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TAX FLASH NEWS

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Taxpayer is qualified to be a resident of India based on the tie-breaker provisions of India-Sri Lanka tax treaty

Background

Where a person qualifies as a resident of more than one country, the tax treaties provide the manner in which such person's residency could be determined in favour of one of the countries. Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Shalini Seekond[1] (the taxpayer) held that the taxpayer is qualified as a resident of India based on the tie-breaker provisions of India-Sri Lanka tax treaty (tax treaty).

Facts of the case

- The taxpayer was a Sri Lankan national holding a Sri Lankan passport. She married an Indian national and moved to India after her marriage.
- The taxpayer sold an immovable property situated in Sri Lanka; using the proceeds of such sale, the taxpayer purchased units of mutual fund in India and also a property in Goa.
- The taxpayer had filed her tax return in India for the financial year 2006-07 as a 'tax resident'.
- Upon scrutiny of the tax return including the source of investments in mutual funds, the taxpayer submitted details of the sale of the immovable property in Sri Lanka to the Assessing Officer (AO).
- The taxpayer submitted the following before the AO:
    - Capital gains derived by a resident of India from the sale of immovable property in Sri Lanka may be taxed[2] in Sri Lanka. The taxpayer accordingly submitted that such capital gains are not eligible to tax in India.
    - She qualified as a resident of India under the Income-tax Act, 1961 (the Act). However, as she was a national of Sri Lanka, she deemed to qualify as a resident of Sri Lanka as per the tax treaty. Hence, the capital gains arising out of the sale of immovable property situated in Sri Lanka would be taxable only in Sri Lanka.
- The AO rejected the taxpayer's contentions on the following basis:
    - The taxpayer qualified as a resident of India under the Act[3], and hence her global income was taxable[4] in India.
    - Relying on the Notification[5] issued by the Central Government, the AO held that the taxpayer should have included the income from capital gains in her total income chargeable to tax in India. Relief under the tax treaty may be claimed thereafter.
    - Since the taxpayer had not paid any tax in Sri Lanka, no relief can be granted to her in India. Accordingly, capital gains arising from the sale of immovable property in Sri Lanka would be taxable in India.
- The taxpayer made an application under Section 144A of the Act to the Additional Commissioner of Income Tax to issue directions in this regard. However, the Additional Commissioner of

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[1] Shalini Seekond v. ITO (ITA No. 3877/Mum/2012) – Taxsutra.com
This decision also covers other issues, however, this flash news only deals with the issues pertaining to tax residency under the tax treaty determined based on the criteria laid down for that purpose

[2] Article 13 of the India-Sri Lanka tax treaty

[3] Section 6 of the Act

[4] Section 5 of the Act

[5] 91 of 2008 issued on 28 August 2008 by the Central Government under Section 90(3) of the Act

Income Tax directed that income from the sale of the property situated in Sri Lanka be taxed in India as long-term capital gains. Accordingly, the AO passed an order to include such income as long-term capital gains.

- Aggrieved by the order passed by the AO, the taxpayer preferred an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)].
- Before the CIT(A), the taxpayer submitted that :
  - She was a national of Sri Lanka though she had been residing in India after her marriage to an Indian national;
  - By virtue of her stay in India, she qualified as a resident in India under the Act;
  - It was undisputed that the immovable property from the sale of which the gains accrued was situated in Sri Lanka;
  - She was a tax resident under the Act, but for the purpose of a tax treaty, she was a tax resident of Sri Lanka.
  - For the purpose of tax treaty, she would be treated as a resident of Sri Lanka as she had a permanent home available to her in Sri Lanka in view of her parents residing there and presence of an immovable property in Sri Lanka;
  - She did not own any property in India;
  - In case of uncertainty, the taxpayer submitted that she should be considered a resident of Sri Lanka considering her Sri Lankan nationality;
  - If the fiscal domicile of the taxpayer was Sri Lanka, then the capital gains arising from sale of immovable property situated in Sri Lanka arose in Sri Lanka and, hence, taxable only in Sri Lanka;
  - The taxpayer also placed reliance on judicial precedents[6] to argue that capital gains deemed to arise in Sri Lanka must be taxed only in Sri Lanka and not India and the words 'may be taxed' in Sri Lanka should be interpreted as 'shall be taxed' in Sri Lanka. Hence, such capital gains were taxable only in Sri Lanka; and
  - Relying on the decision of the Federal Court of Australia[7], it was not necessary that tax should be payable in both countries to grant benefit under a tax treaty.
- The CIT(A) did not allow the taxpayer's appeal as she qualified as a resident in India under the provisions of the Act. The CIT(A) upheld the order passed by the AO taxing the income as capital gains chargeable to tax in India.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Tribunal and submitted the following in support of her appeal:
  - The taxpayer was born and had studied in Sri Lanka;
  - The taxpayer was a resident of Sri Lanka as evidenced by her passport and the restrictions imposed by the Reserve Bank of India (RBI) on foreign exchange remittances were applicable to her;
  - The taxpayer's domicile to be determined based on the place of marriage; the domicile will change in case of a divorce;
  - The taxpayer qualified as a non-resident in India and a resident of Sri Lanka based on commentary on Article 4 of the OECD Model convention;
  - Hence, income arising in Sri Lanka was taxable only in Sri Lanka.
- The tax department arguments before the Tribunal were:
  - The taxpayer qualified as a resident in India under the Act; such position had been admitted in her tax return;
  - Tax-residency and nationality were two different concepts, and the taxpayer was a tax-resident of India; and
  - As the taxpayer had not disputed her tax residency in India, her global income was taxable in India.

Tribunal's Ruling

- The taxpayer filed her tax return in India as a resident. There was no cogent material or evidence to disprove her tax residency in India. Hence, the taxpayer cannot be allowed to change her admitted position as a resident of India. The taxpayer was held to be a tax resident of India under the provisions of the Act.
- As the taxpayer qualified as a resident of India under the Act, in order to determine if the taxpayer could be categorised as a resident of

[6] CIT v. P V A L Kulandagan Chettiar [2004] 267 ITR 654 (SC), CIT v. SRM Firm [1994] 208 ITR 400 (Mad), CIT v. R M Muthaiah [1993] 202 ITR 508 (Kar), UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)
[7] Commissioner of Taxation v. Lamesa Holdings (1997) 785 FCA

Sri Lanka, the following criteria laid down by the tax treaty were examined:

  - A person shall be deemed to be a resident of the state in which he/she has a permanent home available to him or her;
  - In case he/she has a permanent home available to him/her in both states, then he/she shall be deemed to be a resident of the state with which his/her personal and economic relations are closer (centre of vital interests).

- As the taxpayer had been living in India after marrying an Indian national, her husband's home would be the permanent home available to her in India.
- Availability of a permanent home does not mean ownership of property or a home. It refers to a place of abode or dwelling which is available to the person at all times continuously as opposed to occasionally for the purpose of a stay necessarily of short duration such as travel for pleasure/education/business, etc.
- Even though the taxpayer does not own a home in India, her husband's home being available to her at all times, she was deemed to have a permanent home in India;
- As the taxpayer was living in India with her husband, it could not be said that her parents' home was her permanent home in Sri Lanka in the absence of evidence to prove that the taxpayer was, in fact, living in Sri Lanka permanently, regularly and consistently;
- Further, her personal and economic relations had moved to India upon her marrying an Indian national. Though she owned an immovable property in Sri Lanka, the sale of such property and reinvestment of its proceeds in India clearly reflected a strategic shift in vital economic interest from Sri Lanka to India.
- In the absence of evidence to prove that the taxpayer was permanently, regularly and consistently living in both India and Sri Lanka, mere ownership of an immovable property in Sri Lanka and the fact that the taxpayer's parents were residing in Sri Lanka was not sufficient to demonstrate that her habitual abode was in Sri Lanka as per the tax treaty[8].
- The following factors were considered by the Tribunal in concluding that the taxpayer's habitual abode and centre of vital interests were in India:
  - The taxpayer was holding a certificate of registration as Overseas Citizen of India (OCI) issued by the Ministry of Home Affairs under the provisions of the Citizenship Act, 1955;
  - She had a multiple entry visa to India which had life-long validity to enable her to stay indefinitely with her husband;
  - Investment of proceeds of sale in mutual funds and property in India showed her intention to settle permanently in India; and
  - The taxpayer did not provide any details or evidence to prove that she was living permanently, regularly and consistently in Sri Lanka in the relevant FY to consider Sri Lanka to be her habitual abode.
- The taxpayer's contention that domicile would change in case of a divorce was considered hypothetical and irrelevant to the issue to be decided by the Tribunal.
- The provisions of the Act or the taxpayer, whichever is beneficial to the taxpayer, would be applicable. As the immovable property was situated in Sri Lanka, the right to tax was with the Government of Sri Lanka. However, Section 90(3) of the Act empowers the Central Government to assign the meaning to any term used but not defined in the Act or the tax treaty provided it is not inconsistent with the provisions of the Act or the tax treaty.
- Applicability of the Notification issued by the Central Government under Section 90(3) of the Act:
  - The Notification was clarificatory in nature about taxation of incomes arising outside India and the manner of granting relief in order to avoid double taxation. It did not cause any prejudice to the taxpayer in the instant case or her income arising by way of capital gains.
  - Though the Notification was issued in 2008, it could be brought in retrospectively. The taxpayer does not have vested right in the procedures and such procedures could be brought in

[8] Article 4(2)(c) of the India-Sri Lanka tax treaty

retrospectively. The view of the retrospective effect of the Notification was strengthened by the insertion[9] to Section 90(3) of the Act made by the Finance Act, 2012.

- The Notification was also aimed at achieving avoidance of double taxation as in the instant case of capital gains arising from the sale of immovable property situated in Sri Lanka.

- If the income was subject to nil rate of taxation under the Sri Lankan taxing statute, the same could not be brought to tax in India merely because such capital gains were subject to 'nil' rate of taxation in Sri Lanka.
- The Tribunal allowed the taxpayer's appeal and held that
  - The capital gains arising on sale of immovable property situated in Sri Lanka was chargeable to tax only in Sri Lanka;
  - However, the same income was chargeable to tax in India under the provisions of the Act; and
  - Relief shall be granted as laid down in the said Notification read with the tax treaty.

Our comments

Even though the question before the Tribunal was taxability of capital gains arising out of property situated outside India, the Tribunal has made very significant observations in respect of the determination of tax residential status under the Act and tax treaty and of availability of permanent home and centre of vital interests. This decision spells out clearly that questions pertaining to availability of a permanent home and the question should be answered based on 'availability' permanently, regularly and consistently, and not ownership only. As had been observed by the Tribunal, the criteria laid down by tax treaty need to be examined based on the facts and circumstances of each case.

[9] Notification issued under Section 90(3) of the Act shall have effect from the date on which the date on which the agreement came into force.

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