

## UAE TAX LAW: INTERPLAY WITH INDIA TAX RESIDENCY

### OVERVIEW OF RESIDENTIAL STATUS IN VIEW OF INDIAN INCOME TAX ACT, 1961 ('THE ACT')

#### Significance of Residential Status

A person is taxed in a jurisdiction based on residence link or a source link. In India, the taxability of an individual depends on the residential status for any particular year. Generally speaking, the residential status of an individual taxpayer is different from the citizenship status in the country. However, there are few exceptions such as taxation based on citizenship (e.g., USA) or in case of territorial tax regimes (such as Hong Kong).

In India, section 6 of the Act determines the residential status of a person and section 5 defines the scope of total income.

Along with the incidence of tax, residential status is also important to claim relief under a particular tax treaty, as being a resident of either of the contracting states is a prerequisite for the same. Therefore, Article 4 (usually) of tax treaty on Residence is considered to be the gateway to the tax treaty. Once a person is a resident of a contracting state, they get a Tax Residency Certificate which enables them to claim treaty benefits.

#### Resident

Under section 6 of the Act, an individual will be treated as a resident in India for a year if they satisfy any of the following conditions:

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

However, in respect of an Indian citizen and 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 or for the purpose of employment outside India.

The Finance Act, 2020, w.e.f., Financial Year 2020-21 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 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).

#### Rational for the above amendment

The period of 60 days is very short, therefore Indians staying abroad demanded some relaxations. The government also acknowledged the fact that Indian citizens or Persons of Indian Origin (PIO) who stay outside India often maintain strong ties with India and visit India to take care of their assets, families or for a variety of other reasons. Therefore, relaxation has been provided to Indian citizens / PIOs, allowing them to visit India for longer a duration of 182 days without losing their non-resident status.

However, it was found that this relaxation was misused by many visiting Indian citizens or PIOs, by carrying on substantial economic activities in India and yet not paying any tax in India. They managed to stay in India almost for a year by splitting their stay in two financial years and yet escape from taxation in India, even if their global affairs/ businesses were controlled from India. In order to prevent such misuse, the Finance Act, 2020 has reduced the period of stay in India from 182 days to 120 days in case of those individuals whose Indian-sourced income exceeds Rs. 15 lakhs.

#### **Deemed Resident [Section 6(1A)]**

The Finance Act, 2020 has introduced new section 6(1A) to the Act. The new provision provides that 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 **they are not liable to tax** in any country.

Liable to tax has been defined by Finance Act 2021 and it means that there is an income-tax liability on such person under the law of that country for the time being in force and **shall include a person who has**

subsequently been exempted from such liability under the law of that country.

**Rational of deemed resident introduced in India**

Traditionally, in India, income tax is levied based on the residential status of the individual. It was felt that in the residence-based scheme of taxation there was scope for abuse of the provisions. It was possible for a high net-worth individual to arrange their affairs in a manner whereby they are not considered as a resident of any country of the world for tax purposes. In order to prevent such abuse a new Clause 1A as specified above has been inserted to section 6 of the Act. However, this provision is not applicable to Overseas Citizens of India (OCI) card-holders as they are not the citizens of India.

All over the world an individual is categorized as either a Resident or a Non-resident. However, India has an intermediary status, known as Resident but Not Ordinarily Resident (RNOR).

This status provides breathing space to a person from being taxed on a worldwide income, in that such a person is not subjected to Indian tax on passive foreign income i.e., foreign-sourced income earned without business controlled from or a profession set up in India.

A person is said to be not ordinarily resident (RNOR) in India in any previous year if such person is,

“(a) an individual who has been a non-resident in India in 9 out of the 10 previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, 729 days or less; or

(b) a Hindu undivided family whose manager has been a non-resident in India in 9 out of the 10 previous years preceding that year, or has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to, 729 days or less, or

(c) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, as referred to in clause (b) of Explanation 1 to clause (1), who has been in India

for a period or periods amounting in all to 120 days or more but less than 182 days; or

(d) a citizen of India who is deemed to be resident in India under clause (1A)”.

**Non-Resident**

According to section 2(30) of the Act, non-resident means a person who is **not a Resident**.

**Determining the scope of Taxability (Sec 5)**

An individual is subjected to worldwide taxation in India only if they are Resident (ROR). The scope of total income, based on the residential status, is defined in section 5 of the Act which have been summarized below:

S No	Income	ROR	RNOR	NR
1.	Income received or is deemed to be received in India	Taxable	Taxable	Taxable
2.	Income accrues or arises or deemed to accrue or arise in India	Taxable	Taxable	Taxable
3.	Income accrues or arises outside India, but it is derived from a business controlled in or a profession set up in India	Taxable	Taxable	Not Taxable
4.	Income accrues or arises outside India other than derived from a business controlled in or a profession set up in India	Taxable	Not Taxable	Not Taxable

**OVERVIEW OF RESIDENTIAL STATUS IN VIEW OF UAE CORPORATE TAX LAW**

The UAE has been one of the few countries in the world with no taxes on income for most of the taxpayers, with

the exception of a few industries. However, keeping the changing international tax landscape of global minimum tax in mind, the UAE has sought to introduce income tax on **Corporations and Businesses**.

The MoF of the UAE had issued a Public Consultation Document on the 28<sup>th</sup> of April, 2022 seeking comments by 19<sup>th</sup> May, 2022 pertaining to the introduction of corporate income tax.

Following the comments received, the Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses (CT Law or CT Decree-Law) was issued by the UAE on the 9<sup>th</sup> of December, 2022. The CT Law is materially aligned with the Public Consultation Document and expands on many of the key provisions.

#### Effective Date

The CT Law will become effective for financial years starting on or after 1<sup>st</sup> June, 2023. Accordingly, for financial years starting on 1<sup>st</sup> January, and ending on 31<sup>st</sup> December, the first taxable financial year would be the financial year ending in December 2024.

#### Corporate Tax ('CT') Rate

CT will be charged on Taxable Income as follows:

S No	Resident Taxable Person	Rate of Tax
<b>A.</b>	Mainland Companies	
<b>1</b>	Taxable Income not exceeding AED 375,000 and revenue of AED 3,000,000 or less.	<b>0%</b>
<b>2</b>	Taxable Income exceeding AED 375,000 or revenue exceeding AED 3,000,000	<b>9%</b>
<b>B.</b>	Qualifying Free Zone Persons	
<b>1</b>	Qualifying Income	<b>0%</b>
<b>2</b>	Taxable Income that does not meet the Qualifying Income definition	<b>9%</b>
<b>C.</b>	Natural Persons whose total turnover derived from businesses (not including wages, personal investment, and real estate investment) exceeds AED 1,000,000.	<b>9%</b>

For reference, Free Zones are special economic zones within the UAE where not all federal rules and regulations apply and are instead replaced by the regulations of the zone itself that act as the supervising authority on companies incorporated therein, whereas mainland companies are those incorporated before the Department of Economic Development of each Emirate and are considered onshore companies.

Regarding the concept of "Qualifying Income" for Free Zone Persons, further regulations are awaited to provide clarity on the matter.

#### Taxable Person and CT Base, etc

CT applies to the following Taxable Person:

- UAE companies and other juridical persons that are incorporated or effectively managed and controlled in the UAE;
- **Natural persons (individuals) who conduct or undertake a business activity in the UAE as specified in Cabinet Decision no. 49 of 2023; and**
- Non-resident juridical persons (foreign legal entities) that have a Permanent Establishment (PE) in the UAE, derive a UAE-sourced income and have a nexus in the UAE.

**It may be noted that individual earning income, other than from business or business activities (such as salary income) are out of the purview of CT Law.**

The applicable basis of taxation depends on the classification of the Taxable Person.

- A Resident Person is taxed on income derived from both domestic and foreign sources (i.e. a residence basis).
- A Non-Resident Person will be taxed only on income derived from sources within the UAE (i.e. a source basis).

The following aspects should be considered when determining the nature of a Taxable Person as well as the applicable tax base:

Resident Person	Tax Base
An entity that is incorporated in the UAE (including a Free Zone entity)	<b>Worldwide income</b>
A foreign entity that is effectively managed and controlled in the UAE	<b>Worldwide income</b>
A natural person/individual who conducts a business or undertakes business activity in the UAE	<b>Worldwide income</b>

Non-Resident Person	Tax Base
Has a PE in the UAE	Taxable income attributable to the PE
Derives UAE-sourced income	The UAE-sourced income not attributable to the PE
Has a nexus in the UAE	Taxable income attributable to such a nexus

Notwithstanding some exceptions, a “Permanent Establishment” in the UAE is considered satisfied if (i) the person has a fixed or permanent place in the UAE through which the business is fully or partially conducted; or (ii) the non-resident person has a person in the UAE that habitually exercises an authority to conduct an activity on its behalf; or (iii) where the person has any other form of nexus in the UAE as specified by future decisions of the UAE Cabinet (not yet issued as of the date of this Article).

## OVERVIEW OF RESIDENTIAL STATUS IN VIEW OF INDIA-UAE TAX TREATY

Article 4 of the India-UAE Tax Treaty reads as follows:

### ARTICLE 4: RESIDENT

“1. For the purposes of this Agreement the term 'resident of a Contracting State' means:

(a) In the case of India: any person who, under the laws of India, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in India in respect only of income from sources in India; and

(b) in the case of the United Arab Emirates: an individual who is present in the UAE for a period or periods totaling in the aggregate at least 183 days in the calendar year concerned, and a company which is incorporated in the UAE and which is managed and controlled wholly in UAE”.

Thus, as per the India-UAE tax treaty, an individual will be considered a tax resident in the UAE if they are physically present in the country for a total of **at least 183 days during the relevant calendar year**.

The changes made in the rules of residence in India for individuals in the Act by the Finance Act, 2020 and 2021 vis a vis enactment of CT law in UAE, making natural persons liable to pay any tax on income earned in UAE are extremely relevant for Indian citizen and persons of Indian Origins conducting business/ engaged in business activities in UAE. Some of the issues that may arise has been discussed in this article as below:

### ISSUE – 1

**In case an individual is present in UAE for more than 183 days and qualifies as resident as per Article 4 of India-UAE tax treaty. They also stay between 120 days to 181 days in India and qualify as RNOR as per the domestic tax law of India. They have India sourced income (other than foreign source income) more than 15 lakhs in one year.**

### How is their residential status determined?

The tax residency of individuals in UAE addressed in UAE Cabinet Resolution no. 85 of 2022 Determining Tax Residency (the “Cabinet Resolution”).

### Article 4 of the Cabinet Resolution provides:

“A natural person shall be considered a Tax Resident in the State where any of the following conditions are met:

1. If his usual or primary place of residence and the centre of his financial and personal interests are in the State, or he meets the conditions and criteria determined by a decision from the Minister.

2. If he has been physically present in the State for a period of (183) one hundred and eighty-three days or more, within the relevant (12) twelve consecutive months.

3. If he has been physically present in the State for a period of (90) ninety days or more, within the relevant (12) twelve consecutive months, and he is a UAE national, holds a valid Residence Permit in the State or holds the nationality of any member state of the Gulf Cooperation Council, and meets any of the following:

- a. He has a Permanent Place of Residence in the State.
- b. He carries on an employment or Business in the State”.

However as per Article 4 ‘Resident’ of the India-UAE Tax Treaty (which prevails over the Cabinet Resolution), in case of UAE, an individual shall be considered as a ‘resident’ for the purpose tax treaty, where such person is present for 183 days or more in UAE in a calendar year.

In the current scheme of things, this implies that if an individual is present in UAE for less than 183 days in a calendar year, such individual for treaty purposes would not be a resident of UAE.

As is evident from above, in context to India, there is a dichotomy in the residence rule for UAE as per the Cabinet Resolution and the India-UAE Tax Treaty. From a taxation standpoint, an individual can be considered as a tax resident of one country only. Where, based on certain facts an individual qualifies as the tax resident of both the countries, the tie-breaker rule as per the tax treaty comes into play and decides on the tax residence of the individual for the purpose of taxation.

In the above example, if a citizen of India who stays for 183 days or more in UAE, they would be said to be a resident of UAE as per the India-UAE DTAA. Further, since they are also a resident of India (i.e. RNOR)

because of their stay more than 120 days but less than 182 days as per the domestic laws of India, they may resort to the **tie-breaker tests** to determine their final residential status.

Tie-breaker test of India-UAE tax treaty takes into consideration various factors pertaining to the individual such as –

1. Availability of a permanent home in the State,
2. Personal and economic relations (Centre of vital interests),
3. habitual abode, and
4. State of nationality of the individual

The above 4 conditions need to be checked in a sequential order to determine the residential status of an Individual. Further, in a case wherein such factors do not result in a clear state of residence, the competent authorities of the two States in question are required to settle the question by mutual agreement.

It may be possible that applying rule 1-3 may result into a person being qualify as resident of both the states, however, basis 4<sup>th</sup> & final test of citizenship, one may qualify as a resident of India even though his stay in UAE exceeds 183 days.

Therefore, a careful consideration of first 3 tests to become residence of a country is required in view of condition 4 of Tie breaker rule which may make one as a resident of India irrespective of the fact that they stay more than half of the calendar year in UAE.

## ISSUE - 2

**What is the Income liable to be taxed in India for the person treated as RNOR due to his stay between 120 to 181 days in India?**

RNOR is liable to tax on following Income –

- Income received or is deemed to be received in India
- Income accrues or arises or deemed to accrue or arise in India
- Income accrues or arises **outside India, but it is derived from a “business controlled in India” or a “Profession set up in India”**

Accordingly, the income which accrues or arises to them outside India shall not be included/taxable in India unless it is derived from a business controlled in or a profession set up in India.

### ISSUES- 3

**What is the meaning of the term “business controlled in India” or “profession set-up in India” in the context of determination of taxable income in India of a RNOR?**

The expression “business controlled in India” means that the “head and brain” of the trading adventure should be situated in India and should direct the business activities from India. A profession established abroad and afterwards established and continued in India would fall within the category of a profession set up in India. The expression “profession” includes vocation as well.

Accordingly, in case of individual stay is 120 days to 181 days in India wherein they are considered RNOR, the income which accrues or arises to them outside India shall not be included/taxable in India unless it is derived from a business controlled in or a profession set up in India.

### ISSUE - 4

**What is the impact on Indian tax residency rules on introduction of tax laws in UAE?**

With the introduction of CT Law in UAE, Indian citizens undertaking business activities in UAE are covered under the purview of UAE CT Law and their business income is taxable in UAE and therefore are covered under the ‘definition of liable to tax’.

The ‘deemed residency’ provisions in the Indian Income Tax Act, apply to Indian citizens, who are ‘not liable to tax’ in any country. Since the Indian citizens earning business income in UAE are required to pay tax on such income in UAE, hence the ‘deemed residency’ provisions shall not apply to such individuals in India.

As per the UAE Tax Laws such individuals would be considered as tax residents of UAE. Accordingly, given the number of days spent in India, such individuals would need to see whether they qualify as residents in India or

not, as per the Indian Income Tax Act, **other than under the ‘deemed residency’ provisions.**

Where such individuals qualify as non-residents in India (as deemed residency provisions would not be applicable), they shall be liable to pay tax at the rate of 9% in UAE on their business income, obtain tax registration and file their annual income tax return in UAE.

### ISSUES – 5

**Whether deemed residency provisions as specified in Income Tax Act is required to examine if an Indian citizen stays in UAE for 235 days and 130 days in India in one year.**

Deemed resident provisions of Indian Income Tax will not apply as one condition of non-liable to tax in any other country get failed as such individual is liable to tax in UAE in accordance with UAE CT law.

In case, such individual is tax resident in India in view of condition of 120 days to 181 days in India, tie-breaker rule of India-UAE tax treaty will apply and will be considered tax resident of one country.

### ISSUES - 6

**Whether it is to be beneficial for a person to have the status of “non residence” in India, as compared to the status of resident i.e. RNOR which arises due to his stay in between 120 days to 181 days.**

Non-resident is not liable to tax on following income

- Income accrues or arises outside India, but it is derived from a “business controlled in India” or a
- “profession set up in India”
- Income accrues or arises outside India

Further, his Indian sourced Income is liable to tax at a reduced rate of tax –

- Royalty & Fee for technical services @ 10% (plus surcharge & cess)

- **On 24 March 2023**, 10% rate has been increased to 20% via amendment made in Finance Bill 2023)
- Dividend @ 20% (plus surcharge & cess)
- Interest @ 5%/10%/20% (plus surcharge & cess)

The above-mentioned rates are subject to treaty benefits with each country.

In view of the above, it's always beneficial to be non-resident in India to get income such as "business controlled in India" or "profession set up in India excluded from taxation in India as well as certain income such as dividends, etc being taxed at the lower rates for such non-resident individual in India.

In the context of UAE, we further wish to highlight that in case of residential status of Non-Resident in India, such individual needs to pay tax a lower rate such as 9% in UAE which is substantially lower in comparison with 30% (plus surcharge & cess) tax rate in India.

#### ISSUE - 7

**X stays in UAE for 275 days and 90 days in India in a year X carries out business activities in UAE and earn AED 50 million from UAE Business. X also earns certain interest income on Fixed deposits ('FDs') from India amounting AED 10 million.**

X will be resident in UAE and X's global income will be taxed in UAE including income earned in India. X is non-resident in India as stay in India is less than 120 days. However, X would require to pay tax in India on interest income of AED 10 million. X would be eligible to take credit in UAE of taxes paid in India to the extent such income is taxable in UAE.

For the below calculation we have assumed flat 9% tax rate in UAE and flat 30% tax rate in India without any slab benefit –

Particulars	Tax Calculation	
	UAE	India
Residential Status	Resident in UAE and Non-resident in India	
<b>Taxability of Income:</b>	<b>UAE</b>	<b>India</b>
Business Income earned in UAE	50	
Interest income earned in India	10	10
<b>Total Taxable Income</b>	<b>60</b>	<b>10</b>
Tax	5.4	3
Tax Credit	(0.9)	0
<b>Net Tax Payable</b>	<b>4.5</b>	<b>3</b>

#### Conclusion

The introduction of CT law in UAE and the specific provisions for determining tax residency in UAE, shall help streamline the taxability of Indian citizens earning income from UAE. It shall further help in reducing ambiguities with respect to availability of tax treaty benefit between India and UAE to such individuals.

#### How can we help?

- Examine the applicability of UAE CT law of individual(s) having income from UAE;
- Highlights the risk along with solution and opportunities with the introduction of the UAE Corporate tax;
- Assistance in determining the residential status of individual considering the provisions of India tax law, UAE CT law and India-UAE tax treaty;
- Determination of taxability in India and UAE –
  - Determining whether the individual is liable to tax in any other country or not
  - Determining whether the individual is deemed resident in India or not
  - Determining whether business controlled in India/profession setup in India or not
  - Assistance in taking tax credit of the tax paid in respective tax country.
- Assistance in filing of tax return and other compliances in India and UAE, if applicable
- Continue monitor the subsequent developments and prepare for compliance ahead of the effective date.