Salary income earned outside India is exempt from tax in India under the tax treaty based on split residency position

Background
The Income-tax Act, 1961 (the Act) allows for adopting the provisions of the Act or of the tax treaty whichever is beneficial to the taxpayer. Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Raman Chopra (the taxpayer) held that salary income outside India earned by an individual who qualified as a resident of the other country is eligible for tax exemption in India under the relevant tax treaty based on a split residency position.

Facts of the case
- The taxpayer was rendering services in the USA for the period 1 April 2010 to 30 June 2010, during which time he qualified as a tax resident of the USA.
- In his return of income, the taxpayer had claimed the salary income earned in the USA as exempt from tax under Article 16(1) of the India-USA tax treaty (tax treaty). The taxpayer had relied on the Organisation for Economic Co-operation and Development (OECD) commentary in claiming such exemption.
- Upon scrutiny, the Assessing Officer (AO) denied the exemption on the basis of stay in India for a period more than 183 days in the relevant financial year (FY).
- On disallowing the exemption claimed by the taxpayer, the AO levied a penalty for concealment of income/furnishing inaccurate particulars of income without providing the taxpayer with an opportunity of being heard.
- The taxpayer preferred an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) upheld the AO’s order and dismissed the taxpayer’s appeal to delete the penalty imposed by the AO.
- Aggrieved by the order of the CIT(A), the taxpayer appealed before the Tribunal for grant of exemption under the tax treaty and deletion of the penalty imposed by the AO on the ground that he had fully disclosed all information asked for and had not furnished inaccurate particulars. The taxpayer had relied upon the decision in the case of Reliance Petro Products.

Tribunal’s ruling
- The Tribunal observed that the taxpayer had qualified as a resident and ordinary resident in India for the FY 2010-11 and also as a tax resident of the USA during the period 1 April to 30 June 2010. As he qualified as a resident of both countries, his residential status needs to be determined under Article 4(2) of the tax treaty. Based on the tie-breaker analysis, the taxpayer qualified as a tax resident of the USA as per the tax treaty for the said period of 1 April to 30 June 2010. As a resident of the USA, the taxpayer was entitled to claim exemption from tax in India in respect of salary earned in the USA for such period as per Article 16(1) of the tax treaty. Hence, the Tribunal allowed the appeal of the taxpayer for grant of exemption from tax under the tax treaty.

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1 Section 90(2) of the Act
2 Raman Chopra v. DCIT, [2016] 69 taxmann.com 452 (Del)
3 Section 271(1)(c) of the Act

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4 CIT v. Reliance Petroproducts (P.) Ltd. [2010] 322 ITR 158 (SC)
• The Tribunal also noted that the taxpayer had fully cooperated during the assessment proceedings and provided all the details relating to the exemption claimed. The penalty under Section 271(1)(c) of the Act is for furnishing inaccurate particulars of income and concealment of income and mens rea was an essential requirement for imposition of penalty. Otherwise, as observed by the Supreme Court of India in the case of Dilip Shroff, every return of income where the claim of the taxpayer is not accepted by the AO, the taxpayer will invite penalty under Section 271(1)(c) of the Act.

• Following the rationale of the decision in the case of Reliance Petro Products and also placing reliance in the decision of the Supreme Court of India in the case of Hindustan Steel, the ITAT deleted the penalty as the imposition of penalty not being justified in the present case.

Our comments

Tax exemption of income under the tax treaty in this case has been granted purely on the facts of the case and in doing so, the decision endorses the position of split residency which is neither specifically permitted nor prohibited by the Act or the tax treaties. The decision also clarifies on what would qualify as concealment of income/furnishing inaccurate particulars of income giving rise to the levy of penalty under Section 271(1)(c) of the Act. Though the decision has been in favour of the taxpayer and serves as guidance in case of an individual resident in two jurisdictions, adoption of the position of split residency and consequent claim of exemption under the tax treaty needs to be made based on the facts of each case. Treaty claims, especially at lower levels, are often litigious.

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5 Dilip N. Shroff v. JCIT [2007] 291 ITR 519 (SC)