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TAXATION OF INDIVIDUAL INCOME WITH SPECIAL REFERENCE TO CITIZENSHIP BASIS: A COMPARATIVE OVERVIEW OF INDIAN AND USA SYSTEM OF TAXATION

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TAXATION OF INDIVIDUAL INCOME WITH SPECIAL REFERENCE TO CITIZENSHIP BASIS: A COMPARATIVE OVERVIEW OF INDIAN AND USA SYSTEM OF TAXATION

Rakesh Kumar* **& Sonakshi Kashyap****

[Abstract: *Under the Income Tax Law Individual is a separate and distinct taxable entity. Taxes are generally imposed on an individual by a State on attributes of residence, citizenship, or source of income. The Union government of India has the authority to levy and collect income tax from persons including individuals based on their residence or source of income being situated in India. Similarly, the Federal government of United States of America, also has the authority to impose income tax on individuals who hold either U.S. citizenship or green card, or having substantial physical presence or source of income in U.S.A. Under Indian Income tax law, the incidence of tax is dependent on the physical presence of assessee i.e total days spent by an individual in the country, on the other hand, in USA tax liability of an individual depends on its citizenship status or substantial presence in the country. Citizenship as basis of taxation is generally criticized for being unreasonable and arbitrary. Recently, Indian Government has also partially adopted citizenship as basis of taxation for the purpose of collecting taxes from High-Net-Worth individuals (HNWIs) who earlier escaped taxation by planning their period of stay across the globe in a way as to avoid fulfilling criteria for tax residence in any country and paying no taxes at all. Although, the amendment was introduced to prevent double non-taxation and increase government revenue. The present Article is divided into four subheads for sake of convenience. Firstly, the USA approach of taxation and tax administration is being subjected to critical analysis, secondly, the Indian system of imposition of Income tax on Individual and thirdly rational of taxation under the USA and Indian system is being analyzed and last parts records conclusion and suggestions***.]**

Keywords: Income Tax, Individual, Resident, Non-Resident, Citizenship taxation, India, USA, Substantial presence.

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I

Introduction

Taxation lies at the core of a nation's economy as taxes contribute to the States revenue empowering the government to carry out its functions. The jurisdiction to levy taxes is derived by the State on proving a connection between the State and the taxable entity. This connection in case of an individual can be proved by using the criterion of its residence, or citizenship, or source of its income etc. Residence basis of taxation allows taxation of an individual by a State on the ground of tangible presence of the individual in the State for a significant specified time. Citizenship based taxation allows taxation of an individual by a State on the ground that it is a citizen of that State. Source based taxation allows taxation of an individual by a State on the ground that it derives income from its territory. Different countries follow different basis of taxation to impose tax on an individual's income.

The Constitution of India under Article 265 provides that taxes can be levied and collected only if authorized by the law.[1] Entry 82 of List 1 of Seventh Schedule of the Indian Constitution confers power upon the Union government to charge taxes on income other than income from agriculture.[2] Such taxes are levied and collected from different types of entities. The 'Persons' whose income is chargeable to income tax include, "individual, Hindu undivided family, company, firm, association of persons or body of individuals, and every artificial judicial person"[3]. Taxes are imposed on income of these persons according to their 'Residential status' in India. Different rules exist to determine the 'Residential status' for taxation of different types of persons. Section 6 clause (1) of the Income Tax Act,1961 (called as the 1961 Act henceforth), determines the tax status of an individual based on the time span of its presence in the country. However, Section 6 of the 1961 Act was amended

1 The Constitution of India, Art. 265.
2 The Constitution of India, Schedule 7, Entry 82.
3 The Income Tax Act, 1961, S. 2(31).

in the year 2020, introducing the concept of 'Deemed residence', providing for taxation of individuals who are citizens of India earning income above a certain threshold from India and not liable to pay taxes in any other country of the world.[4]

In the United States of America (USA), both federal as well as State governments have the power to impose income tax. The taxation of individuals is based on their citizenship status. The worldwide income of all U.S. citizens is chargeable to tax in the United States (U.S.). Further, individuals fulfilling the green card test or significant presence test are also liable for taxation of their entire income in the U.S. Other individuals earning income from the U.S. have to pay tax only on income earned and having its source in U.S. and not on the foreign income.

The present Article paper analyzes the criteria for taxation of individuals under the law relating to income tax in India and USA, with special reference to efficacy of citizenship-based taxation. For the purpose of convenience, the Article is divided into following sub parts:

(1) What are the criteria for determination of individual tax payers in USA?

(2) Whether the Citizenship basis of taxation is based on principle of justness and fairness in USA system of taxation and what are the option available to Resident Aliens?

(3) What are the tests for determination of residential status in India for the purpose of taxation?

(4) Whether the Citizenship basis of individual taxation introduced by the Finance Act, 2020 will ensure taxation on the basis of equity and fairness?

(5) Concluding Observation.

1.1 Taxation of Individuals in USA:

In the United States of America (USA), taxes on income of individuals are levied both at the Federal as well as the State levels. Federal income tax was introduced in the United States (U.S.) for the first time during the civil

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[4] The Income Tax Act, 1961, S. 6(1A) added by The Finance Act, 2020 (Act 12 of 2020), S. 4(b).

war of 1861 to generate revenue for the federal government. It was repealed post the war as revenue needs of the federal government diminished. It was again introduced in 1894 at the rate of 2% on income above $4000 per year.[5] However, the Supreme Court of U.S. held the tax to be unconstitutional as the federal government had not been conferred with the power to impose direct taxes without considering the population of different States. So, a uniform income tax could not be imposed by the Federal government.[6] Finally, 16th Amendment was introduced in the U.S. Constitution in 1913 conferring power upon the Federal government to levy income tax.[7]

The federal government follows a combination of Resident, Source and Citizenship based models for the purpose of taxation of income earned by individuals. Individuals are be divided into two categories for the purpose of taxation, i.e. 'U.S. persons' or 'Resident' and 'Foreign persons' or 'Non-Resident Alien'.

1.1.1 Determination of Residential Status in USA:

The 'U.S. persons' or 'residents' are persons who are taxable for their worldwide income in the USA, and include:

(i) Citizens of USA[8],

(ii) Green card holders in USA[9], and

(iii) Persons having significant presence in the USA[10]

On the other hand, 'foreign persons' or 'non-residents' consists of individuals who are foreign nations not falling in the above categories but earning income in the U.S..[11] Such persons are taxed on basis of source model of taxation, and are under an obligation to pay tax in U.S. only on such income that is sourced from its land.

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5 The Wilson-Gorman Tariff Act, 1894.

6 *Pollock* v. *Farmers' Loan and Trust Company*, 157 US 429 (1895).

7 The Constitution of United States of America, 1789, Amendment XVI: *"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."*

8 The Internal Revenue Code, 1986, S. 7701(a)(30)(A).

9 *Id*. at S. 7701(b)(1)(A).

10 *Id*. at S. 7701(b)(3).

11 *Id*. at S. 7701(b)(1)(B).

1.1.2 Citizens of USA:

U.S. citizens and green card holders have to pay tax in the U.S. irrespective of the number of days they stay in the country. Thus, such persons must pay income tax in U.S. even if they do not spend a single day in the entire year over there. A person is eligible for U.S. citizenship either by birth or naturalization.[12]

Citizenship taxation emerged in the U.S. during the civil war period to impose tax on Americans who fled the country, and to generate revenue for the federal government. The tax was repealed post the civil war but was again included in the modern income tax law in 1913.[13] The constitutional validity of citizenship-based taxation was challenged in the U.S. Supreme Court in *Cook* v. *Tait*[14]. The Court justified such taxation of citizens, on the ground of the inherent benefits that are derived by non-resident individuals by holding U.S. citizenship. In particular, the Court observed that, "the government, by its very nature, benefits the citizen and his property wherever found, and therefore, has the power to make the benefit complete [by having authority to collect tax.]"[15]

Though, Citizenship taxation continues to be levied in the U.S., but many scholars argue that there is no justification for such taxation. Most countries of the world use residence as basis for taxing the world-wide income of a person rather than citizenship. Thus, the concept of citizenship-based taxation is unique to the U.S., and not followed in this form by any other country of the world. Citizenship taxation was introduced at a time when few people lived outside their country. In todays globalized world, however, people's mobility has increased, and it is highly irrational to tax an individual on its worldwide income because it is a citizen of a particular country despite not even spending a single day in the country. It is argued that "Citizenship taxation undermines not only the value that society places on free movement itself, but its value as an instrument for disciplining government, revealing preferences,

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[12] *Supra,* note 7.
[13] Ruth Mason, *Citizenship Taxation* 89 SCLJ 169, 182 (2016).
[14] 265 U.S. 47 (1924).
[15] *Id.* at 56.

allocating labor efficiently across jurisdictions, and promoting international cooperation as a bulwark against war."[16]

Exponents of Citizenship based taxation generally justify such taxation on the basis of Consent theory, Benefit theory and social obligation theory. Ruth Mason, in her article rebuts all these justifications by arguing that, firstly, continued citizenship does not represent meaningful consent to be taxed, because social as well as financial costs of renouncing citizenship are very high.[17] Secondly, all countries provide certain benefits to its non-resident citizens but do not tax them on basis of these benefits. Moreover, benefits received by non-residents are not at par with residents to justify their taxation.[18] Thirdly, the argument that non-resident citizens should pay taxes due their social obligation for being members of the national community is again flawed, because an individual who does not live in the U.S. can rarely be said to be a member of the U.S. community.[19] Taxing solely on basis of citizenship "commodifies it"[20], and citizenship is not a commodity which can be bought and sold.
Further, various scholars have highlighted that there are several problems associated with Citizenship taxation. One such problem is the curious case of an "Accidental American". An 'Accidental American' is an individual who has lived outside the U.S. for most or all of its lifetime, but is still subject to tax on its entire income by the U.S. government as it is a citizen of U.S..[21] For instance, a person who is born in Canada and never visited U.S. in his lifetime, might be a U.S. citizen because his parents were U.S. citizens. Such a person, under the current law is under an obligation to pay tax on its worldwide income in U.S. despite not having any substantial connection with the U.S. Such taxation is not only arbitrary but also unfair.

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[16] *Supra*, note 13, Ruth Mason, at 230; Allison Christians, *A Global Perspective on Citizenship based Taxation* 38 MJIL *193*, 202 (2017).
[17] *Id*. at 187.
[18] *Id*. at 191.
[19] *Id*. at 204.
[20] *Id*. at 194.
[21] *Supra*, note 16, Allison Christians, at 193.

Also, taxation based on citizenship status is difficult to implement and administer. It is difficult for the U.S. government to collect information and impose a tax on a non-resident citizen unless the State of its residence cooperates in such a matter.[22]

Thus, many argue that taxes should be imposed on resident and source basis rather than citizenship basis in the U.S. However, the United States continues to follow a mix of citizenship, residence, and source-based taxation models for the imposition of income tax on individuals to have a broad tax base and generate substantial tax revenue.

1.1.3 Green card holder Test:

A 'green card holder' is a national of a foreign country who is considered to be a lawful U.S. immigrant. The 'green card' status is granted to an individual by the U.S. Citizenship and Immigration Services (USCIS).[23] There are no restrictions on the period of stay of a 'green card holder' in the USA until such status is revoked by the appropriate authority. A 'green card holder' thus is legally a permanent resident of U.S. and is considered to be a tax resident of U.S. subject to income tax in the country even if it lives outside the country.[24]

1.1.4 Substantial Presence Test: Apart from U.S. citizens and green card holders, a person is classified as a tax resident in the U.S. if it meets the 'Substantial Presence Test'[25] in a particular calendar year. A person is deemed to fulfill the above test if it has been present in person in U.S. for a period of:

(a) 31 days in the current calendar year (*i.e.* the year whose income is to be assessed to tax), and
(b) an aggregate of 183 days in three calendar years consisting of the current year and preceding two calendar years.

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[22] *Id*. at 202.

[23] Publication 519, Cat. No. 15023T, U.S. Tax Guide for Aliens, 2022, p. 4.

[24] Michael W. GalliGan and Ira C. Olshin, *U.S. Residence: A Tale of Two (or More) Definitions* NYLJ (2013).

[25] *Supra*, note 8 at S. 7701(b)(3)(A).

For counting the period of 183 days, all days of physical stay during the current calendar year, 1/3rd of the days of stay in the immediate previous year, and 1/6th of the days of stay in second year before the current calendar year must be taken into account.

A person presents in any of the fifty U.S. States and the District of Columbia, or in the territorial waters and adjacent seabed over which the U.S. has exclusive jurisdiction is considered to be 'physically present in the U.S.'.[26]

However, the following days are not counted while calculating the total period of presence of an individual in the U.S.[27],

(i) The days on which an individual commutes between Canada and U.S., or Mexico and U.S. on a regular basis for the purpose of work in U.S.
(ii) When a person spends less than 24 hours in the U.S. during transit between two places outside the U.S.
(iii) The period spent by a crew member of a foreign ship in U.S.
(iv) The extended period of stay of an individual who becomes medically ill while in U.S. due to which it is not able to leave the country.
(v) Days spent in U.S. by an exempt individual.

The time spent by exempted Individuals is not counted for purpose of determining tax residence of an individual. Such individuals include those belonging to foreign government, a teacher or trainee, or student, a professional athlete competing in a charitable event who are present in U.S. for a temporary period, under specific visas issued by the government and complying with the conditions mentioned thereunder.[28]

1.1.5 Options with Resident Aliens:

Some Resident aliens (i.e. foreign nationals fulfilling the substantial presence test) can save themselves from paying income tax in the U.S. in a particular year, in the following cases:

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[26] *Supra*, note 23.
[27] *Supra*, note 8 at S. 7701(b)(7).
[28] *Id*. at S. 7701(b)(5).

(i) Closer Connection Exemption: Even after fulfilling the criteria of substantial presence in U.S., a person can be treated as a non-resident alien if it is present in U.S. for a period less than 183 days in the relevant calendar year, maintains home in a foreign country, and has a closer connection to such country than the United States.[29]

A person is considered to have a closer connection to a foreign country, if it has more significant contacts with that country as compared to the U.S. Significant contact with foreign country can be determined on grounds like, presence of a permanent home, family, personal belongings like vehicles, jewelry etc., having Voter I.D., driver's license etc. of the foreign State etc.[30]

(ii) Dual Residents: A person may be resident in both United States and some other foreign country. In such cases, resort is made to the tie-breaker test provided under the tax treaty between USA and such other State to ascertain the residential status of such individual. If such person is determined to be a tax resident of the other State in accordance with the tie-breaker rule provided under the tax treaty, it is duty bound to inform the tax authorities in U.S. that it will compute and pay tax as a non-resident alien in the U.S. On failure to inform the U.S. tax authorities, it will be considered a tax resident in U.S. for that specified year.[31]

(iii) First-Year Choice: A foreign national who classifies as a U.S. tax resident for the first time by fulfilling the criteria of substantial presence, can elect to be treated as a U.S. resident for part and U.S. non-resident for remaining part of the immediate previous calendar year, provided that such individual stays in USA:

(i) For a minimum continuous period of 31 days in the immediately preceding calendar year, and

[29] *Id*. at S. 7701(b)(3)(B).

[30] *Supra*, note 23 at 6.

[31] OECD, U*nited States- Information for residency purposes available at* - https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/United-States-Tax-Residency.pdf (last visited May 26, 2023).

(ii) For 75% or more days beginning post the 31-day period till the end of the of the immediately preceding calendar year. Up to five days absence from U.S. can be ignored while determining the 75% requirement.[32]

1.1.6 Filing status of individuals in USA

The Internal Revenue Service (IRS)[33] is a U.S. agency under the Department of Internal Revenue, which is responsible for the collection of income taxes for the Federal government. The income taxes are governed by the Internal Revenue Code of 1986. Income tax returns are filed by individuals by a submitting Form 1040 to IRS by the 15th of April every year. The date of filing can be extended to a maximum of six months till 15th of October.[34] In the United States, an individual can have the following filing status:

(i) Single individual *i.e.* a person who is either unmarried or legally separated from its partner at the end of a calendar year can file return only as a single individual.
(ii) Married Filing jointly: Married couples can opt for filing combined returns and claim combined deductions.[35]
(iii) Married filing separately: Married couples also have the choice of filing separate returns for individual self.[36]
(iv) Head of Household: Head of household is a person who pays half of the household expenses and has a person dependent on it.[37]
(v) Qualifying Widow(er) with a dependent child. This status can be used for 2 years after the death of the spouse.[38]

Marital status of individuals is determined on the last date of the calendar year.[39] Individuals filing under different statuses have different basic exemption limits and can claim different standard deductions. For instance, for filing returns in the year 2022, the standard deductions

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[32] *Supra*, note 8 at S. 7701(b)(4).
[33] *Id*. at S. 7801.
[34] *Supra*, note 22 at 34.
[35] *Supra*, note 8 at S. 7703.
[36] *Id.* at S. 7703.
[37] *Id*. at S. 2(b).
[38] *Id*. at S. 2(a).
[39] *Id*. at S. 2(b)(2) & S. 7703.

allowed to individuals below the age of 65 years filing as single individuals or married filing separately was $12, 950, married filing jointly or qualified widow(er) was $25, 900, and head of household was $19, 400.[40] Apart from standard deductions, other deductions relating to business, healthcare, education, investments etc. are also available to individuals.[41] For instance, business expenses, rents, depreciation etc. are deductible from business income.

Thus, the United States follows a unique system for taxation of individuals. It has established a comprehensive system for the administration and implementation of the Income taxes.

II

Taxation of Individuals in India

In India, the incidence of tax is determined based on the residential status of an assessee. Every taxable entity can be classified as a:

(a) "Resident and Ordinary Resident (ROR)", or
(b) "Resident and Not Ordinary Resident (RNOR)", or
(c) "Non-Resident (NR)"[42]

"Resident and ordinary resident" are charged tax for their global income by the income tax department of India, "Resident and not ordinary resident" are taxed on their Indian income and income received from outside India, which is derived from a business or profession situated or controlled from the Indian territory, and "Non-resident" assesses are charged taxes only on the income that is received or sourced from India.[43]

2.2.1 Determination of Residential Status of Individuals: An 'Individual' is a separate entity for the purpose of taxation. Any 'Individual' earning

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[40] Publication 501, Cat. No. 15000U, Dependents, Standard Deductions and Filing information, 2022, p. 24.

[41] IRS, *Credits and deductions for individuals available at* - https://www.irs.gov/credits-deductions-for-individuals (last visited Jun. 7, 2023).

[42] *Supra,* note 3 at S. 6.

[43] *Supra,* note 3 at S. 5.

income above the basic exemption limit[44] and satisfying criteria of residence[45] provided under the Income tax law is subject to income tax. Same tests for determining residential status for taxation apply in case of individuals irrespective of their citizenship, ethnicity, caste, religion etc.[46] In *CIT* v. *K.S. Ratnaswamy*[47], J. Tulzapurkar had observed that, "[T]he language of the provision makes it clear that it lays down a technical test of territorial connection amounting to residence applicable to all individuals, foreigners as well as Indians, including Hindus, Christians, Muslims, Parsis and others irrespective of the personal law governing them."[48]

For the purpose of income tax, the residential status of an individual is determined according to the period of his or her stay in India during the relevant financial year. Section 6 of the 1961 Act emphasizes upon physical presence of the person in India.[49] As per Section 6 clause (1) of the 1961 Act, a person is classified as a 'Resident in India' if it fulfills either one of the below-mentioned basic conditions:

(a) He stays in India for a period exceeding 182 days in the relevant previous year[50], or

(b) He stays in India in the relevant previous year for a period less than 182 days but more than 60 days, and additionally, the period spent by such person in India should be 365 days or more in the four financial years immediately prior to the relevant previous year.

In the erstwhile Income Tax Act of 1922 (hereinafter referred to as the 1922 Act), the second condition was deemed to be fulfilled if the individual

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[44] Basic exemption limit, is the limit of income upto which no taxes are to be paid. As per the Finance Bill, 2023 (Bill No. 17 of 2023), the basic exemption limit for individuals under 60 years of age is rupees 2,50,000, between 60 to 80 years is rupees 3,00,000, and above 80 years is rupees 5,00,000.

[45] *Supra*, note 3 at S. 6(1).

[46] *CIT* v. *K.S. Ratnaswamy* (1980) 122 ITR (SC) (India).

[47] *Id*. at 217-221.

[48] *Id*. at para 1.

[49] *CIT* v. *Avtar Singh Wadhwan* (2001) 247 ITR 260, 264 (Bom).

[50] Relevant previous year is the financial year whose income is to be assessed to tax.

stayed in the Indian territory for at least 365 days in the four financial years prior to the relevant previous year, and was present for any time in the country in the relevant previous year provided it was not a casual or occasional visit.[51] The burden to prove that the visit was of a casual or occasional character lay on the assessee.[52] The provision was glazed with ambiguity as there was no certain meaning of what constituted a casual or occasional visit. Thus, the 1961 Act removed this ambiguity by providing that at least a stay of 60 days is mandatory in the relevant previous year to qualify the second condition for tax residence.

If neither of the two conditions is satisfied, the individual is classified as 'non-resident' for taxation purpose. However, there are certain exceptions to the basic conditions mentioned above. The second basic condition does not apply in case of some individuals, and they are considered to be tax residents only if they fulfill first of the above mentioned two conditions i.e., they stay in India for a minimum of 182 days in the relevant year. Such individuals include,

(a) A citizen of India, leaving the country during the relevant previous year as a crew member of an Indian ship, or to be employed in a foreign country, or

(b) An Indian citizen or a person of the Indian origin living outside India, who comes to India during the relevant previous year.[53]

The term "employment" mentioned in the explanation to Section 6 of the 1961 Act has not been defined in the statue. It basically means that the person should visit abroad for purpose of work and not on a vacation or for pursuing a degree or for medical treatment etc.[54] Further, it is not required that the person should be unemployed at the time of leaving

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[51] The Income Tax Act, 1922, S. 4A(a)(iii).

[52] *CIT* v. *B.K. Dhote* (1967) 66 ITR 457 (SC) (India); *Moosa S Madha & Ors.* v. *CIT* (1973) 89 ITR 65 (SC) (India).

[53] *Supra,* note 3 at Expl. 1 to S. 6(1).

[54] *CIT* v. *O. Abdul Razak* (2011) 337 ITR 267b (Ker).

India[55], if the purpose of leaving the country is employment outside the country which includes self-employment.

The criteria to ascertain residential status of individuals for tax purposes has gradually evolved over the years. The requirement of stay in India for Indians living abroad and visiting India was initially 60 days of stay in the relevant previous year in addition to an aggregate stay of 365 days in four previous years before that year, which period was increased from 60 days to 90 days[56] to 150 days[57], and eventually the requirement was modified to a stay amounting to 182 days or more in the relevant year to become a tax resident in India.[58] The change was introduced because the periods of 60 days or 90 days were too short for non-resident Indians who had any business or investment in India to supervise the same.[59]

Prior to 1983, there was another criteria to classify an individual as a tax resident in India, i.e. if an individual maintained or caused to be maintained a dwelling place in India for a period of 182 days or more and stayed in India for 30 days or more in the relevant previous year, it would classify as a tax resident in India.[60] The dwelling place should be at the disposal of the assessee, and it is not sufficient if his friends or family occupy it or have control over it.[61] This was later removed as a criteria to determine residential status due to the hardships faced by individuals.[62]

2.2.2 Ordinary or Not-Ordinary Resident:

If an individual is classified as an 'Resident' after fulfilling any of the basic conditions of stay, the next step is to determine if such Resident is an ordinary resident or not-ordinary resident. Two additional conditions are

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[55] *British Gas India P. Ltd. In re*, 285 ITR 218 (AAR).

[56] The Finance Act, 1982, S. 3.

[57] The Direct Tax Laws (Second Amendment) Act,1989.

[58] The Finance Act, 1994, S. 5.

[59] K. Chaturvedi and S.M. Pithisaria, INCOME TAX LAW 981 (2020).

[60] *Supra*, note 3 at S. 6(1)(b).

[61] *S.M. Zackariah Sahib* v. *CIT* (1952) 22 ITR 359.

[62] *Supra, note* 56.

laid down under the 1961 Act to be treated as a "Resident and ordinary resident" in India, which are as follows,
(a) The individual should have classified as a resident for tax purposes in minimum 2 previous years out of the 10 previous years immediately before the relevant previous year, and
(b) The individual should have spent at least a total period of 730 days in India in the 7 years immediately prior to the relevant previous year.[63]

An individual who does not fulfill both or fulfills only one of the additional conditions, is classified as a 'not-ordinary resident' only. Furthermore, the Finance Act of 2020 has added two new categories of 'not ordinary resident' assesses, which includes,

(a) A citizen of India or person of the Indian origin who fulfills two conditions. Firstly, its total income from India should exceed rupees 15 lakhs, and secondly, it should have stayed in India for a minimum of 120 days in the relevant previous year in addition to at least 365 days in the four previous years prior to that year.[64]
(c) A citizen of India whose total income from India exceeds rupees 15 lakhs in the previous year, and such person is not liable to pay tax in any country around the globe based on either its domicile, residence, or any other eligibility criteria for taxation.[65]

Hence, with the introduction of this amendment, the law has introduced a new basis of taxation of individuals in India i.e. citizenship-based taxation.

2.2.3 Computation of period of stay in India:

The period of stay in India is computed in accordance with the underlying principles,

a) In India, tax is paid for income that is earned in a financial year (i.e. period starting from 1 April to 31 March). Residential status for all

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[63] *Supra,* note 3 at S. 6(6).
[64] The Income Tax Act, 1961, Expl. 1 (b) to S. 6(6) added by The Finance Act, 2020 (Act 12 of 2020), S. 4(a).
[65] *Supra,* note 4.

sources of income is determined for the previous year, and not with respect to the assessment year.[66] Previous year is the financial year in which income earned is to be assessed for taxation. The income earned in the previous year is charged to tax in the immediately following financial year called the assessment year. So, the relevant year in which stay of a person must be counted is the previous year.

b) The residential status of an assessee is ascertained for each financial year. An assessee has the same residential status for all the sources of income.[67] The position was different as per the 1922 Act, under which an assessee could have different residential status for different sources of income.[68] In *CIT* v. *Savumiamurthy*[69], the High Court of Madras had held that the residential status has to be determined separately for each source of income. This raised the burden on the income tax department, and thus to make tax administration simpler and effective, Section 6 Clause (5) was included in the 1961 Act.

c) It is not essential that the individual lives at the same place in India during the entire period of its stay. So, the person may live at different locations during its stay in the country. In the English case of *Levene* v. *IR*[70], it was observed that, "a complete wanderer, an absolute tramp, or a rich person of the same type wandering from hotel to hotel and never staying two nights in the same place, may still be a resident here although he cannot be called a resident in any particular spot."

d) Continuous stay in India is not necessary, if the cumulative period of stay is above the required threshold. Also, the place and motive of stay is not important.

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[66] *Wallace Bros. & Co. Ltd.* v. *CIT* ((1948) 50 BOMLR 482).

[67] *Supra,* note 3 at S. 6(5).

[68] *CIT* v. *Savumiamurthy* (1946) 14 ITR 185 (Mad); *Girdharlal Ghelabhai* v. *CIT* (1964) 53 ITR 23 (Guj).

[69] *Id.*

[70] *Levene* v. *IR* 13 TC 486, 492.

e) A person residing within the geographical territories, or on the territorial waters of India is considered to be physically present in India.[71]

f) Day of arrival and departure from India is counted while calculating the total period of stay.

g) Stay may be voluntary or compelled. For instance, due to exigencies of business, a person might have to stay in India longer than anticipated, and such period of stay is still considered for computation of the total period of stay. However, in some situations compelled stay has to be excluded, like, where passport of a person was impounded[72]. During the Covid-19 pandemic, people were stranded in unexpected places due to the lockdown. Since, such a situation was beyond the control of individuals, governments across the globe including the Indian government offered relief to people stranded in their country. [73]

It is for the Income Tax department to prove that an individual was in India for the required period in a financial year to qualify as a tax resident liable to taxation in India.[74] The Income Tax Department comes under the supervision of Central Board of Direct Taxes (CBDT) which is the statutory authority in India which deals with matters relating to levying and collection of direct taxes. Direct taxes are defined as taxes which are directly paid by the person on whom they are imposed i.e. they are charged on and collected from the same person.[75] Income tax is a type of direct tax as it is imposed on the income earned by a person from various sources and collected from the same person. Income tax is governed in India by the Income Tax Act, 1961 supplemented by the Income Tax Rules, 1962[76]. All individuals earning income above the basic exemption limit are

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[71] Arvind P Datar (ed.), *Kanga & Palkhivala's* THE LAW AND PRACTICE OF INCOME TAX 357 (2020).

[72] *Id.* at 358.

[73] Circular No. 2 of 2021, *Residential status of certain individuals under Income Tax Act, 1961* (CBDT, DoR, MoF, GoI 3 Mar. 2021).

[74] *CIT* v. *B.K. Dhote* (1967) 66 ITR 457 (SC) (India); *Moosa S. Madha & Azam S. Madha* v. *CIT* (1973) 89 ITR 65 (SC) (India).

[75] V.S. Datey, CUSTOMS LAW PRACTICE & PROCEDURE 3 (2013).

[76] Income Tax Rules, 1962 enacted vide S. 295 of The Income Tax Act, 1961.

required to file tax return[77] in the assessment year by submitting the required ITR form and other relevant documents with the Income Tax Department by the 31st day of July.[78]

2.2.4 Citizenship based taxation in India:

India uses a mix of residence and source-based taxation to tax individuals. The Finance Act, 2020 has introduced limited application of 'Citizenship based taxation' in India. Citizenship based taxation allows a State to impose tax on an individual by virtue of him/her being a citizen of that State. The recent adoption of partial 'citizenship-based taxation' is an attempt to widen the tax base of India and prevent tax avoidance and evasion. Clause (1A) added to Section 6 of the 1961 Act, provides that,

> *"Notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature."*[79]

The objective behind introducing the provision is to tax 'high net worth individuals' (HNWI), who earn substantial income from India but tend to arrange their activities in a way that they are able to avoid paying taxes to the Indian government. As explained in the Memorandum to Finance Bill, 2020:*"The issue of stateless persons has been bothering the tax world for quite some time. It is entirely possible for an individual to arrange his affairs in such a fashion that he is not liable to tax in any country or jurisdiction during a year. This arrangement is typically employed by high-net-worth individuals (HNWI) to avoid paying taxes to any country/ jurisdiction on income they earn."*[80]

[77] *Supra,* note 3 at S. 139(2).
[78] *Id*. at Expl. 2 to S. 139.
[79] *Supra,* note 4.
[80] Paragraph H. Preventing Tax Abuse, Memorandum to the Finance Bill, 2020.

For instance, a person might live for 50 days or less each in eight different countries during a year, fulfilling physical presence test in none of those countries, and eventually not paying taxes at all. Double non-taxation is as serious an issue as double-taxation of income. Thus, the objective behind introduction of deemed residence concept was to tax Stateless individuals earning huge profits from India but paying taxes nowhere in the world. However, a person who is covered under Section 6(1A) is classified as only a "Resident and Not Ordinary Resident".[81] So, such an individual is under an obligation to pay tax on its Indian income and foreign income earned from a business or profession situated and managed from India, but not any other income from foreign sources. It would be fairly easy to escape such provision by HNWIs by engaging in sophisticated tax planning by deriving income through a foreign business not set up in India. It is to be noted here that, all individuals earning income from India whether resident or non-resident, are obligated by law to pay tax in India on such Indian source income. So, the amendment is unnecessary as treating deemed residents as 'not ordinary residents' does not achieve much in increasing the tax revenue of the government. On the other hand, identification and determination of income of such individuals would increase the administrative burden on the income tax department.[82]

III

Comparison of Taxation of individuals in India and U.S.

India is a developing nation, whereas USA is one of the most developed countries of the world. Both countries levy tax on income earned by individuals to generate revenue for executing its functions. India introduced income tax in the year 1860 to cover the losses suffered by the

[81] *Supra,* note 3 at S. 6(6)(d).

[82] Finance Act, 2020 - Changes affecting NRI *available at* https://www.rashminsanghvi.com/articles/taxation/budget/Long-Version-Finance-Act-changes-affecting-NRIs.html (last visited May 26, 2023).

government in military mutiny of 1857[83]. The U.S. also introduced income taxes around the same time in 1861 to meet the financial needs of the government during civil war.[84] In India, the power to impose income tax lies with the Central Government. On the other hand, in the U.S. both the Central as well as the State governments have been authorized to levy taxes on income. However, initially the federal government of U.S. did not have the authority to impose and collect income taxes, and this power was incorporated in 1913 in the U.S. Constitution.[85]

Though, income tax is imposed on individuals in U.S. as well as India, but the basis of taxation followed in both nations is different. In India, individuals are taxed based on their residential status. Whereas the U.S. taxes individuals on the basis of their citizenship or residential status. However, India has also introduced limited application of citizenship taxation in the year 2020. In the United States, a U.S. citizen has to pay tax on its worldwide income irrespective of the number of days it spends there, or even if it is altogether absent from there in the entire year. The concept of 'deemed resident' determined on basis of citizenship introduced in Indian income tax law is however different and less harsher than the U.S. system of taxation. The aim of the amendment is not to tax all Indian citizens, but only high net worth individuals earning huge income from India. Thus, citizenship alone is not sufficient to justify taxation in India, and only individuals earning income above a certain threshold are to be considered for purpose of taxation. Further, such individuals are not required to pay taxes on their worldwide income in India, but only income that is earned in India, or from outside income but which is derived from a business or profession situated in the Indian territory.

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[83] TAXGURU, *History and evolution of Income Tax Act in India (*Aug. 9, 2020) *available at* - https://taxguru.in/income-tax/history-evolution-income-tax-act-india.html (last visited May 26, 2022).

[84] NATIONAL ARCHIEVES*available at*https://www.archives.gov/milestone-documents/16th-amendment#:~:text=The%20financial%20requirements%20of%20the,the%20concept%20did%20not%20disappear (last visited May 26, 2022).

[85] *Supra*, note 7.

As far as Resident based taxation is concerned, it is more relaxed in U.S. than in India. The period of physical presence required under the Indian law is more than that required in the U.S. to establish significant presence in the country. Based on the number of days spent in India, individuals are divided into three taxable categories, Resident and Ordinary Resident (ROR), Resident and Not Ordinary Resident (RNOR), and Non Resident (NR). On the other hand, in the U.S., individuals are divided into two categories 'U.S. persons' or 'Resident' and 'foreign persons' or 'Non-Resident Aliens'. Residents include U.S. citizens, green card holders, and persons fulfilling physical presence test in U.S. All other individuals earning income from U.S. are Non-Residents.
In India, Resident and Ordinary Resident (ROR) pay tax on their worldwide income, Resident and Not Ordinary Resident (RNOR) pay tax on their Indian income as well as foreign income earned from business or profession situated in India, and Non-Resident (NR) pay tax only on their Indian income. In U.S., Resident are taxable for their entire global income, and Non-resident are taxable for their U.S. source income only.

While primarily India follows a residence-based model of taxation, the U.S. follows a citizenship-based model of taxation for individuals. Both models of taxation provide for similar taxation of domestic income in hands of all individuals, and the real difference lies in the tax treatment of foreign income in hands of different individuals. While, residence-based model exempts taxation of foreign income in hands of individuals who do not fulfill the physical presence criteria, the citizenship model taxes citizens on their foreign income even if they live abroad for that entire year.[86] For example, if an Indian citizen lives for a whole financial year in U.S. and earns its entire income from U.S., Indian government would have no power to impose any tax on such income. However, if a U.S. citizen lives for an entire calendar year in India, and earns its entire income from India, the U.S. government would have power to tax it.

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[86] *Supra*, note 13, Ruth Mason, at 181.

Apart from basis of taxation and scope of taxable income of individuals, various administrative differences exist between the tax regimes of India and U.S. For instance, in India, all individuals must file their tax returns separately with the Income Tax department by the 31st of July every year. On the other hand, in U.S., individuals can have five different filing status as per their marital status and responsibilities. Such individuals must file their tax returns with the Internal Revenue Services by the 15th of April of every year. The differences between system of taxation of individuals in India and U.S. are summarized below:

BASIS	**INDIA**	**U.S.A**
Power to levy income tax	Central government	Federal and State government
Administrative Body	Central Board of Direct Taxation (CBDT)	Internal Revenue Service (IRS)
Governing Act	Income Tax Act, 1961	Internal Revenue Code, 1986
Basis of taxation	Residence and Source Basis	Residence, Source, and Citizenship basis
Scope of taxable income	ROR- Worldwide income RNOR- Indian income, and foreign income earned from a business or profession controlled or situated in India NR- Indian source income	Resident- Worldwide income Non-Resident alien- U.S. source income
Taxable Year	Financial year (1 April- 31 March)	Calendar year (1 January- 31 December)

Tax filing status	Every individual separately files his or her income tax return in India.	In U.S., individuals have the option to file tax return as: • Single • Married filing jointly • Married filing separately • Head of households • Qualifying Widow(er)
Tax Return Form	ITR-1	Form 1040
Tax Filing date	31st July	15th April extendable up to 15th October.

IV

Conclusion

Taxation of individuals is essential to generate revenue for the government, which is used by the government to carry out expenditure for the welfare of individuals and overall development of the nation. Both India and U.S. levy taxes on income of individuals. In India only the Central government has been conferred with the power to impose income tax. On the other hand, both federal and state governments in U.S. have the authority to charge and collect income tax from individuals. India primarily follows resident basis of taxation, whereas U.S. follows citizenship basis of taxation. The residential status of individuals in India is determined in accordance with the number of days they spend in the country in a financial year. In US, citizenship status or period of presence in U.S. is used to ascertain the tax status of an individual during a calendar year. There are several differences in the administration and implementation of income tax in both nations.

The citizenship model of taxation used in the United States is criticized for being unfair, unreasonable, burdensome and arbitrary in nature. India has also adopted partial citizenship-based taxation for high-net-worth

individuals *vide.* Finance Act, 2020. On the one hand citizenship-based taxation might help in increasing government's tax revenue, but the costs of such taxation for the government are much higher. It is also to be noted that non-residents are already under an obligation to pay taxes to the Indian government on their Indian source income. So, considering high net worth individuals who are citizens of India, as not ordinary residence would not contribute much to the government treasury. Rather, the costs involved in collection of information about such individuals might be much higher to outdo any benefit that might accrue from such taxation. Hence, the move towards citizenship-based taxation in India is not based on principle of equity, fairness and needs to be reviewed by the Parliament urgently.