# LESSON-2
# RESIDENTIAL STATUS AND TAX INCIDENCE

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## STRUCTURE



## 2.0 INTRODUCTION

Tax incidence on an assessee depends on his residential status. For instance, whether an income, accrued to an individual outside India, is taxable in India depends upon the residential status of the individual in India. Similarly, whether an income earned by a foreign national in India (or outside India) is taxable in India depends on the residential status of the individual, rather than on his citizenship. Therefore, the determination of the residential status of a person is very significant in order to find out his tax liability.

## 2.1 OBJECTIVES

After going through this lesson you should be able to understand:

- The concept of residential status
- Residential status of an Individual
- Residential status of a Hindu Undivided Family
- Residential status of a Firm and an Association of Persons
- Residential status of a Company
- Residential status of every other person
- Residential status and Incidence of Tax
- Meaning of receipt and accrual of India
- Meaning of income deemed to accrue or arise in India

## 2.2 CONCEPT OF RESIDENTIAL STATUS

The following norms one has to keep in mind while deciding the residential status of an assessee:

1. *Different taxable entities* - All taxable entities are divided in the following categories for the purpose of determining residential status:

*a.* An individual;

*b.* A Hindu undivided family;

*c.* A firm or an association of persons;

*d.* A joint stock company; and

*e.* Every other person.

2. *Different residential status* - An assessee is either: (*a*) resident in India, or (*b*) non-resident in India.

However, a resident individual or a Hindu undivided family has to be (*a*) resident and ordinarily resident, or (*b*) resident but not ordinarily resident. Therefore, an individual and a Hindu undivided family can either be:

*a.* resident and ordinarily resident in India; or

*b.* resident but not ordinarily resident in India; or

*c.* non-resident in India

All other assessees (*viz.,* a firm, an association of persons, a joint stock company and every other person) can either be:

*a.* resident in India; or

*b.* non-resident in India.

The table given below highlights these points-

| *Category* | *Individual/Hindu undivided family* | *Firm, association of persons, joint stock company and every other person* |
|---|---|---|
| *Category 1* | Resident in India<br>Ordinarily resident<br>Not-ordinarily resident | Resident in India |
| *Category 2* | Non-resident in India | Non-resident in India |

*3. Residential status for each previous year* - Residential status of an assessee is to be determined in respect of each previous year as it may vary from previous year to previous year.

*4. Different residential status for different assessment years* - An assessee may enjoy different residential status for different assessment years. For instance, an individual who has been regularly assessed as resident and ordinarily resident has to be treated as non-resident in a particular assessment year if he satisfies none of the conditions of section 6(*1*).

*5. Resident in India and abroad* - It is not necessary that a person, who is "resident" in India, cannot become "resident" in any other country for the same assessment year. A person may be resident in two (or more) countries at the same time. It is, therefore, not necessary that a person who is resident in India will be non-resident in all other countries for the same assessment year.

## 2.3 RESIDENTIAL STATUS OF AN INDIVIDUAL

As per section 6, an individual may be (*a*) resident and ordinarily resident in India, (*b*) resident but not ordinarily resident in India, or (*c*) non-resident in India.

### 2.3.1 RESIDENT AND ORDINARILY RESIDENT

As per section 6(1), in order to find out whether an individual is "resident and ordinarily resident" in India, one has to proceed as follows—

| | |
|---|---|
| *Step 1* | First find out whether such individual is "resident" in India. |
| *Step 2* | If such individual is "resident" in India, then find out whether he is "ordinarily resident" in India. However, if such individual is a "non-resident" in India, then no further investigation is necessary. |

**BASIC CONDITIONS TO TEST AS TO WHEN AN INDIVIDUAL IS RESIDENT IN INDIA -** Under section 6(*1*) an individual is said to be resident in

India in any previous year, if he satisfies at least one of the following basic conditions—

| | |
|---|---|
| *Basic condition (*a*)* | He is in India in the previous year for a period of 182 days or more |
| *Basic condition (*b*)* | He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year |

Note: In the following two cases, an individual needs to be present in India for a minimum of 182 days or more in order to become resident in India:

1. An Indian citizen who leaves India during the previous year for the purpose of taking employment outside India or an Indian citizen leaving India during the previous year as a member of the crew of an Indian ship.
2. An Indian citizen or a person of Indian origin who comes on visit to India during the previous year (a person is said to be of Indian origin if either he or any of his parents or any of his grand parents was born in undivided India).

**ADDITIONAL CONDITIONS TO TEST AS TO WHEN A RESIDENT INDIVIDUAL IS ORDINARILY RESIDENT IN INDIA** - Under section 6(*6*), a resident individual is treated as "resident and ordinarily resident" in India if he satisfies the following two additional conditions —

| | |
|---|---|
| *Additional condition (*i*)* | He has been resident in India in at least 2 out of 10 previous years [according to basic condition noted above] immediately preceding the relevant previous year. |
| *Additional condition (*ii*)* | He has been in India for a period of 730 days or more during 7 years immediately preceeding the relevant previous year. |

In brief it can be said that an individual becomes resident and ordinarily resident in India if he satisfies at least one of the basic conditions [*i.e.,* (*a*) or (*b*)] and the two additional conditions [*i.e.,* (*i*) and (*ii*)].

It will be worthwhile to note the following propositions:

1. It is not essential that the stay should be at the same place. It is equally not necessary that the stay should be continuous. Similarly, the place of stay or the purpose of stay is not material.

2. Where a person is in India only for a part of a day, the calculation of physical presence in India in respect of such broken period should be made on an hourly basis. A total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day.

If, however, data is not available to calculate the period of stay of an individual in India in terms of hours, then the day on which he enters India as well as the day on which he leaves India shall be taken into account as stay of the individual in India.

## 2.3.2 RESIDENT BUT NOT ORDINARILY RESIDENT

As per section 6(1), an individual who satisfies at least one of the basic conditions [*i.e.,* condition (*a*) or (*b*) mentioned in Para 2.3.1a] but does not satisfy the two additional conditions [*i.e.,* conditions (*i*) and (*ii*) mentioned in Para 2.3.1b], is treated as a resident but not ordinarily resident in India. In other words, an individual becomes resident but not ordinarily resident in India in any of the following circumstances:

| | |
|---|---|
| *Case 1* | If he satisfies at least one of the basic conditions [*i.e.*, condition (*a*) or (*b*) of Para 12.1-1] but none of the additional conditions [*i.e.*, (*i*) and (*ii*) of Para 12.1-2] |
| *Case 2* | If he satisfies at least one of the basic conditions [*i.e.*, condition (*a*) or (*b*) of Para 12.1-1] and one of the two additional conditions [*i.e.*, (*i*) and (*ii*) of Para 12.1-2] |

## 2.3.3 NON-RESIDENT

An individual is a non-resident in India if he satisfies none of the basic conditions [*i.e.,* condition (*a*) or (*b*) of Para 12.1-1]. In the case of non-resident, additional conditions [*i.e.,* (*i*) and (*ii*) of Para 12.1-2] are not relevant.

***Illustration 2.1:*** X left India for the first time on May 20, 2003. During the financial year 2005-06, he came to India once on May 27 for a period of 53 days. Determine his residential status for the assessment year 2006-07.

Since X comes to India only for 53 days in the previous year 2005-06, he does not satisfy any of the basic conditions laid down in section 6(*1*). He is, therefore, non-resident in India for the assessment year 2006-07.

***Illustration 2.2:*** X comes to India, for the first time, on April 16, 2003. During his stay in India up to October 5, 2005, he stays at Delhi up to April 10, 2005 and thereafter remains in Chennai till his departure from India. Determine his residential status for the assessment year 2006-07.

During the previous year 2005-06, X was in India for 188 days (*i.e.,* April 2005 : 30 days ; May 2005 : 31 days; June 2005 : 30 days ; July 2005 : 31 days ; August 2005 : 31 days ; September 2005 : 30 days and October 2005 : 5 days). He is in India for more than 182 days during the previous year and, thus, he satisfies condition (*a*) mentioned in Para 19.1-1. Consequently, he becomes resident in India. A resident individual is either ordinarily resident or not ordinarily resident. To determine whether X is ordinarily resident or not, one has to test the two additional conditions as laid down by section 6(*6*) (*a*) [*see* conditions (*i*) and (*ii*), Para 19.1-2].

*Condition (i) of Para 19.1-2* - This condition requires that X should be resident in India in at least 2 years out of 10 years preceding the relevant previous year. X is resident in India for the previous years 2003-04 and 2004-05.

*Condition (ii) of Para 19.1-2* - This condition requires that X should be in India for at least 730 days during 7 years immediately preceding the previous year. X is in India from April 16, 2003 to March 31, 2005 (*i.e.*, 716 days).

X satisfies one of the basic conditions and only one of the two additional conditions. X is, therefore, resident but not ordinarily resident in India for the assessment year 2006-07.

*Note*: In order to determine the residential status, it is not necessary that a person should continuously stay in India at the same place. Therefore, the information that X is in Delhi up to April 10, 2005 is irrelevant.

Check Your Progress

Activity A- X, a foreign citizen comes to India, for the first time in the last 30 years on March 20, 2005. On September 1, 2005, he leaves India for Nepal on a business trip. He comes back on February 26, 2006.

Determine the residential status of X for the assessment year 2006-07.

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Activity B- X, an Italian citizen, comes to India for the first time (after 20 years) on May 28, 2005. Determine his residential status for the assessment year 2006-07.

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# 2.4 RESIDENTIAL STATUS OF A HINDU UNDIVIDED FAMILY

As per section 6(2), a Hindu undivided family (like an individual) is either resident in India or non-resident in India. A resident Hindu undivided family is either ordinarily resident or not ordinarily resident.

## 2.4.1 HUF- Resident or Non-Resident

A Hindu undivided family is said to be resident in India if control and management of its affairs is wholly or partly situated in India. A Hindu undivided family is non-resident in India if control and management of its affairs is wholly situated outside India.

Control and management means *de facto* control and management and not merely the right to control or manage. Control and management is situated at a place where the head, the seat and the directing power are situated.

### 2.4.2 HUF- When ordinarily resident in India

A resident Hindu undivided family is an ordinarily resident in India if the karta or manager of the family (including successive kartas) satisfies the following two additional conditions as laid down by section 6(*6)(b*):

| | |
|---|---|
| *Additional condition (*i) | Karta has been resident in India in at least 2 out of 10 previous years [according to the basic condition mentioned in Para 12.1-1] immediately preceding the relevant previous year |
| *Additional condition (*ii*)* | Karta has been present in India for a period of 730 days or more during 7 years immediately preceding the previous year |

If the karta or manager of a resident Hindu undivided family does not satisfy the two additional conditions, the family is treated as resident but not ordinarily resident in India.

## 2.5 RESIDENTIAL STATUS OF FIRM AND ASSOCIATION OF PERSONS

As per section 6(2), a partnership firm and an association of persons are said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. They are, however, treated as non-resident in India if control and management of their affairs are situated wholly outside India.

## 2.6 RESIDENTIAL STATUS OF A COMPANY

As per section 6(3), an Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated wholly in India. However, a foreign company is treated as non-resident if, during the previous year, control and management of its affairs is either wholly or partly situated out of India.

## 2.7 RESIDENTIAL STATUS OF EVERY OTHER PERSON

As per section 6(4), every other person is resident in India if control and management of his affairs is, wholly or partly, situated within India during the relevant previous year. On the other hand, every other person is non-resident in India if control and management of its affairs is wholly situated outside India.

## 2.8 RESIDENTIAL STATUS AND INCIDENCE OF TAX

As per section 5, incidence of tax on a taxpayer depends on his residential status and also on the place and time of accrual or receipt of income.

### 2.8.1 INDIAN AND FOREIGN INCOME

In order to understand the relationship between residential status and tax liability, one must understand the meaning of "Indian income" and "foreign income".

*"INDIAN INCOME"* - Any of the following three is an Indian income —

*1.* If income is received (or deemed to be received) in India during the previous year and at the same time it accrues (or arises or is deemed to accrue or arise) in India during the previous year.

*2.* If income is received (or deemed to be received) in India during the previous year but it accrues (or arises) outside India during the previous year.

*3.* If income is received outside India during the previous year but it accrues (or arises or is deemed to accrue or arise) in India during the previous year.

*FOREIGN INCOME* - If the following two conditions are satisfied, then such income is "foreign income" —

*a.* Income is not received (or not deemed to be received) in India; and

*b.* Income does not accrue or arise (or does not deemed to accrue or arise) in India.

**Illustration 2.3**- The above provisions may be explained in brief as follows:

| *Whether income is received (or deemed to be received) in India during the relevant year* | *Whether income accrues (or arises or is deemed to accrue or arise) in India during the relevant year* | *Status of the income* |
|---|---|---|
| *Yes* | *Yes* | Indian income |
| *Yes* | *No* | Indian income |
| *No* | *Yes* | Indian income |
| *No* | *No* | Foreign income |

## 2.8.2 INCIDENCE OF TAX FOR DIFFERENT TAXPAYERS

Tax incidence of different taxpayers is as follows—

| | *Individual and Hindu undivided family* | | |
|---|---|---|---|
| | *Resident and ordinarily resident in India* | *Resident but not Ordinarily resident in India* | *Non-resident in India* |
| ► Indian income | Taxable in India | Taxable in India | Taxable in India |
| ► Foreign income | | | |
| - If it is business income and business is controlled wholly or partly from India | Taxable in India | Taxable in India | Not taxable in India |
| - If it is income from profession which is set up in India | Taxable in India | Taxable in India | Not taxable in India |
| - If it is business income and business is controlled from outside India | Taxable in India | Not taxable in India | Not taxable in India |
| - If it is income from profession which is set up outside India | Taxable in India | Not taxable in India | Not taxable in India |
| - Any other foreign income (like salary, rent, interest, etc.) | Taxable in India | Not taxable in India | Not taxable in India |

| | *Any other taxpayer (like company, firm, co-operative society, association of persons, body of individual, etc* | |
|---|---|---|
| | *Resident in India* | *Non-resident in India* |
| Indian income | Taxable in India | Taxable in India |
| Foreign income | Taxable in India | Not taxable in India |

## 2.8.3 CONCLUSIONS

The following broad conclusions can be drawn —

*1. Indian income* - Indian income [*see* Para 2.8.1a for meaning] is always taxable in India irrespective of the residential status of the taxpayer.

*2. Foreign income* - Foreign income [*see* Para 2.8.1b for meaning] is taxable in the hands of resident (in case of a firm, an association of persons, a joint stock company and every other person) or resident and ordinarily resident (in case of an individual and a Hindu undivided family) in India. Foreign income is not taxable in the hands of non-resident in India.

In the hands of resident but not ordinarily resident taxpayer, foreign income is taxable only if it is (*a*) business income and business is controlled from India, or (*b*) professional income from a profession which is set up in India. In any other case, foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers.

**Activity C:** Determine whether the following is true or false:

1. The business income received by X Ltd. an Indian company in New York is foreign income of X.

2. The dividend received from a foreign company in India is Indian company.

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## 2.9 MEANING OF RECEIPT OF INCOME

Income received in India is taxable in all cases irrespective of the residential status of an assessee. The following points are worth mentioning in this respect:

## 2.9.1 RECEIPT vs. REMITTANCE

The "receipt" of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in "receipt" at the other place.

## 2.9.2 ACTUAL RECEIPT vs. DEEMED RECEIPT

It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India in the previous year is also included in the taxable income of the assessee. The Act enumerates the following as income deemed to be received in India:

► Interest credited to recognized provident fund account of an employee in excess of 9.5 per cent.

► Excess contribution of employer in the case of recognized provident fund (*i.e.,* the amount contributed in excess of 12 per cent of salary).

► Transfer balance.

► Contribution by the Central Government to the account of an employee under a pension scheme referred to in section 80CCD.

► Tax deducted at source.

► Deemed profit under section 41.

## 2.10 MEANING OF ACCRUAL OF INCOME

Income accrued in India is chargeable to tax in all cases irrespective of residential status of an assessee. The words “accrue” and “arise” are used in contradistinction to the word “receive”. Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

## 2.11 MEANING OF INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

In some cases, income is deemed to accrue or arise in India under section 9 even though it may actually accrue or arise outside India. Section 9 applies to all assessees irrespective of their residential status and place of business. The categories of income which are deemed to accrue or arise in India are as under:

| *Nature of income* | *Whether income is deemed to accrue or arise in India* |
|---|---|
| Income from business connection in India | Yes |
| Income from any property, asset or source of income in India | Yes |
| Capital gain on transfer of a capital asset situated in India | Yes |
| Income from salary if service is rendered in India | Yes |
| Income from salary (not being perquisite/allowance) if service is rendered outside India (provided the employer is Government of India and the employee is a citizen of India) | Yes |
| Income from salary if service is rendered outside India (not being a case stated above) | No |

| | | | |
|---|---|---|---|
| Dividend paid by the Indian company | | | Yes |
| *Nature of income* | *From whom income is received* | *Payer's source of income* | Yes |
| Interest | Government of India | Any | Yes |
| Interest | A person resident in India | Borrowed capital is used by the payer for carrying on business/profession outside India or earning any income outside India | No |
| Interest | A person resident in India | Borrowed capital is used by the payer for any other purpose | Yes |
| Interest | A person non-resident in India | Borrowed capital is used by the payer for carrying on business/profession in India | Yes |
| Interest | A person non-resident in India | Borrowed capital is used by the payer for any other purpose | No |
| Royalty/fees for technical services | Government of India | Any | Yes |
| Royalty/fees for technical services | A person resident in India | Payment is relatable to a business or profession or any other source carried by the payer outside India | No |
| Royalty/fees for technical services | A person resident in India | Payment is relatable to any other source of income | Yes |
| Royalty/fees for technical services | A person non-resident in India | Payment is relatable to a business or profession or any other source carried by the payer in India | Yes |
| Royalty/fees for technical services | A person non-resident in India | Payment is relatable to any other source of income | No |

**Illustration 2.4** – For the assessment year 2006-07 (previous year 2005-06), X is employed in India and receives Rs. 24,000 as salary. His income from other sources includes:

Dividend received in London on June 3, 2005: Rs. 31,000 from a foreign company; share of profit received in London on December 15, 2005 from a business situated in Sri Lanka but controlled from India: Rs. 60,000; remittance from London on January 15, 2006 out of past untaxed profit of 2003-04 earned and received there: Rs. 30,000 and interest earned and received in India on May 11, 2006: Rs. 76,000. Find out his gross total income, if he is (*a*) resident and ordinarily resident, (*b*) resident but not ordinarily resident, and (*c*) non-resident for the assessment year 2006-07.

If X is resident and ordinarily resident, his gross total income will be Rs. 1, 15,000 (*i.e.,* Rs. 24,000 + Rs. 31,000 + Rs. 60,000). If X is resident but not ordinarily resident, his gross total income will work out to be Rs. 84,000 (*i.e.,* Rs. 24,000 + Rs. 60,000). If X is non-resident, his gross total income will come to Rs. 24,000.

*Notes:*

*1.* The remittance from London of Rs. 30,000 is not taxable in the previous year 2005-06 because it does not amount to "receipt" of income.

*2.* Although the interest of Rs. 76,000 earned and received in India is taxable, it is not included in the total income of the assessment year 2006-07, as it is not earned or received in the previous year 2005-06. It will, therefore, be included in the total income of X for the assessment year 2007-08.

# 2.12 LET US SUM UP

The lesson discusses in detail the meaning of the term residential status as incidence of tax depends upon this status of the assessee. The residential status of individual, Hindu undivided family, firm association of persons, company and every other person are analysed. In addition the concept of Indian income and foreign income has also been dealt with so as to give a complete picture to the students of the income, which is liable to be taxed in India according to the residential status.

# 2.13 GLOSSARY

**Incidence of tax**: Tax incidence means the final burden of tax. In other words, incidence of tax is on person who actually bears/pays the final tax liability.

**Remittance**: Remittance is transmission of income after its first receipt.

## 2.14 SELF ASSESSMENT QUESTIONS

1. How is residential status determined?

*2.* What are the different categories of residential status? Explain how these categories are determined and affect the tax liability of an assessee?

*3.* "The incidence of income-tax depends upon the residential status of an assessee". Discuss fully.

*4.* Write short notes on the following:

*a.* Income received in India

*b.* Income deemed to accrue or arise in India

*c.* Control and management of a business

5. X, an Indian citizen, leaves India on May 22, 2005 for vacation to Uganda and returns on April 9, 2006. Determine the residential status of X for the assessment year 2006-07?

6. X, a foreign citizen, visits India since 1985 every year for a period of 100 days. Determine the residential status of X for the assessment year 2006-07?

## 2.15 FURTHER READINGS

Income-tax Act, 1961, Taxmann Publications Pvt. Ltd., New Delhi (latest edition).

Singhania, Vinod. K. and Monica Singhania, *Students Guide to Income-tax,* Taxmann Publications Pvt. Ltd., New Delhi (latest edition).