CBDT Circular on Forced Stay in India – No real relief!

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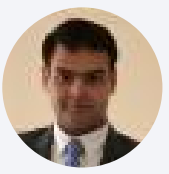

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Recently, the Central Board of Direct Taxes (**"CBDT"**) issued a circular for determination of residency of individuals for the current tax year for individuals who were forced to remain in India due to suspension of international flights in light of the Covid-19 (**"2021 Circular"**). The 2021 Circular comes as a follow up to the circular which was issued in March 2020 (**"2020 Circular"**) where it was clarified that the period from March 22, 2020 to March 31, 2020 (or a date prior to March 31, 2020 as applicable) would be excluded in determining the residential status of an individual for the purposes of the Income Tax Act, 1961 (**"Act"**). A press-note was also released along with the 2020 Circular which stated that had stated that as the lockdown had continued into the current tax year, and it is not yet clear as to when international flight operations would resume, a circular excluding the period of stay of these individuals up to the date of normalisation of international flight operations, for determination of the residential status for the previous year 2020-21 shall be issued after the said normalisation.

It is also relevant to note a petition was filed by Mr. Gaurav Baid in the Supreme Court of India seeking directions as to whether he would be considered a non-resident under the Act for the current tax year, irrespective of his stay in India, on account of the Covid-19 pandemic. The Supreme Court, directed the petitioner, Mr. Gaurav Baid, to make representation before the CBDT and had directed the CBDT to consider the same within 3 weeks thereof. Mr. Gaurav Baid had sought a direction whether

2020 Circular

The 2020 Circular provided that for individuals who had visited India before 22nd March, 2020 but has been unable to leave before 31st March, 2020, the period from 22nd March, 2020 to 31st March, 2020 would not be taken into account in calculating his / her residential status under the India. Further, where an individual who had visited India before 22nd March, 2020 and had been quarantined in India (on or before 1st March, 2020), the period from the date of his quarantine till the date of his departure (if unable to leave, the period till 31st March, 2020) shall not be considered for the purposes of determining his / her residency under the Act.

2021 Circular

The 2021 Circular provides that various representations have been received by the CBDT from individuals who had come on a visit to India during the previous tax year (i.e. between April 1, 2019 and March 31, 2020) and intended to leave India but could not do so due to suspension of international flights seeking further relaxations in the conditions applicable for determining the residential status of an individual under the Act. In light of the representations, the 2021 Circular provides as follows:

The Board essentially dismissed these requests by clarifying that the current provisions dealing with the determination of residential status under the ITA read with the various Double Taxation Avoidance Agreements (**"DTAA"**) that India has entered into with other countries contain sufficient checks and balances for preventing the individuals from being subjected to double taxation in the PY 2020-2021.

I. **The ITA does not Consider Short Stays as Residency:** The 2021 Circular clarifies that that the conditions provided under the Act for assessing an individual as an Indian resident, requires a sufficiently long duration of stay before declaring an individual as an Indian resident (usually a stay of 182 days or more in a tax year). It goes on to assume that in such a situation there are less chances that the person would acquire resident status under the Act for the current tax year. It further reiterates the provisions of residency as specified under the Act and gives instances when an Indian citizen or an individual of Indian origin would be considered to be an Indian resident under the ITA.

An Indian citizen or an individual of Indian origin would be considered as a resident only when he has stayed in India for a minimum duration of 182 days in the tax year (where his/her income in such tax year does not exceed fifteen lakh rupees). Further, an individual who is neither an Indian citizen nor of Indian origin will be considered as a resident only when he/she has stayed in India for 182 days or more in the PY; or stayed for 120 days or more in PY and stayed for 365 days or more in the preceding four PYs.

II. **General relaxation may lead to dual non-residency:** Taking cognizance of the fact that most countries have a condition of a minimum stay of 182 days to consider an individual as a resident, the 2021 Circular clarifies that a general relaxation may lead to a situation where the individual may not be a resident for any country and thereby resulting in complete non-taxation.

III. **Tax treaties for tie-breaker rules in cases of a prima facie dual-residency:** It further goes onto to state that in case of a dual residency, the tax treaties signed between India and other countries already contemplate and provide a solution to such exceptional situations. This ensures that an individual is assessed as a resident for only in one country in a tax year. For instance, Article 4(2) of the Indo-USA Double Taxation Avoidance Agreement (**"DTAA"**)[1] provides for a tie-breaker rule which takes into consideration various alternative factors like a permanent home, Country of vital interests, country of habitual abode, nationality etc. in determining the residency of an individual in cases of dual-residency.

IV. **Taxability of employment income is subjected to the conditions under the DTAA:** The 2021 Circular further highlights the fact that the DTAAs provide for certain conditions that need to be fulfilled before assessing the tax on the employment income earned during a tax year. For instance, Article 16 of the Indo-USA DTAA provides that salaries, wages, and other similar remuneration shall be taxable in the country of residence, except where such employment has been exercised in the other contracting country. Therefore, where a resident of the USA who is employed by an employer in the USA has got stuck in India due to any reason (say travel restrictions imposed during COVID-19), his employment income continues to be taxed in the USA, unless such individual has stayed in India for 183 days or more in a tax year or if his salary is credited on the account of his employer's permanent establishment in India (if any).

V. **The income-tax rules provide for tax credit paid in other countries:** the 2021 Circular provides that the provisions under the Income tax rules, 1962 entitle a tax payer to credit of taxes already paid in any other country which should be helpful in case of an individual becomes a resident under the Act because he was forced to remain in India due to the pandemic.

VI. **Observations Made by OECD and Steps Taken by Other Countries:** The 2021 Circular provides that the CBDT has considered the observations made by the OECD and the steps taken in regards to the determination of residency by other countries and after observing the above, it has been found that there is a consensus internationally on the fact that domestic income tax laws read with the DTAAs have considerable checks and balances to avoid double taxation on individuals stranded in countries where they are not ordinarily taxed.

VII. **Representation to be made to the income tax office:** While the 2021 Circular states that there does not appear to be a possibility of double taxation of the income for the current tax year due to the reasons stated within the circular, it still provides that that in order understand the possible situations in which a particular taxpayer is facing double taxation due to the forced stay in India, it would be in the fitness of things to obtain relevant information from such individuals. After understanding the possible situations of double taxation, the CBDT shall examine

1. whether any relaxation is required to be provided in this matter; and

2. if required, then whether general relaxation can be provided for a class of individuals or specific relaxation is required to be provided in individual cases.

Therefore, if any individual is facing double taxation even after taking into consideration the relief provided by the respective DTAAs, the circular provides that such individuals may furnish the information in a form that has been provided by March 31, 2021.

Analysis

The 2021 Circular provides no real relief to individuals stranded in India and forced to stay in India due to the pandemic. While the circular points out the various checks and balances provided for under the Act and the DTAA, it fails to appreciate the far-reaching consequences of the pandemic. For instance, it has been assumed that under the air bubble agreement that India has signed up, all individuals who were forced to stay in India would leave the country and go back to their home countries thereby not completing the 182-day period as specified under the Act. While the air bubble agreement covers more than 100 countries, it does not cover all countries around the world. Other than that, the circular fails to appreciate that individuals who got stuck in India due to the pandemic may not be willing to travel due to health reasons (especially individuals with co-morbidities) and hence may want to stay in India till the situation is better. Further, countries are still mandating quarantine periods on arrival which may not be acceptable to every individual and hence they may not want to travel back and hence are forced to stay in India.

Apart from becoming a resident of India there are other challenges from a Place of Effective Management (POEM) and Business Connection (BC) / Permanent Establishment (PE) perspective that the 2021 Circular fails to throw light on. An individual who is forced to stay in India would also be forced to carry out his / her business from India during the said period. If this results in the POEM of the business to be India, the foreign company may be considered to be a resident of India and subject to tax in India. While there are threshold provided under Act for POEM to be triggered, the circular should have provided for exemption for this period. Additionally, the risk of BC / PE for the foreign entity in India also exists because of an individual forced stay in India resulting in profits attributable to the BC / PE in India being taxable in India. In this context, reference is made to the guideline issued by the Australian tax office which has provided that employees will not be considered to form PEs for foreign entities if they were forced to remain in Australia due to travel related restrictions. Similarly, other countries had provided various exemptions in terms of number of days which will remain excluded in calculating residency etc.

After the 2020 Circular and the press-note (which clearly stated that the period of exclusion for the current tax year will be laid out) there were hopes of a clearer direction from the CBDT on this issue and by asking individuals to make representation post which a decision would be taken is rather unwelcomed. In summary, there should not be any hope of any further direction on this issue by the CBDT and each individual should be required to take his / her own stand on this issue and it is only with time will be know of any dispute that may arise due to an individual who has been forced stay in India

[1] See: https://www.incometaxindia.gov.in/pages/international-taxation/dtaa.aspx.