without reduction of liabilities</strong>, if any, in respect of the asset, determined in prescribed manner.</td>
</tr>
<tr>
<td>Specified date</td>
<td>The date on which the <strong>accounting period</strong> of the company or, as the case may be, the entity <strong>ends</strong> preceding the date of transfer of a share or an interest. However, the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer.</td>
</tr>
<tr>
<td>Accounting period</td>
<td>Each period of twelve months ending with 31st March. However, where a company or an entity, referred to in <em>Explanation 5</em>, regularly adopts a period of twelve months ending on a day other than 31st March for the purpose of - (a) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (b) reporting to persons holding the share or interest, then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:</td>
</tr>
<tr>
<td>First Accounting Period</td>
<td>First accounting period of the company or, as the case may be, the entity shall <strong>begin from the date of its registration or incorporation</strong> and <strong>end with the 31st March</strong> or such other day, as the case may be, following the date of such registration or incorporation.</td>
</tr>
<tr>
<td>Later accounting period</td>
<td>Later accounting period shall be the <strong>successive periods of twelve months</strong></td>
</tr>
<tr>
<td>Accounting period of an entity which ceases to exist</td>
<td>If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.</td>
</tr>
</tbody>
</table>

*Explanation 7* to section 9(1)(i) provides that **no income shall be deemed** to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, in the following cases;
Residence and Scope of Total Income  2.16

| (1) | Foreign company or entity **directly** owns the assets situated in India | AND | the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, does not hold
- the right of management or control in relation to foreign company or entity; or
- the voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or |

| (2) | Foreign company or entity **indirectly** owns the assets situated in India | AND | the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, does not hold
- the right of management or control in relation to foreign company or entity; or
- any right in, or in relation to, foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India; or
- such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India; |

In effect, **the exemption shall be available to the transferor** of a share of, or interest in, a foreign entity if he along with its associated enterprises, -

- neither holds the right of control or management,
- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital, in the foreign company or entity directly holding the Indian assets (direct holding company).

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises,-

- neither holds the right of management or control in relation to such company or the entity,
(b) nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power exceeding 5% in the direct holding company or entity.

Further, where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity registered or incorporated outside India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in the foreign company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in the prescribed manner.

“Associated enterprise”, in relation to another enterprise, means an enterprise—

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) & (3) Income from salaries: Under section 9(1)(ii) income which falls under the head ‘salaries’, would be deemed to accrue or arise in India, if it is in respect of services rendered in India.

Exception under section 9(2): Pension payable outside India by the Government to its officials and judges who permanently reside outside India shall not be deemed to accrue or arise in India. It may however, be noted here that the salary of an employee in the United Nations Organisation (UNO) or in its constituent bodies is exempt under United Nations (Privilege and Immunity) Act.

(4) Income from dividends: All dividends paid by an Indian company must be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O are exempt from tax in the hands of the shareholder. It may be noted that dividend distribution tax under section 115-O does not apply to deemed dividend under section 2(22)(e), which is chargeable in the previous year in which such dividend is distributed or paid.

Further, section 115BBDA has been inserted to provide that any income by way of aggregate dividend in excess of `10 lakh shall be chargeable to tax in the case of an individual, HUF or a firm who is resident in India, at the rate of 10%.

Also, the taxation of dividend income in excess `10 lakh shall be on gross basis i.e., no deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of dividends. Accordingly, exemption under section 10(34) in respect of dividend received by a shareholder from a domestic company would not apply to income by way of dividend chargeable to tax under section 115BBDA.
Illustration 7

A Ltd., a domestic company, declared dividend of ₹170 lakh for the year F.Y.2015-16 and distributed the same on 10.7.2016. Mr. X, holding 10% shares in A Ltd., receives dividend of ₹17 lakh in July, 2016. Mr. Y, holding 5% shares in A Ltd., receives dividend of ₹8.50 lakh. Discuss the tax implications in the hands of Mr. X and Mr. Y, assuming that Mr. X and Mr. Y have not received dividend from any other domestic company during the year.

Solution

(i) The dividend of ₹170 lakh declared and distributed in the P.Y.2016-17 is subject to dividend distribution tax in the hands of A Ltd., a domestic company.

(ii) In the hands of Mr. X, dividend received up to ₹10 lakh would be exempt under section 10(34). ₹7 lakh, being dividend received in excess of ₹10 lakh, would be taxable at 10% under section 115BBDA. Such dividend would not be exempt under section 10(34). Therefore, tax payable by Mr. X on dividend of ₹7 lakh under section 115BBDA would be ₹72,100 [i.e., 10% of ₹7 lakh + cess @3%].

(iii) In the hands of Mr. Y, the entire dividend of ₹8.50 lakh received would be exempt under section 10(34), since only dividend received in excess of ₹10 lakh would be taxable under section 115BBDA.

(5) Interest: Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Central Government or any State Government.

(ii) a person resident in India (except where it is payable in respect of any money borrowed and used for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India)

(iii) a non-resident when it is payable in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on in India by him. Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India. Thus, if a non-resident ‘A’ borrows money from a non-resident ‘B’ and invests the same in shares of an Indian company, interest payable by ‘A’ to ‘B’ will not be deemed to accrue or arise in India.

Taxability of interest payable by the Permanent Establishment of a non-resident engaged in banking business to the head office

In order to provide clarity and certainty, on the issue of taxability of interest payable by the PE of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v). Accordingly, in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the PE in India of such non-
2.19 Income-tax

resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.

Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Also, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Non-deduction would result in disallowance of interest claimed as expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Act.

Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

(6) Royalty: Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government; or

(ii) a person who is a resident in India except in cases where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India.

Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the Government under the Policy on Computer Software Export, Software Development and Training, 1986 shall not be deemed to accrue or arise in India.

“Computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

The term ‘royalty’ means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head ‘Capital gains’) for:

(i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark.
or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;

(vii) the rendering of any service in connection with the activities listed above.

The definition of ‘royalty’ for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head ‘capital gains’.

**Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)**

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term “royalty” means consideration for transfer of all or any right in respect of certain rights, property or information. There have been conflicting court rulings on the interpretation of the definition of royalty, on account of which there was a need to resolve the following issues –

(i) Does consideration for use of computer software constitute royalty?

(ii) Is it necessary that the right, property or information has to be used directly by the payer?

(iii) Is it necessary that the right, property or information has to be located in India or control or possession of it has to be with the payer?

(iv) What is the meaning of the term “process”?

In order to resolve the above issues arising on account of conflicting judicial decisions and to clarify the true legislative intent, Explanations 4, 5 & 6 have been inserted with retrospective effect from 1st June, 1976.

*Explanation 4* clarifies that the consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.
Note - The Central Government has, vide Notification No.21/2012 dated 13.6.2012 to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if -

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

Explanation 5 clarifies that royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6 clarifies that the term “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

(7) Fees for technical services: Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India, except in cases where the fees are payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services means any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head ‘Salaries’.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty
and fee for technical services to be taxed irrespective of territorial nexus (Explanation to section 9)

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or
(ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

Illustration 8

Compute the total income in the hands of an individual, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2017-18 -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of interest received in India</td>
<td>10,000</td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>20,000</td>
</tr>
<tr>
<td>Profits on sale of shares of an Indian company received in London</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
</tr>
<tr>
<td>Profits on sale of plant at Germany 50% of profits are received in India</td>
<td>40,000</td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi</td>
<td>70,000</td>
</tr>
<tr>
<td>(₹ 40,000 is received in India)</td>
<td></td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from house property in London deposited in a Indian Bank at London,</td>
<td>50,000</td>
</tr>
<tr>
<td>brought to India (Commed)</td>
<td></td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London.</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
</tr>
<tr>
<td>Profits from a business in Bombay managed from London</td>
<td>26,000</td>
</tr>
<tr>
<td>Pension for services rendered in India but received in Burma</td>
<td>4,000</td>
</tr>
<tr>
<td>Income from property situated in Pakistan received there</td>
<td>16,000</td>
</tr>
<tr>
<td>Past foreign untaxed income brought to India during the previous year</td>
<td>5,000</td>
</tr>
<tr>
<td>Income from agricultural land in Nepal received there and then brought to</td>
<td>18,000</td>
</tr>
<tr>
<td>India</td>
<td></td>
</tr>
<tr>
<td>Income from profession in Kenya which was set up in India, received there</td>
<td>5,000</td>
</tr>
<tr>
<td>but spent in India</td>
<td></td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding</td>
<td>20,000</td>
</tr>
</tbody>
</table>
## 2.23 Income-tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident and ordinarily resident ₹</th>
<th>Resident but not ordinarily resident ₹</th>
<th>Non-resident ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on savings bank deposit in State Bank of India</td>
<td>12,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from a business in Russia, controlled from Russia</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend from Reliance Petroleum Limited, an Indian Company</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural income from a land in Rajasthan</td>
<td>15,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Solution:

**Computation of total income for the A.Y. 2017-18**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident and ordinarily resident ₹</th>
<th>Resident but not ordinarily resident ₹</th>
<th>Non-resident ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of interest received in India</td>
<td>10,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Profits on sale of shares of an Indian company received in London (assuming that they are in the nature of short-term capital gains)</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Profits on sale of plant at Germany, 50% of profits are received in India</td>
<td>40,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India</td>
<td>70,000</td>
<td>70,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from property in London deposited in a Bank at London, later on remitted to India</td>
<td>50,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London.</td>
<td>12,000</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
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<tr>
<td>Profits from a business in Bombay managed from London</td>
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<td>26,000</td>
<td>26,000</td>
</tr>
<tr>
<td>Pension for services rendered in India but received in Burma</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Income from property situated in Pakistan received</td>
<td>16,000</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
### Past foreign untaxed income brought to India during the previous year

<table>
<thead>
<tr>
<th>Source of Income</th>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from agricultural land in Nepal received there and then brought to India</td>
<td>18,000</td>
</tr>
<tr>
<td>Income from profession in Kenya which was set up in India, received there but spent in India</td>
<td>5,000 purely for agricultural income</td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding [not taxable]</td>
<td>-</td>
</tr>
<tr>
<td>Interest on savings bank deposit in State Bank of India</td>
<td>12,000</td>
</tr>
<tr>
<td>Income from a business in Russia, controlled from Russia</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from Reliance Petroleum Limited, an Indian Company [Exempt under section 10(34)]</td>
<td>-</td>
</tr>
<tr>
<td>Agricultural income from a land in Rajasthan [Exempt under section 10(1)]</td>
<td>-</td>
</tr>
</tbody>
</table>

**Gross Total Income**

<table>
<thead>
<tr>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,51,000</td>
</tr>
<tr>
<td>2,17,000</td>
</tr>
<tr>
<td>1,82,000</td>
</tr>
</tbody>
</table>

**Less: Deduction under section 80TTA**

<table>
<thead>
<tr>
<th>Amount (INR)</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000</td>
<td>Interest on savings bank account subject to a maximum of ₹ 10,000</td>
</tr>
</tbody>
</table>

**Total Income**

<table>
<thead>
<tr>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,41,000</td>
</tr>
<tr>
<td>2,07,000</td>
</tr>
<tr>
<td>1,72,000</td>
</tr>
</tbody>
</table>

### 2.4 Presence of eligible fund manager in India not to constitute business connection in India of such eligible investment fund on behalf of which he undertakes fund management activity [Section 9A]

1. Under section 9(1)(i), income would be deemed to accrue or arise in India in the hands of non-resident, if it arises from a business connection in India. Consequently, income attributable to the activities constituting business connection in India would be taxable in India.

2. As per Double Taxation Avoidance Agreements (DTAAs), the source country assumes taxation rights on certain incomes, if the non-resident has a Permanent Establishment (PE) in that country.

3. Under section 6, the residential status of a person other than individual is determined based upon the location of its “control and management”. As per the existing provisions of law, in case of off-shore funds, the presence of a fund manager in India may create sufficient nexus of the off-shore fund with India and may constitute a business connection in India inspite of the fund manager being an independent person.
Likewise, if the fund manager located in India undertakes fund management activity in respect of investments outside India for an off-shore fund, the profits made by the fund from such investments may be liable to tax in India due to the location of fund manager in India and attribution of such profits to the activity of the fund manager undertaken on behalf of the off-shore fund.

(4) Further, presence of the fund manager under certain circumstances may lead to the off shore fund being held to be resident in India on the basis of its control and management being in India.

(5) On account of the fund management activity undertaken in, and from India constituting a business connection –
   (a) the fees received by the fund manager for fund management activity gets taxed in India; and
   (b) income of off-shore fund from investments made in countries outside India may also get taxed in India.

Due to the above tax consequences in respect of income from the investments of offshore funds made in other jurisdictions, many fund managers who are of Indian origin, are managing the investment of offshore funds in other countries without locating in India.

(6) With a view to facilitate location of fund managers of off-shore funds in India, section 9A has been inserted to provide for a specific regime in the Act in line with global best practices with the aim that, subject to fulfillment of certain conditions by the fund and the fund manager,-
   (a) the tax liability in respect of income arising to the Fund from investment in India would be neutral to the fact as to whether the investment is made directly by the fund or through engagement of Fund manager located in India; and
   (b) that income of the fund from the investments outside India would not be taxable in India solely on the basis that the Fund management activity in respect of such investments have been undertaken through a fund manager located in India.

(7) Fund Management Activity through an eligible fund manager not to constitute business connection: In the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, subject to fulfillment of certain conditions.

(8) Location of Fund Manager in India not to affect residential status of an eligible investment fund: An eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf is located in India.
(9) **Conditions to be fulfilled by an Eligible Investment Fund:** The eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit. Further, it should fulfill the following conditions:

(a) the fund should not be a person resident in India;

(b) the fund should be a resident of a country or a specified territory with which an agreement referred to in section 90(1) or section 90A(1) has been entered into or is established or incorporated or registered in a country or specified territory notified by the Central Government in this behalf;

(c) the aggregate participation or investment in the fund, directly or indirectly, by persons being resident in India should not exceed 5% of the corpus of the fund;

(d) the fund and its activities should be subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;

(h) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(i) no investment shall be made by the fund in its associate entity;

(j) the monthly average of the corpus of the fund shall not be less than ₹ 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than ₹ 100 crore rupees at the end of such previous year;

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(l) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than the arm’s length price of such activity.
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(10) Certain conditions not to apply to investment fund set up by the Government or the Central Bank of a foreign State or a Sovereign Fund

The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government:

(i) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(ii) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(iii) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

(11) Eligible Fund Manager [Section 9A(4)]: The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(a) the person should not be an employee of the eligible investment fund or a connected person of the fund;

(b) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations;

(c) the person should be acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

(12) Furnishing of Statement in prescribed form [Section 9A(5)]: Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(1) the fulfillment of the above conditions; and

(2) such other relevant information or document which may be prescribed.

(13) Non-applicability of special taxation regime under section 9A: This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.
CBDT to prescribe guidelines for the manner of application of the provisions of this section.

**Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
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<tbody>
<tr>
<td>Associate</td>
<td>An entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than 15% of its share capital or interest, as the case may be.</td>
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<tr>
<td>Corpus</td>
<td>The total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date.</td>
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<tr>
<td>Connected person</td>
<td>Any person who is connected directly or indirectly to another person and includes,—</td>
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<td></td>
<td>(a) any relative of the person, if such person is an individual;</td>
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<tr>
<td></td>
<td>(b) any director of the company or any relative of such director, if the person is a company;</td>
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<td></td>
<td>(c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals;</td>
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<td></td>
<td>(d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;</td>
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<td></td>
<td>(e) any individual who has a substantial interest in the business of the person or any relative of such individual;</td>
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<td></td>
<td>(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;</td>
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<td></td>
<td>(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;</td>
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<tr>
<td></td>
<td>(h) any other person who carries on a business, if -</td>
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<td></td>
<td>(i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or</td>
</tr>
<tr>
<td></td>
<td>(ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu</td>
</tr>
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</table>
2.29 Income-tax

<table>
<thead>
<tr>
<th>Entity</th>
<th>An entity in which an eligible investment fund makes an investment.</th>
</tr>
</thead>
</table>
| Specified regulations | • The Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993; or  
• The Securities and Exchange Board of India (Investment Advisers) Regulations, 2013; or  
• Such other regulations made under the SEBI Act, 1992 which may be notified by the Central Government. |