RESIDENCE AND SCOPE OF TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **determine** the residential status of Individuals, HUFs, AOPs/BOIs, Firms & Companies.

- **determine** the residential status of foreign companies applying the Place of Effective Management (POEM) Guidelines.

- **examine** the scope of income chargeable to tax in respect of different persons, after ascertaining their residential status.

- **appreciate** how the residential status of a person determines the income includible in his total income and consequently impacts his income-tax liability.

- **examine** when income arising in the hands of non-resident from a transaction is deemed to accrue or arise in India.

- **appreciate** the circumstances when the presence of eligible fund manager in India would not constitute business connection in India for an eligible investment fund.
2.1 RESIDENTIAL STATUS [SECTION 6]

The incidence of tax on any assessee depends upon his residential status under the Act. 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:

(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.

**Notes:**

(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.

(i) 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

(ii) 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

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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.
How to determine period of stay in India for an Indian citizen, being a crew member?

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

To remove this uncertainty, *Explanation 2* has been inserted in section 6(1) to provide 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>
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<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, 1958.</td>
</tr>
</tbody>
</table>
| (b) Eligible voyage | A voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where –
| &nbsp;&nbsp;&nbsp;&nbsp;&nbsp;i) for the voyage having originated from any port in India, has as its destination any port outside India; and  
| &nbsp;&nbsp;&nbsp;&nbsp;&nbsp;ii) for the voyage having originated from any port outside India, has as its destination any port in India.’. |

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,*
2017. From the following details for the P.Y.2017-18, determine the residential status of Mr. Anand for A.Y.2018-19, assuming that his stay in India in the last 4 previous years (preceding P.Y.2017-18) is 400 days and last seven previous years (preceding P.Y.2017-18) is 750 days:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Anand</td>
<td>6th June, 2017</td>
</tr>
<tr>
<td>Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Anand</td>
<td>9th December, 2017</td>
</tr>
</tbody>
</table>

**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, 2017 and ending on 9th December, 2017, 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+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.2017-18 would be 178 days [i.e., 365 days – 187 days]. Since his period of stay in India during the P.Y.2017-18 is less than 182 days, he is a non-resident for A.Y.2018-19.

**Note** - Since the residential status of Mr. Anand is “non-resident” for A.Y.2018-19 consequent to his number of days of stay in P.Y.2017-18 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

**Resident and ordinarily resident/Resident but not ordinarily resident**

Only individuals and HUFs can be resident but not ordinarily resident in India. All other classes of assessees 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

*Brett Lee, an Australian cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2018-19.*

**Solution**

**Determination of Residential Status of Mr. Brett Lee for the A.Y. 2018-19:**

Period of stay during previous year 2017-18 = 100 days

Calculation of period of stay during 4 preceding previous years (100 x 4=400 days)

<table>
<thead>
<tr>
<th>Year</th>
<th>Days</th>
</tr>
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<tbody>
<tr>
<td>2016-17</td>
<td>100</td>
</tr>
<tr>
<td>2015-16</td>
<td>100</td>
</tr>
<tr>
<td>2014-15</td>
<td>100</td>
</tr>
<tr>
<td>2013-14</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>400 days</strong></td>
</tr>
</tbody>
</table>

Mr. Brett Lee has been in India for a period more than 60 days during previous year 2017-18 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2018-19.

Computation of period of stay during 7 preceding previous years = 100 x 7=700 days

<table>
<thead>
<tr>
<th>Year</th>
<th>Days</th>
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<tbody>
<tr>
<td>2016-17</td>
<td>100</td>
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<td>2015-16</td>
<td>100</td>
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<tr>
<td>2014-15</td>
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<td>2013-14</td>
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<td>2012-13</td>
<td>100</td>
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<tr>
<td>2011-12</td>
<td>100</td>
</tr>
<tr>
<td>2010-11</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>700 days</strong></td>
</tr>
</tbody>
</table>
Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2018-19. (See Note below)

Therefore, Mr. Brett Lee is a resident but not ordinarily resident during the previous year 2017-18 relevant to the assessment year 2018-19.

**Note:** A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6), i.e.,

(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.

In this case, since Mr. Brett Lee satisfies condition (ii), he is a not-ordinary resident for the A.Y. 2018-19.
(2) **Residential status of HUFs**

**Resident:** A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India.

**Non-resident:** If the control and management of the affairs is situated wholly outside India it would become a non-resident.

### Meaning of the term “control and management”
- 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. This is because the control and management of a business need not necessarily be done from the place of business or from 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.

### Resident and ordinarily resident/Resident but not ordinarily resident

If karta of resident HUF satisfies both the following additional conditions (as applicable in case of individual) then, resident HUF will be ROR, otherwise it will be RNOR.

**Additional conditions:**
1. Karta of resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year.
2. Stay of Karta during 7 previous years immediately preceding relevant previous year should be 730 days or more.

### Illustration 3

*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.2017-18 after 15 years. He comes to India on 1.4.2017 and leaves for Australia on 1.12.2017. Determine the residential status of Mr. E and the HUF for A.Y. 2018-19.*

**Solution**

(a) During the P.Y.2017-18, 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 does not satisfy any of the conditions for being ordinarily resident.
Therefore, the residential status of Mr. E for the P.Y.2017-18 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.2017-18.

(3) Residential status of firms and association of persons

**Resident:** 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.

**Non-resident:** Where the control and management of the affairs is situated wholly outside India, the firm and AOP would become a non-resident.

(4) Residential status of companies

With effect from Assessment year 2017-18, 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.
Determination of residential status of a company

Is the company an Indian company?  No  Whether POEM of the company is in India in the relevant P.Y.  NO  The company is a non-resident for the relevant P.Y.

Yes

The company is a resident in India for the relevant P.Y.

Guiding principles for determination of Place of Effective Management (POEM) of a company, other than an Indian company – [Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017]

‘Place of effective management’ (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of ‘place of effective management’ for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

The CBDT has laid down the following guiding principles to be followed for determination of POEM.

**Concept of Substance over form**

Any determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since “residence” is to be determined for each year, POEM will also be required to be determined on year to year basis.

**Whether the company is engaged in active business outside India? - An important criterion for determination of POEM**

The process of determination of POEM would be primarily based on the fact as to whether or
A company shall be said to be engaged in “active business outside India”
- if the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or (b) As per books of account, where the laws of the country of incorporation does not require such a computation.</td>
</tr>
<tr>
<td>Value of assets</td>
<td>(a) In case of an individually depreciable asset: The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and (b) In case of pool of fixed asset, being treated as a block for depreciation: The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year; (c) In case of any other asset: Value as per books of account</td>
</tr>
<tr>
<td>Number of employees</td>
<td>The average of the number of employees as at the beginning and at the end of the year. It shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.</td>
</tr>
</tbody>
</table>
### Pay roll

This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.

### Passive income

It is the aggregate of, -

1. income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
2. income by way of royalty, dividend, capital gains, interest or rental income;

However, any income by way of interest shall not be considered to be passive income in cases of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.

### Place of Effective Management:

**(i) In case of companies engaged in active business outside India**

POEM of a company engaged in active business shall be presumed to be outside India if the majority of the board meetings are held outside India.

However, in case the Board is not exercising its powers of management and such powers are being exercised by either the holding company or any other person, resident in India, then POEM shall be considered to be in India.

For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then, data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

**(ii) In case of companies not engaged in active business outside India**

The guidelines provide a two-stage process for determination of POEM in case of companies not engaged in active business.
RESIDENCE AND SCOPE OF TOTAL INCOME

(a) **First stage:** Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

(b) **Second stage:** Determining the place where these decisions are, in fact, being made.

The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.

Some of the guiding principles which may be taken into account for determining the POEM are as follows:

(a) **The location where a company's Board regularly meets and makes decisions** may be the company's place of effective management provided, the Board-

(i) retains and exercises its authority to govern the company; and

(ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.

As an example, there may be a case where the board meetings are held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company’s place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

“**Senior Management**” in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may vary, these persons may include:

(i) Managing Director or Chief Executive Officer;

(ii) Financial Director or Chief Financial Officer;
(iii) Chief Operating Officer; and
(iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

(b) **Location of executive committee, in case powers are delegated by the board:** A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the Executive Committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.

The delegation of authority may be either de jure (by means of a formal resolution or Shareholder Agreement) or de facto (based upon the actual conduct of the board and the executive committee).

(c) **Location of head office:** The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:

- If the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters, then, that location is the place where head office is located.

- If the company is more decentralized (for example, where various members of senior management may operate, from time to time, at offices located in the various countries) then, the company's head office would be the location where these senior managers,
  - (i) are primarily or predominantly based; or
  - (ii) normally return to following travel to other locations; or
  - (iii) meet when formulating or deciding key strategies and policies for the company as a whole.

Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.

In situations where the senior management is so decentralised that it is not possible to determine the company's head office with a reasonable degree of certainty, the location of
a company’s head office would not be of much relevance in determining that company’s place of effective management.

| "Head Office" of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company’s head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets. |

(d) **Use of modern technology:** The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

(e) **Decision via circular resolution or round robin voting:** In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered. It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.

(f) **Decisions made by Shareholders are not relevant factor in determination of POEM:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company’s place of effective management. Such decisions may include sale of all or substantially all of the company’s assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company’s business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company’s place of effective management.

However, the shareholder’s involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. As an example if the shareholders limit the authority of board and senior managers of a company and thereby remove the company’s real authority to make decision then the shareholder guidance
transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.

Therefore, whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

(g) **Day to day routine operational decisions are not relevant for determination of POEM:**

It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM. The operational decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be examples of key commercial decisions affecting the company’s business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be examples of routine operational decisions. In certain situations it may happen that person responsible for operational decision is the same person who is responsible for the key management and commercial decision. In such cases it will be necessary to distinguish the two type of decisions and thereafter assess the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words a “snapshot” approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

The CBDT also clarified that the Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Example 1: Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company’s total income for three years is,

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;
(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

**Interpretation:** In this case passive income is 40% of the total income of the company. The passive income consists of,

- (i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

- (ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

**Example 2:** The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of ₹ 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ₹ 3 crore.

**Interpretation:** Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

**Example 3:** The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.

**Interpretation:** The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

**Example 4:** The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.’s senior management team signs all the contracts, for all the contracts above ₹ 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ₹ 10 lakh and over past years also the same trend in respect of value contribution of contracts above ₹ 10 lakh is seen.
Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since companies B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ₹50 crores or less in a financial year.

Illustration 4

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2017 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company’s products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2018-19.

Solution

Section 6(3) provide that 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.

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2017-18 only if 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. In the case of ABC Inc., its place of effective management for P.Y.2017-18 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2018-19, since its place of effective management is outside India in the P.Y.2017-18.

Transition Mechanism for a company incorporated outside India and has not been assessed to tax earlier [Chapter XII-BC – Section 115JH]

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 comprising of section 115JH.

(a) Accordingly, the Central Government is empowered to notify exception, modification and adaptation subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

(b) In a case where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, these transition provisions would also cover any subsequent previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed. In effect, the transition provisions would also cover any subsequent amendment upto the date of determination of POEM in an assessment proceeding. However, once the transition is complete, then, normal provisions of the Act would apply.

(c) In the notification issued by the Central Government, certain conditions including procedural conditions subject to which these adaptations shall apply can be provided for and in case of failure to comply with the conditions, the benefit of such notification would not be available to the foreign company.
Accordingly, where in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification, and subsequently, there is failure to comply with any of the conditions specified therein, then –

(i) the benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications and adaptations as per the notification does not apply; and

(iii) the provisions of section 154 shall, so far as may be, apply thereto and the period of four years for rectification of mistake apparent from the record has to be reckoned from the end of the previous year in which the failure to comply with the condition stipulated in the notification takes place.

(d) Every notification issued in exercise of this power by the Central Government shall be laid before each house of the Parliament.

(5) **Residential status of local authorities and artificial juridical persons**

**Resident:** 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.

**Non-resident:** Where the control and management of the affairs is situated wholly outside India, they would become non-residents.

### 2.2 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;

(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 alone are chargeable to tax in respect of income which accrues or arises outside India.

---

### Residential Status and Scope of Total Income

<table>
<thead>
<tr>
<th>Scope of total Income</th>
<th>Resident and Ordinarily Resident</th>
<th>Resident but not Ordinarily Resident</th>
<th>Non-Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income received or deemed to be received in India during the previous year</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income accruing or arising or deeming to accrue or arise in India during the previous year</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
### Illustration 5

*From the following particulars of income furnished by Mr. Anirudh pertaining to the year ended 31.3.2018, compute the total income for the assessment year 2018-19, if he is:*

- (i) Resident and ordinary resident;
- (ii) Resident but not ordinarily resident;
- (iii) Non-resident

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Short term capital gain on sale of shares in Indian Company received in Germany</td>
<td>15,000</td>
</tr>
<tr>
<td>(b) Dividend from a Japanese Company received in Japan</td>
<td>10,000</td>
</tr>
<tr>
<td>(c) Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels</td>
<td>75,000</td>
</tr>
<tr>
<td>(d) Dividend from RP Ltd., an Indian Company</td>
<td>6,000</td>
</tr>
<tr>
<td>(e) Agricultural income from lands in Gujarat</td>
<td>25,000</td>
</tr>
</tbody>
</table>

### Solution

**Computation of total income of Mr. Anirudh for the A.Y. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident &amp; ordinarily resident (₹)</th>
<th>Resident but not ordinarily resident (₹)</th>
<th>Non-Resident (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Short term capital gain on sale of shares of an Indian company, received in Germany</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
</tbody>
</table>
2.24 DIRECT TAX LAWS

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2)</td>
<td>Dividend from a Japanese company, received in Japan</td>
<td>10,000</td>
<td>-</td>
</tr>
<tr>
<td>3)</td>
<td>Rent from property in London deposited in a bank in London [See Note (i) below]</td>
<td>52,500</td>
<td>-</td>
</tr>
<tr>
<td>4)</td>
<td>Dividend from RP Ltd., an Indian Company [See Note (ii) below]</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5)</td>
<td>Agricultural income from land in Gujarat [See Note (iii) below]</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Income</td>
<td>77,500</td>
<td>15,000</td>
<td>15,000</td>
</tr>
</tbody>
</table>

Notes:

(i) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent received (assumed as gross annual value)</td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Deduction under section 24 (30% of ₹75,000)</td>
<td>22,500</td>
</tr>
<tr>
<td>Income from house property</td>
<td>52,500</td>
</tr>
</tbody>
</table>

(ii) Dividend from Indian company is exempt under section 10(34).

(iii) Agricultural income is exempt under section 10(1).

(4) **Meaning of “Income received or deemed to be received”**

All asseesees 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.
(5) **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 accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation.

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.

(6) **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:

(i) 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 would be deemed to accrue or arise in India. [Section 9(1)(i)]

(a) What is Business Connection?

‘Business connection’ shall include any business activity carried out through a person acting on behalf of the non-resident [Explanation 2 to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident –

(i) must have an authority which is habitually exercised to conclude contracts on behalf of the non-resident or;

   However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.

(ii) In a case, 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, or

(iii) habitually secures orders in India, mainly or wholly for the non-resident.

Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

(a) such other non-resident controls the non-resident or

(b) such other non-resident is controlled by the non-resident or

(c) such other non-resident is subject to same control as that of 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.
Agents having independent status are not included in Business Connection: Business connection, however, shall not be established, where the non-resident carries on business through a broker, general commission agent or any other agent having 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 above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (i), (ii) or (iii) of (a) 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 [Explanation 3 to section 9(1)(i)]

In the case of a Non-resident the following shall not, however, be treated as business connection in India [Explanation 1 to section 9(1)(i)]:

(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:

- an individual, who is not a citizen of India or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

(v) **Activities confined to display of rough diamonds in SNZs [Explanation 1(e) to section 9(1)(i)]**: In order to facilitate the foreign mining companies 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.

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

Any income which arises from any property (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

**Examples:**

- 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.

**d) Income through transfer of a capital asset situated in India**

Capital gains arising through or 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

- the capital asset is movable or immovable, tangible or intangible;
- the place of registration of the document of transfer etc., is in India or outside; and
- the place of payment of the consideration for the transfer is within India or outside.

Accordingly, 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”. [Explanation 4 to section 9(1)(i)]

Further, 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. [Explanation 5 to section 9(1)(i)]

**However, the following shall not be deemed to be or deemed to have been situated in India [Proviso to Explanation 5 to section 9(1)(i)]**

- any asset or capital asset being investment held by non-resident, directly or indirectly, in a Foreign Institutional Investor, as referred to in clause (a) of the Explanation to section 115AD for any assessment year commencing on or after 1st April 2012 but before 1st April 2015.

- an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992.

**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 section 9(1)(i).

**Explanation 6 to section 9(1)(i)** 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, -

- exceeds the amount of ₹ 10 crore; and
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 <em>fair market value as on the specified date</em>, of such asset <em>without reduction of liabilities</em>, if any, in respect of the asset, determined in prescribed manner</td>
</tr>
<tr>
<td>Specified date</td>
<td>The date on which the <em>accounting period</em> of the company or, as the case may be, the entity <em>ends</em> 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 12 months ending with 31st March. However, where a company or an entity, referred to in <em>Explanation 5</em>, regularly adopts a period of 12 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 <em>begin from the date of its registration or incorporation</em> and <em>end with the 31st March</em> 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 <em>successive periods of twelve months</em></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:

<table>
<thead>
<tr>
<th>Case</th>
<th>Condition</th>
<th>Transferor Condition</th>
</tr>
</thead>
</table>
| 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 or total interest,

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,
• 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 or share capital or total interest 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—

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

• 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.

(ii) **Income from salaries earned in India [Section 9(1)(ii)]**

Income, which falls under the head “Salaries”, deemed to accrue or arise in India, 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 employment, shall be regarded as income earned in India.

(iii) **Income from salaries payable by the Government for services rendered outside India [Section 9(1)(iii)]**

Income from ‘Salaries’ which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.
However, allowances and perquisites paid outside India by the Government is exempt, by virtue of section 10(7).

**Illustration 6**

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2018 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2018-19. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2018-19.

**Solution**

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2018-19.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

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

All dividends paid by an Indian company must be deemed to accrue or arise in India. *(Taxability of dividend is discussed in Chapter 8 in more detail)*. Under section 10(34), income from dividends referred to in section 115-O is 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.

(v) **Interest [Section 9(1)(v)].**

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

(a) the Government;

(b) a person resident in India;

**Exception:** 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, it will not be deemed to accrue or arise in India.

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(c) 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.

Exception: 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.

Example: 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-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.

(vi) Royalty [Section 9(1)(vi)]

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

(a) the Government;

(b) a person who is a resident in India

Exception: 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
(c) 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.

**Important points:**

1. **Lumpsum royalty not deemed to accrue arise 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.

2. **Meaning of Computer software:** “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.

3. **Meaning of Royalty:** 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’.
4. **Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)**

*Explanation 4* provides 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.

5. **Consideration in respect of any right, property or information – Is it royalty?**

*Explanation 5* provides 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.

6. **Meaning of Process**

*Explanation 6* provides 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.
Illustration 7

Mr. Soham, an Indian Citizen, left India on 20-04-2015 for the first time to setup a software firm in Singapore. On 10-04-2017, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2017 and was able to complete his assignment on 20-08-2017. He left for Singapore on 21-08-2017. He charged ₹ 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2018-19 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

Solution

Determination of residential status of Mr. Soham

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:

(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.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2015. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y.2017-18. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2017-18 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2018-19 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2017-18.
Section 9(1)(vi) defines “royalty” to mean consideration for transfer of all or any rights in respect of, inter alia, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of “royalty”.

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by an Indian company to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2018-19.

**(vii) Fees for technical services [Section 9(1)(vii)]**

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

(a) the Government.

(b) a person who is resident in India

   **Exception:** Where the fees is 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.

(c) 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** mean 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

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India?

Solution

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of “fees for technical services”.

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services, 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 or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.
Illustration 9

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. 2018-19:

<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 (₹ 40,000 is received in India)</td>
<td>70,000</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, brought to India (Computed)</td>
<td>50,000</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 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</td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding</td>
<td>20,000</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>
</tbody>
</table>
### Solution

**Computation of total income for the A.Y. 2018-19**

<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>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>
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<td>40,000</td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
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<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>
</tbody>
</table>
### RESIDENCE AND SCOPE OF TOTAL INCOME

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<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>
</tr>
<tr>
<td>Profits from a business in Bombay managed from London</td>
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<td>4,000</td>
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<tr>
<td>Income from property situated in Pakistan received there</td>
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<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Past foreign untaxed income brought to India during the previous year</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income from agricultural land in Nepal received there and then brought to India</td>
<td>18,000</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Income from profession in Kenya which was set up in India, received there but spent in India</td>
<td>5,000</td>
<td>5,000</td>
<td>-</td>
</tr>
<tr>
<td>Gift received on the occasion of his wedding [not taxable]</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest on savings bank deposit in State Bank of India</td>
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<td>12,000</td>
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<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Dividend from Reliance Petroleum Limited, an Indian Company [Exempt under section 10(34)]</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Agricultural income from a land in Rajasthan [Exempt under section 10(1)]</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>3,51,000</td>
<td>2,17,000</td>
<td>1,82,000</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 80TTA [Interest on savings bank account subject to a maximum of ₹10,000]</strong></td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>3,41,000</td>
<td>2,07,000</td>
<td>1,72,000</td>
</tr>
</tbody>
</table>
2.3 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 9A, a special regime has been provided in respect of offshore funds.

(2) **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.

(3) **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.

(4) **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:

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

(ii) 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 should be established or incorporated or registered outside India in a country or a specified territory notified by the Central Government in this behalf;

(iii) 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;

(iv) 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;

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

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

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

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

(x) 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;

*However, this condition shall not be applicable to a fund which has been wound up in the previous year.*

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

(xii) 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.

(xiii) 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.

(5) **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%.

(6) **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:
(i) the person should not be an employee of the eligible investment fund or a connected person of the fund;

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

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

(iv) 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.

(7) **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.

(8) **Non-applicability of special taxation regime under section 9A [Section 9A(6)]:** 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.

(9) CBDT to prescribe guidelines for the manner of application of the provisions of this section.

(10) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<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>
</tr>
<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>
</tr>
<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>-----------------------------------------------------------------------------</td>
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<tr>
<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</td>
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<tr>
<td></td>
<td>person is a company;</td>
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<tr>
<td></td>
<td>(c) any partner or member of a firm or association of persons or body of</td>
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<tr>
<td></td>
<td>individuals or any relative of such partner or member, if the person is</td>
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<tr>
<td></td>
<td>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</td>
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<td></td>
<td>member, if the person is a Hindu undivided family;</td>
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<tr>
<td></td>
<td>(e) any individual who has a substantial interest in the business of the</td>
</tr>
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<td></td>
<td>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,</td>
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<tr>
<td></td>
<td>whether incorporated or not, or a Hindu undivided family having a</td>
</tr>
<tr>
<td></td>
<td>substantial interest in the business of the person or any director,</td>
</tr>
<tr>
<td></td>
<td>partner, or member of the company, firm or association of persons or body</td>
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<tr>
<td></td>
<td>of individuals or family, or any relative of such director, partner or</td>
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<tr>
<td></td>
<td>member;</td>
</tr>
<tr>
<td></td>
<td>(g) a company, firm or association of persons or body of individuals,</td>
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<tr>
<td></td>
<td>whether incorporated or not, or a Hindu undivided family, whose director,</td>
</tr>
<tr>
<td></td>
<td>partner, or member has a substantial interest in the business of the</td>
</tr>
<tr>
<td></td>
<td>person, or family or any relative of such director, partner or member;</td>
</tr>
<tr>
<td></td>
<td>(h) any other person who carries on a business, if -</td>
</tr>
<tr>
<td></td>
<td>(i) the person being an individual, or any relative of such person,</td>
</tr>
<tr>
<td></td>
<td>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</td>
</tr>
<tr>
<td></td>
<td>individuals, whether incorporated or not, or a Hindu undivided family, or</td>
</tr>
<tr>
<td></td>
<td>any director, partner or member of such company, firm or association of</td>
</tr>
<tr>
<td></td>
<td>persons or body of individuals or family, or any relative of such director,</td>
</tr>
<tr>
<td></td>
<td>partner or member, has a substantial interest in the business of that</td>
</tr>
<tr>
<td></td>
<td>other person;</td>
</tr>
</tbody>
</table>
Question 1

Peeyush, returned to India on 12th June, 2017 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2018-19:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2017.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2017 for permanently residing in India after staying in UK for 20 years. During the P.Y.2017-18, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2017-18, he would be a resident in India for the A.Y.2018-19. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2017-18 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2018-19 is, therefore, Resident but Not Ordinarily Resident.

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.
(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹1,500 per child under section 10(32). Accordingly, income of ₹20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2018-19 since it is not the income of the P.Y.2017-18.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2018-19. Since his total income (i.e., ₹18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2018-19.

**Question 2**

Mr. David, a Government employee serving in the Ministry of External Affairs, left India for the first time on 31.03.2017 due to his transfer to High Commission of Canada. He did not visit India at any time during the previous year 2017-18. He has received the following income for the Financial Year 2017-18:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Salary</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Foreign Allowance</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Interest on fixed deposit from bank in India</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Income from agriculture in Pakistan</td>
<td>2,00,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Income from house property in Pakistan</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

Compute his gross total income for Assessment Year 2018-19.

**Answer**

As per section 6(1), Mr. David is a non-resident for the A.Y. 2018-19, since he was not present in India at any time during the previous year 2017-18.
As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from ‘Salaries’ payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident. It has been assumed that Mr. David is a citizen of India.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7).

### Gross Total Income of Mr. David for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Income from other sources (Interest on fixed deposit in India)</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>6,00,000</strong></td>
</tr>
</tbody>
</table>

**Question 3**

*Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2017. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who left India one week before Mr. A’s departure, to the extent of ₹ 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B’s hands where the same has been received in New York.*

**Answer**

An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In this case, A has been in India only from 1.4.2017 to 30.04.2017 i.e. for 30 days. Therefore,
he does not satisfy either of the conditions in (i) or (ii) and is, hence, a non-resident. B, who left India one week before A’s departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by A on money borrowed from B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of B.

**Question 4**

Poulomi, a chartered accountant, is presently working in a firm in India. She has received an offer for the post of Chief Financial Officer from a company at Singapore. As per the offer letter, she should join the company at any time between 1st September, 2017 and 31st October, 2017. She approaches you for your advice on the following issues to mitigate her tax liability in India:

(i) **Date by which she should leave India to join the company**;

(ii) **Direct credit of part of her salary to her bank account in Kolkata maintained jointly with her mother to meet requirement of her family**

(iii) **Period for which she should stay in India when she comes on leave**.

**Answer**

The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more:

(a) Indian citizens, who leave India in any previous year, *inter alia*, for purposes of employment outside India, or

(b) Indian citizen or person of Indian origin engaged outside India, *inter alia*, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Poulomi should leave India on or before 28th September, 2017, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable.
The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2018-19, if she leaves India on or before 28th September, 2017.

(ii) If any part of Poulomi’s salary will be credited directly to her bank account in Kolkata then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Poulomi should receive her entire salary in Singapore and then remit the required amount to her bank account in Kolkata in which case, the salary earned by her in Singapore would not be subject to tax in India.

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if the period of her stay during the relevant previous year amounts to 182 days or more.

Therefore, when Poulomi comes India on leave, she should stay in India for less than 182 days during the relevant previous year so that her status remains as a non-resident for the relevant previous year. Moreover, she should not visit India again during the current previous year i.e. P.Y. 2017-18.
Can consideration for supply of software embedded in hardware tantamount to ‘royalty’ under section 9(1)(vi), where the software was no independent functional existence?

CIT v. Alcatel Lucent Canada (2015) 372 ITR 476 (Del)

Facts of the case: The assessee, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by the assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available the process to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is ‘royalty’ under section 9(1)(vi).

Appellate Authorities’ Views: The Commissioner (Appeals) and Tribunal held that the consideration for supply of embedded software (which is part of the hardware supplied to the assessee customers) did not constitute royalty and therefore, section 9(1)(vi) was not attracted.

High Court’s Observations: The High Court, at the outset, noted that the Tribunal had relied upon the precedent in the case of DIT v. Ericsson A.B. (2012) 343 ITR 470 (Del), where the High Court observed that what was sold by the assessee to its Indian customers was a GSM which consisted of both hardware and software. The High Court had also observed that -

(i) the software that was loaded on the hardware did not have any independent existence;
(ii) the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers;
(iii) the software is embedded in the system and there could not be any independent use of such software;
(iv) this software merely facilitates the functioning of the equipment and is an integral part of the hardware.

Further, the High Court had also referred the decision of the Apex Court in Tata Consultancy Services v. State of Andhra Pradesh (2004) 271 ITR 401, wherein it was held that software incorporated on a media would be goods liable to sales tax.

High Court’s Decision: The High Court concurred with the decision of the Tribunal holding that where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as ‘royalty’ for software in terms of section 9(1)(vi).