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International Tax

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CBDT notifies US, UK, and Canada as "notified countries" under section 89A, provides for manner of taxability of income from retirement benefit accounts

Snapshot

Taxability of income arising by way of retirement benefits accrued in funds maintained in foreign jurisdiction were being taxed in India on accrual basis in absence of any specific statutory provision providing for taxability on receipt / withdrawal basis. This resulted in timing mismatch in offering the income to tax in India (accrual basis) and the foreign jurisdiction (withdrawal basis). In order to provide relief from genuine hardships resulting from possible double taxation, Central Government had amended the provisions of the Act by inserting a new section (section 89A) providing for taxability of withdrawal in certain cases. However, certain parameters were not notified.

Recently, the US, the UK and Canada have been notified as the "*notified countries*" and rules have been prescribed to determine the taxability of such income on withdrawal basis which provide for an option to be exercised by a resident desirous of offering such income to tax in the year of withdrawal. These notifications provide clarity regarding the provisions of section 89A and more importantly will benefit taxpayers who had been contributing to retirement accounts in the "*notified countries*" by eliminating timing mismatch and possible double taxation.

Background

In the era of global mobility, workforce is deployed from one country to another for various purposes. Multinational corporations are deploying their workforce outside India to perform official duty either on a long-term or a short-term basis.

Generally, in case of long-term projects, workforce stay outside India for a long time, and they may become non-residents of India or residents of the foreign jurisdiction during such time. During their stay in foreign jurisdiction, employer and / or employee may have to contribute certain amount to the retirement funds, as per the requirement of local laws of foreign jurisdiction. On completion of projects, workforce may decide to come back to their home country (India) and may become residents of India.

Income accumulated in the Indian retirement fund such as PF, PPF, etc. are typically taxed in the year of withdrawal or maturity and not in the year of accrual. However, in absence of any specific provision in the Indian tax law dealing with taxability of income arising in retirement funds maintained in foreign jurisdiction, difficulties arose on taxability of annual accretions in such foreign retirement funds and timing of taxability. This also challenged the claiming of foreign tax credit in India due to mismatch in timing of taxability of such income.

Earlier, CBDT had issued a circular¹, wherein it was held that pension income earned and received

abroad will not be chargeable to tax in India if the residential status of the pensioner is either 'non-resident' or 'resident but not ordinarily resident'. It will be chargeable to tax if the residential status is 'resident and ordinarily resident'.

Various representations were received by the Central Government in relation to mismatch in year of taxability of withdrawal of retirement funds in the hands of residents, who had opened such funds when they were non-residents of India and residents of foreign jurisdiction.

As per the provisions of the Income-tax Act, 1961 ('the Act'), a person who is ordinarily resident of India, global income arising, or accruing is getting taxed in India on an accrual basis. However, retirements funds maintained in a foreign jurisdiction may be taxed on receipt / withdrawal basis in such foreign jurisdictions (for e.g., Canada Pension Plan, Quebec pension plan, UK State Pension etc.). This creates a mismatch in timing of taxation of such retirement funds in India and foreign jurisdiction.

To provide relief and to remove genuine hardships, Central Government had come up with the new provision (section 89A) in the Act, vide Finance Act, 2021. The said amendment was brought in for addressing the mismatch in taxation of income arising from notified foreign retirement fund.

Relevant provisions

Section 89A of the Act provides that where a *specified person has income accrued in a specified account*, such income shall be taxed in such manner as may be prescribed.

Meaning of the terms used in section:

Notified country means a "country as may be notified by the Central Government in the Official Gazette for the purposes of this section."

Specified account means "an account maintained in a notified country by the specified person in respect of *his retirement benefits and the income from such account is not taxable on accrual basis but is taxed by such country at the time of withdrawal or redemption.*"

Specified person means a *person resident in India* who opened a specified account in a notified country while *being non-resident in India and resident in that country.*

Notification 25 of 2022 dated 04 April 2022

In exercise of powers conferred under section 89A of the Act, CBDT has notified three countries namely Canada, UK, and USA as "notified country".

Notification 24 of 2022 dated 04 April 2022

In exercise of powers conferred under section 89A read with section 295 of the Act, CBDT has notified Rule 21AAA to provide manner of taxation of income arising from retirement funds maintained in a notified country.

Important points:

- The rule is applicable in case where a specified person has income accrued in a specified account, during the previous year relevant to assessment year beginning on or after 01 April 2022. In such case, at the option of the specified person, such income shall be included in the total income of the specified person, in the year of redemption or withdrawal of retirement funds.

¹ Circular: No. 4 [F. No. 73A/2/69-IT(A-II)], dated 20-2-1969

- In case the option given under this Rule is exercised by the specified person, then, while computing the total income of such person for the year of redemption / withdrawal, following shall not be considered:
 - Income which has already been included in the total income in any of the earlier assessment years during which such income was accrued and tax thereon has been paid as per the provisions of the Act;
 - Income which was not taxable in India in the previous year during which such income was accrued due to following reasons:
 - Specified person was non-resident or resident but not ordinary resident during such previous year as per section 6 of the Act; or
 - Application of Double Taxation Avoidance Agreement.

In above case, foreign tax paid on such income shall be ignored for the purpose of computation of foreign tax credit under Rule 128 of the Rules.
- The option given under this rule shall apply in respect of all the specified accounts maintained by specified person.

Subsequent change in residential status

- It is further provided that where the specified person becomes a non-resident during any subsequent year (such year being referred to as 'relevant previous year'), following consequences shall arise:
 - it will be presumed that option given under this rule was deemed to have never been exercised with effect from the relevant previous year; and

- income accrued in the specified account during the period, **beginning with the previous year** in respect of which option under this rule was exercised and ending with the previous year, **immediately preceding to the relevant previous year**, shall be taxable during the previous year immediately preceding the relevant previous year and tax shall be paid on or before the due date of furnishing the return of income of the relevant previous year.

Example

Mr. X (resident individual) has exercised the option given under this rule from previous year 2021-22. Assuming Mr. X becomes a non-resident in previous year 2027-28.

In the above case, income accrued in specified account for the period beginning from previous year 2021-22 and ending with previous year 2026-27, shall be taxable in previous year 2026-27. Tax in respect of such income is also required to be paid on or before due date of filing return of income of previous year 2027-28.

Our remarks

One interesting aspect to consider here that though income is taxable in the previous year 2026-27, corresponding tax is required to be paid on or before the due date of filing return of income of the previous year 2027-28. It means, one year deferral has been granted for making payment of tax. However, no clarity has been provided for in the Rule casting an obligation on the specified person to file a return of income for relevant previous year for reporting above income and payment of tax thereon.

Year of taxability - Different Scenarios

Considering that applicability of Rule 21AAA requires the residential status of the individual to be a Resident and under an assumption that the option is exercised by a taxpayer, taxability in different scenarios could be summarized as under:

Scenario	Residential Status			Year of Taxability
	Year of Accrual	Any intermittent Year	Year of Withdrawal	
I	Resident	Resident	Resident	Year of withdrawal
II	Resident	Non-Resident	Resident	Year preceding year of becoming Non-resident. No clarity on income that accrues subsequent to the year of becoming a non-resident.
III	Resident	Resident	Non-Resident	Year preceding year of becoming Non-resident
IV	Resident	Non-Resident	Non-Resident	Year preceding year of becoming Non-resident for the first time

Exercise of Option

The option under this rule can be exercised by filing electronic form (Form 10 – EE), on or before the due date of filing the return of income. Option once exercised under this rule shall continue to be applicable for subsequent assessment years and cannot be withdrawn, except in a case where specified person became non-resident during the previous year (discussed earlier).

Form 10-EE - Important points

Form 10 – EE is an exhaustive form and seeks the following details:

- Details of specified account maintained by specified person (along with copy of statement of specified account)
- Balance in retirement fund / accounts as on the last date of the previous year immediately prior to previous year in which option is exercised (along with copy of statement of specified account)
- Methodology on how income from specified person is taxable in notified country (whether accrual or cash or other method) (along with documentary evidence to show how income from specified account is taxable in notified country like relevant statutory provision or any other document)
- Year in which income accrued in specified account can be withdrawn
- Nature of income (whether salary, interest, dividend or others)
- Details of income already included in total income of earlier previous years (along with computation of income of all previous years where such income was offered to tax and reconciliation statement between computation of income and return of income)

- Details of income not included in the total income of any previous year due to residential status of specified person or application of DTAA provisions. In such case, details of return of income filed in respect of such years are also required to be furnished
 - Details of option being exercised under this rule (**Yes / No**)
- ✓ Form ITR notified by CBDT for AY 2022-23 specifically provides for disclosure of details in respect of income covered under section 89A (one may refer to Schedule S and Schedule OS).
 - ✓ These provisions would be relevant for a large number of taxpayers. It is important that in order to avail the relief provided under this section, Form 10-EE is filed electronically on or before the due date of filing the return of income for AY 2022-23. It is also important to maintain robust documentation and tracking of information in relation to income earned in specified account.

Key takeaways

- ✓ Section 89A and Rule 21AAA are intended to provide relief to an Indian resident, against differential tax treatment of retirement funds maintained in foreign jurisdiction
- ✓ CBDT has currently notified three countries viz. UK, USA and Canada for the purpose of section 89A of the Act. It is expected the going forward, other countries may also get notified
- ✓ Form 10 – EE requires details of income from retirement fund / account which has already been offered to tax in the earlier years
- ✓ The Rule provides for deemed withdrawal of option in case person becomes non-resident during the relevant previous year. In such case, no clarity has been provided on eligibility of such person to exercise option under this rule in case such non-resident person again becomes a resident of India
- ✓ Form 10 – EE requires providing a response in **Yes or No** in relation to exercising of option under this Rule. A possible interpretation is that filing of Form is mandatory even in cases where the option is not exercised. However, such interpretation seems to be going against the intent of the provision that requires filing of the form only when the option is to be exercised.

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For further analysis and discussion, you may please reach out to us.

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