Concept of "Residence" Under Income Tax Act, 1961

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In India, as in many other countries, the charge of income tax and the scope of taxable income varies with the factor of residence. Thus, identification and classification of the residence of a person is one of the first steps carried out in order to proceed with assessing the liability of an individual. There are two categories of taxable entities viz. (1) residents and (2) non-residents. Residents are further classified into two sub-categories (i) resident and ordinarily resident and (ii) resident but not ordinarily resident. Section 6 of the Income Tax Act deals with residence. This article aims to clarify and elucidate the concept of residence under the IT Act and to show how there are different types of statuses applicable and consequently, different incidences of tax liability on individuals respectively.

Concept of "Residence" under Income Tax Act

Tax incidence and imposition on an assessed is dependent on his residential status. For example, whether an income, accrued to an individual out of India, is taxable in India is dependent upon the residential status of an individual in India. Likewise, whether an income secured by a foreign national in India (or out of India) is taxable in India is dependent on the residential status of an individual, rather than his citizenship. Consequently, the determination of the residential status of the person is very important to ascertain his tax liability[1]. One can affirmatively conclude that taxation of the assessee is dependent on his residence. As a result, the first question is always towards appropriate establishment of the residential status of an assessee.

In the case of the Resident, the entire income is taxable, oblivious to the fact that it is earned in India or outside India. In the situation of a Non-resident, only the income earned in India is taxed. There should be a basis for the government for taxing any income of an indivudual. Indian Government has taken 3 conditions for levy of income-tax in India[2]:

1. Residence.
2. Source of Income.
3. Receipt of Income.

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1 Taxman, *Students' Guide to Income Tax,* Tans Prints (India) Pvt. Ltd., 33rd Ed., 2005-06, p-27

2 *Ibid.*

For the charge of income-tax, Indian Government can tax the total income of Indian tax residents; or the Indian sourced income & income earned in India of tax non-residents of India.

Fundamental rules for determining residential status of an Assessee:

Section 6[3] lays down the tests of territorial correlation amounting for residence for all taxable entities. Two different tests are provided for individuals, two for companies, and one for Hindu undivided families, firms, associations of persons and other assessable units. The tests are mock - staying for a day more or less may make a difference- but they make for exactitude and accuracy, and they were held legitimate and *inter vires* under the 1922 Act[4].

Residential status: Three types of residential status are envisaged for an assessee under the Act. He may be-

1. Resident (also known as resident and ordinarily resident)
2. Non resident or not resident.
3. Resident but not ordinarily resident (a category of residential status) only valid for individuals and Hindu undivided families.[5]

The following essential rules must be kept in mind while determining the residential status[6];

- Residential status is established by each category of persons disjointedly e.g., there are distinct set of rules for establishing the residential status of an individual and distinct rules for companies etc.
- Residential status is always established for the previous year because one has to establish the total income of the previous year only.
- Residential status of person is established for every previous year because it may change to year to year. For example, A, who is resident of India in the previous year 2004-05, may become a non-resident in the previous year 2005-06.

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3 *See* Section 6, Income Tax Act, 1961.

4 Kanga, Palkhivala and Vyas, *The Law and Practice of Income Tax,* Lexis Nexis Buttersworths, I Vol, IX Ed.,2004, p-348.

5 *Supra* at n. 3.

6 Girish Ahuja and Ravi Gupta. *Concise Commentary on Income Tax,* Bharat Law House Pvt. Ltd., 6th Ed., 2005, pp-60.

- If a person is resident in India in a previous year applicable to assessment year in respect of any source of income, he shall considered to be resident in India in previous year applicable to the assessment year with regard to each of his other source(s) of his income.
- A person may be resident of more than a country in any previous year.
- Citizenship of a country and residential status of that country are disconnect concepts. An individual may be an Indian national/citizen, but may not be a resident in India. Conversely, a person may be a foreign national/citizen, but may be a resident in India.[7]
- It is the obligation of the assessee to place all relevant facts before the assessing officer to facilitate him to establish his exact residential status.[8]

The tests of residence provided in Clause (1) for individuals are substitutes and not collective. Each of the tests needs the personal attendance of assessee in India for the said period in the duration of the accounting year. If the assessed is incessantly out of India during whole of a year, even though, he may be, in the non-technical sense, normally resident in India.[9]

The term 'India' means the geographical territories and the territorial waters of the country, and does not involve Indian ships operating beyond the Indian territorial waters. Thus, for counting the days, for which a person is in India, his stay in Indian ship abroad is not considered.[10] The Finance Act 1990 gave statutory recognition to this aspect with an amendment to the explanation to Section 6(1) which ensured that the Indian seamen working on board an Indian ship would be seen as resident in India for any year, only if the sojourn in India is for 182 days and more in that year.[11]

A Hindu undivided family, firm or other association of persons are classified as residents in India in any previous year in every case excluding where during that year the control and administration of its affairs is entirely outside India.[12] Additionally, the existence of one of the partners in India who keep himself

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7 A.C. Sampath Iyengar, *The Law of Income Tax,* Bharat Law House Private Limited, 1994, p-869.

8 *Ibid.*

9 *Supra* at n. 7.

10 *CIT v. Avtar Singh,*247 ITR 260

11 Kanga, Palkhivala and Vyas, *The Law and Practice of Income Tax,* Lexis Nexis Buttersworths, I Vol, IX Ed.,2004, pp-354-357.

12 Girish Ahuja and Ravi Gupta. *Concise Commentary on Income Tax,* Bharat Law House Pvt. Ltd., 6th Ed., 2005, p-78.

abreast with the affairs of the business will not comprise a second centre of management in India. It has been constantly held by the Courts that just mere presence of partners in India would not lead to a supposition that the running and supervision of the firm had been exercised in India.[13]

An Indian company is considered always to be resident in India, where it may have its business. Additionally, if the company is not an Indian company, it shall be deal with as resident in India in any previous year, if throughout that year, the control and running of its affairs are positioned completely in India. Direction and administration is one thing but the carrying of business operation of a company is quite another.[14] By management of affairs means not running and supervision of the daily affairs of the business performed through agents, employees and servants. In interpreting the expression "control and management", it is compulsory to keep in mind the difference between doing of business and control and management of the business. Business and the whole of it may be carried outside and yet, the control and management of the business is entirely within India.[15]

In case of non- companies' entities such as firms and associations of persons, if throughout the previous year, the control and management is located partially in India, they become resident in India.[16] In situations of non- Indian Companies, such part situation of control and management of its affairs is not adequate to consider it a resident in India. This is the concept of "residence" as envisaged in the Income Tax Act, 1961.

As has been seen, foreign- earned income of the Indian residents becomes taxable in India. Equally, foreign earned income of the non- residents are not taxable in India. Thus, a person will always attempt to become a non- resident in India for the purpose of taxation.[17] Consequently, it is very imperative to appreciate when a person becomes resident in India. Likewise it's vital to recognize the conception of resident and not ordinarily resident in terms of Hindu undivided family (HUFs) and companies under the Income Tax Act, 1961.

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13 *Ibid.*

14 *Supra* at n. 10.

15 *Supra* at n. 10

16 Ajoy Halder, "*Residence with respect to Artificial entities", Taxman,* Feb 28- March 5, 2004.

17 Sampath Iyenger. *Law of Income Tax: A commentary on Income Tax Act, 1961,* Bharat Law House Pvt. Ltd., p-848.