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PROVISIONS OF INCOME-TAX LAW AND FEMA USEFUL FOR NON-RESIDENTS

In this part you can gain knowledge about various provisions of Income-tax Law and Foreign Exchange Management Act, 1999 (FEMA) which are useful to a non-resident.

The first part deals with provisions of Income-tax Law and the second part deals with the provisions of FEMA.

Different classes of residential status prescribed under the Income-tax Law for an individual

For the purpose of Income-tax Law, an individual may have any one of the following residential status:

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

Every year the residential status of the taxpayer is to be determined by applying the provisions of the Income-tax Law designed in this regard (discussed later) and, hence, it may so happen that in one year the individual would be a resident and ordinarily resident and in the next year he may become non-resident or resident but not ordinarily resident and again in the next year his status may change or may remain same.

Different classes of residential status prescribed under the Income -tax Law for a Hindu Undivided Family (HUF)

For the purpose of Income-tax Law, an HUF may have any one of the following residential status:

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

Every year the residential status of the taxpayer is to be determined by applying the provisions of the Income-tax Law designed in this regard (discussed later) and, hence, it may so happen that in one year the HUF would be a resident and ordinarily resident and in the next year it may become non-resident or resident but not ordinarily resident and again in the next year its status may change or may remain same.

Different classes of residential status prescribed under the Income-tax Law for a person other than an individual or a HUF

For the purpose of Income-tax Law, a person other than an individual or a HUF, i.e., company, partnership firm, etc., may have any one of the following residential status:

- (1) Resident
- (2) Non-resident

Every year the residential status of the taxpayer is to be determined by applying the provisions of the Income-tax Law designed in this regard (discussed later) and, hence, it may so happen that in one year the taxpayer would be a resident and in the next year the taxpayer may become non-resident and again in the next year the status may change or may remain same.

Determination of the residential status of an Individual

To determine the residential status of an individual, the first step is to ascertain whether he is resident or non-resident. If he turns to be a resident, then the next step is to ascertain whether he is resident and ordinarily resident or is a resident but not ordinarily resident.

Step 1 given below will ascertain whether the individual is resident or non-resident; and Step 2 will ascertain whether he is ordinarily resident or not ordinarily resident. Step 2 is to be performed only if the individual turns to be a resident in India.

Step 1: Determining whether resident or non-resident

Under the Income-tax Law, an individual will be treated as a resident in India for a year if he satisfies any of the following conditions (i.e. may satisfy any one or may satisfy both the conditions):

- 1) He is in India for a period of 182 days or more in that year; or
- 2) He is in India for a period of 60 days or more in the year and for a period of 365 days or more in immediately preceding 4 years.

However, in respect of an Indian citizen or a person of Indian origin who visits India during the year, the period of 60 days as mentioned in (2) above shall be substituted with 182 days. The similar concession is provided to the Indian citizen who leaves India in any previous year as a crew member of an Indian ship or for the purpose of employment outside India.

The Finance Act, 2020, w.e.f., Assessment Year 2021-22 has amended the above exception to provide that the period of 60 days as mentioned in (2) above shall be substituted with 120 days, if an Indian citizen or a person of Indian origin who visit India and whose total income, other than income from foreign sources, exceeds Rs. 15 lakhs during the previous year. Income from foreign sources means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

Note: The Finance Act, 2020 has introduced new section 6(1A) to the Income-tax Act, 1961. The new provision provides that an Indian citizen shall be deemed to be resident in India only if his total income, other than income from foreign sources, exceeds Rs. 15 lakhs during the previous year. For this provision, income from foreign sources means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

However, such individual shall be deemed to be Indian resident only when he is not liable to tax in any country or jurisdiction by reason of his domicile or residence or any other criteria of similar nature.

Thus, from Assessment Year 2021-22, an Indian Citizen earning total income in excess of Rs. 15 lakhs (other than from foreign sources) shall be deemed to be resident in India if he is not liable to pay tax in any country.

“Liable to tax” in relation to a person and with reference to a country means that there is an income-tax liability on such person under the law of that country for the time being in force. It shall include a person who has subsequently been exempted from such liability under the law of that country.

If an individual does not satisfy any of the above conditions then he will be treated as non-resident in India.

Step 2: Determining whether resident and ordinarily resident or resident but not ordinarily resident

A resident individual will be treated as resident but not ordinarily resident in India during the year if he satisfies the following conditions:

- 1) He is non-resident in India in 9 out of last 10 years immediately preceding the relevant year; or
- 2) His stay in India is for 729 days or less in last 7 years immediately preceding the relevant year.

However, w.e.f., Assessment Year 2021-22, the Finance Act, 2020 has inserted the following two more situations wherein a resident person is deemed to be ‘Not Ordinarily Resident’ in India:

- a) An Indian Citizen or a person of Indian origin whose total income (other than income from foreign sources) exceeds Rs. 15 lakhs during the previous year and who has been in India for a period of 120 days or more but less than 182 days;

b) An Indian Citizen who is deemed to be resident in India as per new Section 6(1A).

A resident individual who does not satisfy any of the aforesaid conditions in step 2 will be treated as resident and ordinarily resident.

In short, following test will determine the residential status of an individual:

1. If the individual satisfies any one or both the conditions specified at step 1 and satisfies any of the conditions specified at step 2, then he will become resident but not ordinarily resident in India.
2. If the individual satisfies any one or both the conditions specified at step 1 and does not satisfy any of the condition specified at step 2, then he will become resident and ordinarily resident in India.
3. If the individual satisfies none of the conditions specified at step one, then he will become non-resident.

Determination of the residential status of a HUF

To determine the residential status of a HUF, the first step is to ascertain whether the HUF is resident or a non-resident. If the HUF turns to be a resident, then the next step is to ascertain whether it is resident and ordinarily resident or is resident but not ordinarily resident. Step 1 given below will ascertain whether the HUF is resident or non-resident and Step 2 will ascertain whether the HUF is ordinarily resident or not ordinarily resident. Step 2 is to be performed only if the HUF turns to be a resident in India.

Step 1: Determining whether resident or non-resident

For the purpose of Income-tax Law, an HUF will be treated as resident in India, if the control and management of the affairs of the HUF is located (partly or wholly) in India.

Step 2: Determining whether resident and ordinarily resident or resident but not ordinarily resident

A resident HUF will be treated as resident and ordinarily resident in India during the year if its manager (i.e. karta or manager) satisfies both the following conditions:

- (1) He is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.
- (2) His stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

A resident HUF whose manager (i.e. karta or manager) does not satisfy any of the aforesaid conditions or satisfies only one of the aforesaid conditions will be treated as resident but not ordinarily resident.

In short, following test will determine the residential status of a HUF :

1. If the control and management of the affairs of the HUF is located (partly or wholly) in India and the manager (i.e. karta or manager) satisfies both the conditions specified at step 2, then the HUF will become resident and ordinarily resident in India.
2. If the control and management of the affairs of the HUF is located (partly or wholly) in India and the manager (i.e. karta or manager) satisfies none or only one condition specified at step 2, then the HUF will become resident but not ordinarily resident in India.
3. If the control and management of the affairs of the HUF is located wholly outside India, then the HUF will become non-resident.

Determination of the residential status of a company

A company incorporated in India will always be considered as resident of India.

A company other than an Indian company (i.e., a foreign company) is said to be resident in India during a year, if its place of effective management, in that year, is in India.

Place of effective management (POEM) means a place where key management and commercial decision that are necessary for conduct of the business of an entity as a whole are in substance made.

The concept of POEM is effective from Assessment Year 2017-18. Therefore, the CBDT has recently issued the final guidelines for determination of POEM of a foreign company.

The final guidelines on POEM contain some unique features. One of the unique features is test of Active Business Outside India (ABOI). The guidelines prescribe that a company shall be said to engaged in 'active business outside India' if passive income is not more than 50% of its total income. Further, there are certain additional cumulative conditions to be satisfied regarding location of total assets, employees and payroll expenses.

The place of effective management in case of a company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India.

In cases of companies other than those that are engaged in active business outside India, the determination of POEM would be a two stage process, namely:—

- (i) First stage would be identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole.
- (ii) Second stage would be determination of place where these decisions are in fact being made.

However, it has been provided that the POEM guidelines shall not apply to a company having turnover or gross receipts of INR 50 crores or less in a financial year vide *CIRCULAR NO.8, DATED 23-2-2017*.

(To know more about POEM guidelines, read *CIRCULAR NO.6, DATED 24-1-2017*.)

Determination of the residential status of person other than an individual, HUF and company

Every person other than an individual, HUF and company is said to be resident in India during the year, if the control and management of its affairs for that year is located wholly or partly in India.

Incomes which are charged to tax in India

The following chart highlights the tax incidence in case of different persons:

<i>Nature of income</i>	<i>Residential status</i>		
	<i>ROR (*)</i>	<i>RNOR (*)</i>	<i>NR (*)</i>
Income which accrues or arises in India	Taxed	Taxed	Taxed
Income which is deemed to accrue or arise in India	Taxed	Taxed	Taxed
Income which is received in India	Taxed	Taxed	Taxed
Income which is deemed to be received in India	Taxed	Taxed	Taxed
Income accruing outside India from a business controlled from India or from a profession set up in India	Taxed	Taxed	Not taxed
Income other than above (<i>i.e.</i> , income which has no relation with India)	Taxed	Not taxed	Not taxed

- (*) ROR means resident and ordinarily resident.
 RNOR means resident but not ordinarily resident.
 NR means non-resident.

Incomes which are deemed to be received in India

Following incomes are treated as incomes deemed to be received in India:

1. Interest credited to recognised provident fund account of an employee in excess of 9.5% per annum.
2. Employer's contribution to recognised provident fund in excess of 12%.
3. Transferred balance in case of reorganisation of unrecognised provident fund.
4. Contribution by the Central Government or other employer to the account of the employee in case of notified pension scheme referred to in section 80CCD.

Incomes which are deemed to accrue or arise in India

Following incomes are treated as incomes deemed to accrue or arise in India:

1. Capital gain arising on transfer of property situated in India.
2. Income from business connection (to be discussed in later part) in India (*).
3. Income from salary in respect of services rendered in India.
4. Salary received by an Indian national from Government of India in respect of service rendered outside India. However, allowances and perquisites are exempt in this case.
5. Income from any property, asset or other source of income located in India.
6. Dividend paid by an Indian company.
7. Interest received from Government of India.
8. Interest received from a resident is treated as income deemed to accrue or arise in India in all cases, except where such interest is earned in respect of funds borrowed by the resident and is used for carrying on business/profession outside India or is in respect of funds borrowed by the resident and is used for earning income from any source outside India.
9. Interest received from a non-resident is treated as income deemed to accrue or arise in India if such interest is earned in respect of funds borrowed by the non-resident for carrying on any business/profession in India.
10. Royalty/fees for technical services received from Government of India.
11. Royalty/fees for technical services received from resident is treated as income deemed to accrue or arise in India in all cases, except where such royalty/fees relates to business/profession/other source of income carried on by the payer outside India.
12. Royalty/fees for technical services received from non-resident is treated as income deemed to accrue or arise in India if such royalty/fees is received for business/profession/other source of income carried on by the payer in India.
13. With effect from September 1, 2019, Section 201 has been amended to extend the benefit to a deductor even in respect of failure to deduct tax from sum paid to non-resident.

In case of non-resident, being a person engaged in business of banking any interest payable by the permanent establishment in India of such non-resident to the head-office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India.

Meaning of business connection

Business connection shall include following business activities carried out by a person acting on behalf of a non-resident:

1. If a person has and habitually exercises in India, an authority to conclude contracts on behalf of non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are:
 - a) in the name of the non-resident; or

- b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
 - c) for the provision of services by the non-resident
2. If such person has no authority to conclude contracts but he 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
 3. If such person habitually secures orders in India mainly or wholly for the non-resident or for other non-residents under the same management.

No business connection shall be deemed to have been established, if the business is carried on through an independent broker, general commission agent or other agent (i.e., a broker or commission agent who is not working mainly or wholly for such non-resident or other non-residents under same management), provided such person is working in his ordinary course of business.

Only so much of income which accrues or arises due to such business connection is deemed to be income accruing or arising from India and not the entire income of the non-resident.

Further, the significant economic presence of a non-resident in India shall constitute “business connection” in India. The “significant economic presence” shall mean:

- a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or
- b) Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:

Only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

The transactions or activities shall constitute significant economic presence in India, whether or not the agreement is entered in India or non-resident has a residence or place of business in India or renders services in India.

Note: The transaction or activities which are confined to the purchase of goods in India for the purpose of export shall not constitute significant economic presence in India [Effective from AY 2026-27]

Other provisions of Income-Tax Act applicable to a Non-resident

Refer chart and Table on ‘Non-Resident Benefits Allowable’.

Provisions of FEMA useful for non-residents

Objectives of FEMA

FEMA stands for Foreign Exchange Management Act, 1999. In this part you can gain knowledge about important provisions of FEMA 1999.

The main objective of FEMA is to facilitate external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. FEMA deals with provisions relating to procedures, formalities, dealings, etc. of foreign exchange transactions in India. The transactions relating to foreign exchange have been classified under FEMA into two main categories, viz., (1) Capital Account Transaction, (2) Current Account Transaction.

Meaning of capital account transaction

As defined in Section 2(e) of the FEMA, 1999 "Capital Account Transaction" means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6¹.

Capital account transactions are governed by Section 6 of the FEMA, 1999 read with Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000

Meaning of current account transaction

As defined in Section 2(j) of the FEMA, 1999 "Current Account Transactions" means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,—

- (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
- (ii) payments due as interest on loans and as net income from investments,
- (iii) remittances for living expenses of parents, spouse and children residing abroad, and
- (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children

Current account transactions are governed by section 5 of the Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Current Account Transaction) Rules, 2000

Major provisions covered in FEMA, 1999

The major provisions of FEMA, 1999 relate to following matters :

1. Dealing in foreign exchange, etc.
2. Holding of foreign exchange, etc.
3. Current account transactions
4. Capital account transactions
5. Acquisition and transfer of Immovable property in India
6. Acquisition and transfer of Immovable property outside India
7. Export of goods and services
8. Realization and repatriation of foreign exchange
9. Exemption from realization and repatriation in certain cases.
10. Provisions relating to authorised persons. i.e. authorised by RBI to deal with

¹ Earlier, section 6(3) of the Foreign Exchange Management Act, 1999, contained a list of capital account transactions which the RBI could have prohibited, restricted or regulated. However, the section 6(3) got deleted with effect from October 15, 2019.



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- foreign exchange or in foreign securities
11. Power of RBI to inspect authorized person
 12. Contravention and penalties
 13. Adjudication and appeal
 14. Directorate of enforcement
 15. Miscellaneous provisions

For more details on FEMA refer the FAQ section at www.rbi.org.in

MCQ on provisions of Income-tax Law and FEMA useful for non-residents

Q1. For the purpose of Income-tax Law, an individual can have any one of the following residential status:

- (1) Resident and ordinarily resident in India
- (2) Resident but not ordinarily resident in India
- (a) True (b) False

Correct answer : (b)

Justification of correct answer :

For the purpose of Income-tax Law, an individual can have any one of the following residential status:

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

Thus, the statement given in the question is false and hence, option (b) is the correct option.

Q2. Under the Income-tax Law, the residential status of a person is to be determined only once in his life time.

- (a) True (b) False

Correct answer : (b)

Justification of correct answer :

For the purpose of Income-tax Law, an individual can have any one of the following residential status:

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

Every year the residential status of the taxpayer is to be determined by applying the provisions of the Income-tax Law designed in this regard and, hence, it may so happen that in one year the individual would be a resident and ordinarily resident and in the next year he may become non-resident or resident but not ordinarily resident and again in the next year his status may change or may remain same.

Thus, the statement given in the question is false and hence, option (b) is the correct option.

Q3. An individual will be said to be resident in India during a year if, if he satisfies both of the following conditions.

- (1) He is in India for a period of 182 days or more in that year; and
 - (2) He is in India for a period of 60 days or more in the year and for a period of 365 days or more in immediately preceding 4 years .
- (a) True (b) False

Correct answer : (b)

Justification of correct answer :

Under the Income-tax Law, an individual will be treated as a resident in India for a year if he satisfies any of the following conditions (*i.e.* may satisfy any one or may satisfy both the conditions):

- (1) He is in India for a period of 182 days or more in that year; or
- (2) He is in India for a period of 60 days or more in the year and for a period of 365 days or more in immediately preceding 4 years .

Thus, the statement given in the question is false and hence, option (b) is the correct option.

Q4. A resident individual will be treated as resident and ordinarily resident in India during the year if he satisfies any one of the following conditions:

- (1) He is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.
- (2) His stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

- (a) True (b) False

Correct answer : (b)

Justification of correct answer :

A resident individual will be treated as resident and ordinarily resident in India during the year if he satisfies both the following conditions:

- (1) He is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.
- (2) His stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

Thus, the statement given in the question is false and hence, option (b) is the correct option.

Q5.For the purpose of Income-tax Law, a HUF will be treated as resident in India, if the control and management of the affairs of the HUF is located_____in India.

- (a) Partly (b) Wholly
(c) Exclusively (d) Partly or wholly

Correct answer : (d)

Justification of correct answer :

For the purpose of Income-tax Law, a HUF will be treated as resident in India, if the control and management of the affairs of the HUF is located (partly or wholly) in India.

Thus, option (d) is the correct option.

Q6.A resident HUF will be treated as resident and ordinarily resident in India during the year if its manager (*i.e.* karta or manager) satisfies both the following conditions :

- (1) He is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.
- (2) His stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

- (a) True (b) False

Correct answer : (a)

Justification of correct answer :

For the purpose of Income-tax Law, a HUF will be treated as resident in India, if the control and management of the affairs of the HUF is located (partly or wholly) in India.

A resident HUF will be treated as resident and ordinarily resident in India during the year if its manager (*i.e.*, karta or manager) satisfies both the following conditions:

- (1) He is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.
- (2) His stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

Thus, the statement given in the question is true and hence, option (a) is the correct option.

Q7.An Indian company is always resident in India.

- (a) True (b) False

Correct answer : (a)

Justification of correct answer :

A company is said to be resident in India if it is an Indian company or its place of effective management, in that year, is in India.

Thus, the statement given in the question is true and hence, option (a) is the correct option.

Q8. The transactions relating to foreign exchange have been classified under FEMA into two main categories, viz., (1) Receipt Transaction, (2) Payment Transaction.

(a) True

(b) False

Correct answer : (b)

Justification of correct answer :

The transactions relating to foreign exchange have been classified under FEMA into two main categories, viz., (1) Current Account Transaction, (2) Capital Account Transaction.

Thus, the statement given in the question is false and hence, option (b) is the correct option.