TAXATION OF NON-RESIDENT

With the rise of technology, earning income from multiple sources across the globe has become increasingly common. You may be wondering which of these incomes are taxable in India and whether any of them are subject to taxation in a foreign jurisdiction. In some cases, income may be taxed both in India and abroad, leading to potential complexities. Sounds confusing? Let's simplify it for you.

RULES OF TAXATION OF INCOME

Every country in the world imposes taxes based on two important rules:

(i) Source Rule and
(ii) Residence Rule

SOURCE RULE:

Under this rule, income is taxed in the country where it is earned, regardless of who earns it. The focus is on the source of the income—whether it is generated through resources, businesses, or individuals within that country—rather than the residential status of the earner.

For example, if you are a tax resident of India but earn income in the United States (USA), the USA will tax that income based on the source rule. Similarly, if a foreign resident earns income in India, it will be subject to taxation in India.

RESIDENCE RULE:

Under this rule, a country taxes the income of individuals who are considered its tax residents, regardless of where the income is earned. This means taxation is based on the individual's residential status rather than the source of the income. If you are a tax resident of a country, your global income—whether earned locally or internationally—is subject to taxation in that country.

Continuing with the previous example, as a tax resident of India, if you earn income in the United States (USA), the USA will tax it based on the source rule. However, India will also impose a tax on this income because, as a tax resident, your worldwide income is taxable in India.

Since taxation in India on foreign income depends on your residential status, let's first understand how an individual's residential status is determined.

RESIDENTIAL STATUS IN INDIA

A residential status of an Individual in India is governed by Section 6 of Indian Income-tax Act, 1961.

As per it there are ***three types of residential status*** that an individual can have in India:

1. A resident and ordinarily resident (ROR)
2. A resident but not ordinarily resident (RNOR)
3. A non-resident (NR)

The taxability of an income depends on the **type of residential status** of an Individual.

Conditions for Non-Resident Status

An individual is said to be a resident in the tax year if he/she is:

- physically present in India for a period of 182 days or more in the tax year (182-day rule), or
- physically present in India for a period of 60 days or more during the relevant tax year and 365 days or more in aggregate in four preceding tax years (60-day rule).

If none of the above two conditions are met, the individual is said to be an **NR in that tax year.**

NEW INCOME TAX BILL, 2025

The biggest change lies in Section 6 of the Income Tax Act, 1961, which defines tax residency.

Old Law (Income Tax Act, 1961 – Section 6)

An Indian citizen leaving India "***for the purpose of employment outside India***" was not subject to the 60-day rule for tax residency.

This meant that if such individuals stayed in India for less than 182 days in a financial year, they were classified as non-residents and thus not taxed on their global income.

The phrase "for the purpose of employment" was broadly interpreted, covering:

- Salaried employees moving abroad for work
- Self-employed professionals and business owners setting up businesses abroad
- Freelancers and consultants working internationally
- Job-seekers looking for work overseas

New Law (Income Tax Bill 2025 – Section 6 Amendment)

The government has replaced the phrase "for the purpose of employment outside India" with ***"for employment outside India"***.

This seemingly minor change could have a major impact, as it may now exclude job-seekers, freelancers, and self-employed professionals from claiming non-resident tax status.

Now, only those with a secured foreign job offer may qualify for non-resident status.

What's the Key Difference?

Earlier: If you moved abroad ***<u>to search</u>*** for a job, set up a business, or start freelancing, you could still qualify as a non-resident.

Now: You may need ***<u>to show proof of employment before leaving India</u>***, such as an offer letter or an employment contract, to avoid being taxed as an Indian resident.

<u>Why Is This Change Important?</u>

The narrower definition of employment could significantly impact Indians moving abroad for work.

Who Will Still Qualify for the 182-Day Rule?

- Individuals already have a job abroad before leaving India.
- Employees sent abroad on deputation or working with a foreign employer.
- Professionals who can provide official documentation proving their employment abroad.

Who May Lose Non-Resident Status?

- Job-seekers moving abroad without a confirmed job.
- Self-employed professionals shifting their businesses overseas.
- Freelancers and consultants working for international clients.
- Entrepreneurs setting up startups abroad.
- Without proof of employment, these individuals could be classified as Indian residents if they stay in India for more than 60 days in a financial year.

Other Key Residency Changes in the Income Tax Bill 2025

- NRIs with Indian Income Over Rs. 15 Lakh May Face Stricter Residency Rules
- New Law: If an NRI earns Rs. 15 lakh or more from Indian sources, they may be considered residents if they stay in India for just 120 days (instead of 182 days).

"Deemed Residency" for NRIs in Tax Havens

New Law: Any Indian citizen earning Rs. 15 lakh or more from Indian sources, who does not pay taxes anywhere else, will now be deemed a resident of India.

This prevents tax avoidance by NRIs in tax-free countries like UAE, Monaco, or the Bahamas.

Our Final Comments:

- Taxability of an income will arise in India only if an income is accrued or arises or received in India. So as a non-resident, if you earn an income in any country other than India that income will not be taxed in India (subject to the condition that income should not be received in India).
- However, all non-residents should verify the Double Tax Avoidance Agreement (DTAA) entered by India with the respective Foreign Countries *(available at Income Tax Portal).*
- Further non-residents can claim Foreign Tax Credits of the taxes paid in the Foreign Country if the DTAA exists as prescribed under sections 90 & 91 of the Act. A Tax Residency Certificate is mandatorily required to be mentioned in the ITR to avail of the benefit.
- The Income Tax Bill 2025 introduces stricter tax residency rules, significantly impacting job-seekers, freelancers, and self-employed professionals. Additionally, NRIs earning over ₹15 lakh from Indian sources now face a reduced residency threshold of 120 days instead of 182 days.
- A new "deemed residency" rule also ensures that Indians earning ₹15 lakh or more from Indian sources, who do not pay taxes anywhere else, will now be considered Indian residents. These changes aim to curb tax avoidance, particularly for those living in tax-free countries like the UAE, Monaco, or the Bahamas.