

INVESTMENT BY NON-RESIDENT INDIVIDUALS IN INDIAN NON-DEBT SECURITIES – PERMISSIBILITY UNDER FEMA, TAXATION AND REPATRIATION ISSUES

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EDITOR'S NOTE ON NRI SERIES:

This is the 10th article in the ongoing NRI Series dealing with “Investment in Non-Debt Securities – Permissibility under FEMA. Taxation and Repatriation Issues”. This article attempts to cover an overview of investments in non-debt securities that can be made by an NRI / OCI under repatriation and non-repatriation route, the nuances thereof, and issues relating to repatriation. It also covers the tax implications related to income arising out of investment in Indian non-debt securities and the issues relating to repatriation of insurance proceeds, profits from Limited Liability Partnership (“LLP”), and formation of trust by Indian residents for the benefit of NRIs / OCIs.

Readers may refer to earlier issues of BCAJ covering various aspects of this Series: (1) NRI – Interplay of Tax and FEMA Issues – Residence of Individuals under the Income-tax Act – December 2023; (2) Residential Status of Individuals – Interplay with Tax Treaty – January 2024; (3) Decoding Residential Status under FEMA – March 2023; (4) Immovable Property Transactions: Direct Tax and FEMA issues for NRIs – April 2024; (5) Emigrating Residents and Returning NRIs Part I – June 2024; (6) Emigrating Residents and Returning NRIs Part II – August 2024; (7) Bank Accounts and Repatriation Facilities for Non-Residents – October 2024; (8) Gifts and Loans – By and To Non Resident Indians Part I – November 2024; and (9) Gifts and Loans – By and To Non Resident Part -II – December 2024.

1. INTRODUCTION

A person resident outside India may hold investment in shares or securities of an Indian entity either as Foreign Direct Investment (“FDI”) or as a Foreign Portfolio Investor (“FPI”). While NRIs can make portfolio investments in permitted listed securities in India through a custodian, one of the important routes by which a Non-resident individual can invest is through the FDI Route. Individuals can invest directly or through an overseas entity under this route.

Since 1991, India has been increasingly open to FDI, bringing about time-to-time relaxations in several key economic sectors. FDI has been a major non-debt financial resource for India’s economic development. India has been an attractive destination for foreign investors because of its vast market and burgeoning economy. However, investing in shares and securities

in India requires a clear understanding of the regulatory framework, particularly the Foreign Exchange Management Act, 1999 (“FEMA”) regulations. This article highlights the income tax implications and regulatory framework governing FDI in shares and securities in India and repatriation issues.

2. REGULATORY ASPECTS OF NON-RESIDENTS INVESTING IN INDIA

FDI is the investment by persons resident outside India in an Indian company (i.e., in an unlisted company or in 10 per cent or more of the post-issue paid-up equity capital on a fully diluted basis of a listed Indian

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#Investment in debt securities and sector specific conditionality are covered under separate articles of the series.

company) or in an Indian LLP. Investments in Indian companies by non-resident entities and individuals are governed by the terms of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("NDI Rules"). With the introduction of NDI Rules, the power to regulate equity investments in India has now been transferred to the Ministry of Finance from the central bank, i.e., the Reserve Bank of India ("RBI"). However, the power to regulate the modes of payment and monitor the reporting for these transactions continues to be with RBI. Investments in Indian non-debt securities can be made either under repatriation mode or non-repatriation mode. It is discussed in detail in the ensuing paragraph. Securities which are required to be held in a dematerialised form are held in the NRE demat account if they are invested/acquired under repatriable mode and are held in the NRO demat account if they are invested/acquired in a non-repatriable mode.

3.INVESTMENT IN NON-DEBT SECURITIES, REPATRIATION AVENUES AND ISSUES

3.1. Indian investments through repatriation route

Schedule 1 of NDI Rules permits any non-resident investor, including an NRI / OCI, to invest in the capital instruments of Indian companies on a repatriation basis, subject to the sectoral cap and certain terms and conditions as prescribed under Schedule 1. Such capital instruments include equity shares, fully convertible and mandatorily convertible debentures, fully convertible and mandatorily convertible preference shares of an Indian company, etc. Further, there will be reporting compliances as prescribed by the RBI by Indian investee entities, by resident buyers/sellers in case of transfer of shares and securities, and by non-residents in some cases, such as the sale of shares on the stock market. A non-resident investor who has made investments in India on a repatriable basis can remit full sale proceeds abroad without any limit. The current income, like dividends, remains freely repatriable under this route.

Essential to note that if a non-resident investor who has invested on a repatriation basis returns to India and becomes a resident, the resultant situation is that a "person resident in India" is holding an Indian investment. Consequently, the repatriable character of such investment is lost. As such, all investments held by a non-resident on a repatriable basis become non-

repatriable from the day such non-resident qualifies as a "person resident in India"; and the regulations applicable to residents with respect to remittance of such funds abroad shall apply. When a non-resident holding an investment in an Indian entity on a repatriable basis qualifies as a "person resident in India", he should intimate it to the Indian investee entity, and the entity should record the shareholding of such person as domestic investment and not foreign investment. Subsequently, the Indian investee entity needs to get the Entity Master File (EMF) updated for changes in the residential status of its investors through the AD bank.

If the investment by a non-resident in Indian shares or securities is made on a repatriable basis, albeit not directly but through a foreign entity, any subsequent change in the residential status of such person should not have any impact or reporting requirement on the resultant structure. In this case, an Indian resident now owns a foreign entity which has invested in India on a repatriable basis. Consequently, such investment shall continue to be held on a repatriable basis and dividend and sale proceeds thereon can be freely repatriated outside India by such foreign entity without any limit. Had the NRI or OCI directly held Indian shares and subsequently become resident, the repatriable character would have been lost, as highlighted above.

3.2. Indian investments through non-repatriation route

NRIs / OCIs are permitted to invest in India on a non-repatriable basis as per Schedule IV of NDI Rules (subject to prohibitions and conditions under Schedule IV). Such investment is treated on par with domestic investments, and as such, no reporting requirements are applicable. Essential to note that Schedule IV restricts its applicability specifically only to NRIs and OCI cardholders (referred to as OCIs hereon). Also, the definition of NRI and OCI, as provided under NDI Rules, does not include a 'person of Indian origin' ("PIO") unless such person holds an OCI Card. As such, it may be considered that a PIO should not be eligible to invest in Indian shares or securities on a non-repatriable basis as per Schedule IV unless such a person is an OCI Cardholder. Permissible investment for NRIs / OCIs under Schedule IV includes investments in equity instruments, units of an investment vehicle, capital of LLP, convertible notes issued by a startup, and capital contribution in a firm or proprietary concern.

In case such NRIs / OCIs relocate to India and qualify as “person resident in India,” there is no change in the character of holding their investment. This is because such investment was always treated at par with domestic investment without any reporting requirement. Additionally, there is no requirement even for an Indian investee entity regarding the change in the residential status of such shareholders if the investment is on a non-repatriation basis. However, under the Companies Act 2013, the Indian company has to disclose various categories of investors in its annual return in Form MGT, including NRIs. It does not matter whether holding is repatriable or non-repatriable. Hence, for this purpose, the Indian company should change its record appropriately.

Typically, the Indian investee entity should collate the details of the residential status of the person along with a declaration from such investor that the investment is made on a non-repatriable basis. It is mandatory that a formal record is kept even by the Indian investee entity where an NRI / OCI, holding shares on a non-repatriable basis, transfers it by way of gift to another NRI / OCI, who shall hold it on a non-repatriable basis. In such cases, a simple declaration by the transferee to the Indian investee entity may suffice, providing that the shares have been gifted to another NRI / OCI, and such transferee shall hold investment on a non-repatriable basis.

Investment under the non-repatriation route at times is less cumbersome, not only for an NRI / OCI investor, but also for the Indian investee entity as well, considering it saves a great amount of time and effort as there is no reporting compliances, no need for valuation, etc. This route has also benefited the Indian economy, as the NRIs / OCIs have been using the monies in their Indian bank accounts to invest in Indian assets (equity instruments, debt instruments, real estate, mutual funds, etc.) instead of repatriating them out of India. Such investments on a non-repatriable basis are typically made via NRO accounts by NRIs and OCIs. RBI has introduced the USD Million scheme under which proceeds of such non-repatriable investments can be remitted outside India per financial year. The prescribed limit of USD 1 Million per financial year per NRI / OCI is not allowed to be exceeded. In case a higher amount is required to be remitted, approval shall be required from RBI. Basis practical experience, such approvals are given in very few / rare cases by RBI based on facts. However,

any remittance of dividend and interest income from shares and securities credited to the NRO account will be freely allowed to be repatriated, being regarded as current income, and shall not be subject to the aforesaid USD 1 Million limit.

The repatriation by NRI / OCI from the NRO account to their NRE / foreign bank account does not contain any income element and, accordingly, should not be chargeable to tax in India. Thus, there should not be any requirement for filing both Form 15CA and Form 15CB. However, certain Authorised Dealer banks insist on furnishing Form 15CA along with Form 15CB along with a certificate from a Chartered Accountant in relation to the source of funds from which remittance is sought to be made. In such case, time and effort would be incurred for reporting in both Form 15CA and Form 15CB, along with attestation from a Chartered Accountant who would analyse the source of funds for issuing the requisite certificate.

It is essential to note that any gift of shares or securities of an Indian company by an NRI / OCI, who invested under schedule IV on a non-repatriation basis, to a person resident outside India, who shall hold such securities on a repatriation basis, shall require prior RBI approval. On the other hand, if the transferee non-resident continues to hold such securities on a non-repatriation basis (instead of holding it on a repatriation basis), no such approval shall be required.

Schedule IV also permits any foreign entity owned and controlled by NRI / OCI to invest in Indian shares/ securities on a non-repatriation basis. In such a case, sale proceeds from the sale of securities of the investee Indian company shall be credited to the NRO account of such foreign entity in India. However, any further repatriation from the NRO account by such foreign entity shall require prior RBI approval since the USD 1 Million scheme is restricted to only non-resident individuals (NRIs / OCIs / PIOs) and not their entities.

3.3. Repatriation of Insurance Proceeds

While the compliances/permmissibility to avail various types of insurance policies in and outside India by resident/non-resident individuals is the subject matter of guidelines as per Foreign Exchange Management (Insurance) Regulations, 2015, we have summarised below brief aspects of repatriation of insurance maturity proceeds by a non-resident individual.

The basic rule for settlement of claims on rupee life insurance policies in favour of claimants who is a person resident outside India is that payments in foreign currency will be permitted only in proportion to which the amount of premium has been paid in foreign currency in relation to the total premium payable.

Claims/maturity proceeds/ surrender value in respect of rupee life insurance policies issued to Indian residents outside India for which premiums have been collected on a non-repatriable basis through the NRO account to be paid only by credit to the NRO account. This would also apply in cases of death claims being settled in favour of residents outside India assignees/ nominees.

“Remittance of asset” as per Foreign Exchange Management (Remittance of Assets) Regulations, 2016, inter-alia includes an amount of claim or maturity proceeds of an insurance policy. As per the said regulation, an NRI, OCI, or PIO may remit such proceeds from the NRO account under USD 1 Million scheme. As such, proceeds of such insurance will have to be primarily credited to the NRO account.

Residents outside India who are beneficiaries of insurance claims / maturity / surrender value settled in foreign currency may be permitted to credit the same to the NRE/FCNR account, if they so desire.

Claims/maturity proceeds/ surrender value in respect of rupee policies issued to foreign nationals not permanently resident in India may be paid in rupees or may be allowed to be remitted abroad, if the claimant so desires.

3.4.Repatriation from LLP by non-resident partners

Non-residents are permitted to contribute from their NRE or foreign bank accounts to the capital of an Indian LLP, operating in sectors or activities where foreign investment up to 100 per cent is permitted under the automatic route, and there are no FDI-linked performance conditions.

The share of profits from LLP is tax-free in the hands of its partners in India. Further, such repatriation should typically constitute current income (and hence current account receipts) under FEMA and regulations thereunder. Recently, some Authorised Dealer (AD) banks in India have raised apprehension and have insisted on assessing the nature of underlying profits of Indian LLP to evaluate whether the same comprises current income (interest, dividend,

etc.), business income, or capital account transactions (sale proceeds of shares, securities, immovable property, etc).

In relation to the evaluation of the nature of LLP profits, AD banks have been insisting i furnishing a CA certificate outlining the break-up of such LLP profits, which has to be repatriated to non-resident partners. Where the entire LLP profits comprise current income, it has been permitted to be fully repatriated to foreign bank accounts of non-resident partners. In case such LLP profits comprise of capital account transactions such as profits on the sale of shares, immovable property, etc., some AD banks have practically considered a position to allow such profits to be credited only to the NRO account of non-resident partners. The subsequent repatriation of such profits from the NRO account is permissible up to USD 1 million per financial year, as discussed above. Certain AD banks emphasise that any such share of profit received by a non-resident as a partner of Indian LLPs should be classified as a capital account transaction only and subject to a USD 1 million repatriation limit.

It is essential to note that since dividends are in the nature of current income, there are no restrictions per se for its repatriation from an Indian company to non-resident shareholders, irrespective of whether such dividend income comprises capital transactions such as the sale of shares, immovable property, etc. In such a case, where an Indian company has been converted to LLP, any potential repatriation of profit share from such LLPs will have different treatment from AD banks vis-à-vis company structure. Consequently, though both dividends from the Indian company and the distribution of the share of profits from LLP are essentially the distribution of profits, with respect to repatriation permissibility, they are treated differently. This may lead to discouraging LLPs as preferable holding cum operating vehicles for non-residents.

It may be possible that the aforesaid position was taken by some AD banks to check abuse by NRIs, as has been reported recently in news articles. Thus, the interpretation of repatriation of profit share of LLPs varies from one AD bank to another, thereby indicating that there may not be any fundamental thought process in the absence of regulation for such repatriation or some internal objection / communication from RBI with respect to share of profits from LLP as a holding structure. However, NRI / OCI investors should note the cardinal principle of “What cannot be done directly,

cannot be done indirectly.” Thus, capital account transactions should not be abused by converting them into current account transactions, such as profits whereby they can be freely repatriated without any limit.

3.5. Repatriation from Indian Trusts to Non-resident Beneficiaries

Traditionally, trusts were created for the benefit of family members residing solely in India. However, with globalisation, several family members now relocate overseas, pursuant to which compliance with NDI rules between trusts and such non-resident family members as beneficiaries can become a complex web.

Setting up of family trust with non-resident beneficiaries has been the subject matter of debate, specifically in relation to the appointment of non-resident beneficiaries, settlement of money and assets in trust, subsequent distribution, and repatriation from trusts to non-resident beneficiaries. There are no express provisions under FEMA permitting or restricting transactions related to private family trusts involving non-resident family members. For most of the transactions where non-residents have to be made beneficiaries, it amounts to a capital account transaction. The non-resident acquires a beneficial interest in the Indian Trust. Without an express permissibility for the same under FEMA, this should not be permitted without RBI approval. Further, generally, RBI takes the view that what is not permissible directly under the extant regulations should not be undertaken indirectly through a private trust structure. FEMA imposes various restrictions vis-a-vis transfer or gift of funds or assets to non-residents, as well as repatriation of cash or proceeds on sale of such assets by the non-residents. As such, AD banks and RBI have been apprehensive when such transactions / repatriations are undertaken via trust structures.

If a person resident in India wants to give a gift of securities of an Indian company to his / her non-resident relative (donor and donee to be “relatives” as per section 2(77) of the Companies Act, 2013), approval is required to be taken from RBI as per NDI rules. From the plain reading of the said Regulation, a view may be considered that the said RBI approval is also required in a case where the gift of shares or securities of an Indian company is to his NRI / OCI relative who shall hold it on non-repatriation basis even though such investments are considered at par with domestic investment. The

reason for the said view is NRIs / OCIs holding shares or securities of Indian companies on non-repatriation can gift to NRIs / OCIs who shall continue to hold on non-repatriation without RBI approval. Consequently, since the gift of shares by a person resident in India to a person resident outside India who shall hold it on non-repatriation is not specially covered, it is advisable to seek RBI approval in such cases. Further, up to 5% of the total paid-up capital of shares or securities can be given as gifts per year and limited to a value of \$50,000. This restriction per se affects the settlement of shares and securities by a resident as a Settlor in trust with non-resident beneficiaries (The effect of the transaction is that a non-resident is entitled to ownership of Indian shares or securities via trust structure). However, certain AD banks have considered a practical position that settlement of Indian shares and securities is a transaction per se between Indian settlor and trust and ought not to have any implications under NDI rules as long as trustee/s, being the legal owner of trust assets, are person resident in India. Considering that RBI has apprehensions with cross-border trust structures, it is always advisable to apply to RBI with complete facts before execution of such trust deeds and obtain their prior comprehensive approval for both settling/contribution of assets in the trust as well as subsequent distribution of such assets to non-resident beneficiaries.

The aforesaid uncertainty for settlement of assets in the Indian trust may also occur in another scenario where the trust was initially set up when all beneficiaries were persons resident in India and subsequently became non-resident on account of relocation outside India. In such cases, a practical position may be taken that no RBI approval or threshold limit as specified above shall apply since the trust was settled with resident beneficiaries. Essential to evaluate whether any reporting or intimation is required at the time when such beneficiaries become non-residents. In this regard, a reference may be considered to section 6(5) of FEMA, which permits a person resident in India to continue to hold Indian currency, security, or immovable property situated in India once such person becomes a non-resident. This provision does not seem to specifically cover a beneficial interest in the trust. However, a practical view may be considered that as long as the assets owned by the trust are in nature of assets permissible to be held under section 6(5), there ought not be a violation of any FEMA provisions. Still, on a conservative note, one may consider intimating the AD Bank by way of a letter about the existence of the trust and subsequent changes in the residential status of the respective beneficiaries. Also,

subsequent distribution to non-resident beneficiaries by such trust shall be credited to the NRO account of non-resident beneficiaries (refer to below para for detailed discussion on repatriation issues).

Repatriation of funds generated by such trust from sale of Indian assets viz shares and securities has been another subject matter of debate and there is no uniform stand by AD banks on this issue. Under the LRS, the gift of funds by Indian residents to non-residents abroad or NRO accounts of such NRI relatives is subject to the LRS limit of USD 2,50,000. Consequently, any repatriation of funds from trusts to foreign bank accounts / NRO accounts of non-resident beneficiaries is being permitted by some AD banks only up to the aforesaid LRS limit. Alternatively, a position has been taken that repatriation of funds, which predominantly consist of current income generated by trusts, should be freely permissible to be remitted without any limit, and the remaining shall be subject to LRS. In other cases, the remittance of funds from the trust to the NRO accounts of non-resident beneficiaries is considered permissible to be transferred without any limit (since subsequent repatriation from the NRO account is already subject to USD 1 Million limit per year).

3.6. Tabular summary of our above analysis on the gift of Non-debt Securities and settlement and Repatriation issues through a Trust structure

a. Settlement and repatriation issues through trust structure

Sr. No.	Scenarios	View 1	View 2	View 3
1.	Setting up trust with non-resident beneficiaries			
i.	Settlement of shares and securities in trust by resident settlor	Subject to prior RBI approval and threshold limits	Permissible during settlement - subsequent distribution of shares subject to approval and threshold limit (in case RBI approval is not granted or rejected, there is a possibility that set up of trust may also be questioned)	No third view to our knowledge

ii.	Repatriation of funds generated by a trust from the sale of shares	Subject to LRS limit irrespective of nature of trust income	Only income from capital transactions is subject to the LRS limit.	No limit on remittance to an NRO account, irrespective of the nature of the income
	to a foreign bank account / NRO account of beneficiaries		Current income is freely repatriable to the foreign bank account	
2.	Setting up trust with resident beneficiaries - subsequently, beneficiaries become non-resident.			
i.	Settlement of shares and securities	Settlement permissible and even distribution to be arguably permissible in light of section 6(5)	No second view to our knowledge	-

b. RBI approval under various scenarios of gift of Non-debt Instruments

Sr. No.	Gift of securities	Regulation	RBI approval
1.	By a person resident outside India to a person resident outside India	9(1)	Not required
2.	By a person resident outside India to a person resident in India	9(2)	Not required
3.	By a person resident in India to a person resident outside India	9(4)	Required
4.	By an NRI or OCI holding on a repatriation basis to a person resident outside India	13(1)	Not required
5.	By NRI or OCI holding on a non-repatriation basis to a person resident outside India	13(3)	Required
6.	By NRI or OCI holdings on non-repatriation basis to NRI or OCI on non-repatriation basis	13(4)	Not required

4. TAX IMPLICATIONS FOR NON-RESIDENTS ON INVESTMENT IN INDIA SECURITIES

The taxability of an individual in India in a particular

financial year depends upon his residential status as per the Income-tax Act, 1961 ("the Act"). This section of the article covers taxability in Indian in the hands of NRI in relation to their investment in shares and securities of the Indian company. It should be noted that all incomes earned by an NRI / OCI are allowed to be repatriated only if full and appropriate taxes are paid before such remittance.

We have summarised below the key tax implications in the hands of NRIs under the Act on various shares or securities. For the purpose of this clause, the capital gain rates quoted are for the transfers which have taken place on or after 23rd July, 2024.

5. TAX RATES FOR VARIOUS TYPES OF SECURITIES FOR NON-RESIDENTS

In India, the taxation of shares and securities in the hands of non-residents depends on several factors, including the type of security, the nature of income generated, and the relevant Double Taxation Avoidance Agreement ("DTAA") entered with India.

5.1 Capital Gains on the transfer of Capital Assets being Equity Shares, Units of an Equity Oriented Fund, or Units of Business Trust through the stock exchange ("Capital Assets"):

Short-term capital gain (STCG): If a capital asset is sold within 12 months from the date of purchase, the gains are treated as short-term. As per section 111A of the Act, the tax rate on STCG for non-residents is 20 per cent (plus applicable surcharge and cess) on the gains.

Long-term capital gains (LTCG): If the capital asset is sold after holding it for more than 12 months, the gains are treated as long-term. LTCG on equity shares is exempt from tax up to ₹1.25 lakh per financial year. However, gains above ₹1.25 lakh are subject to 12.5 per cent tax (plus applicable surcharge and cess) without indexation benefit.

5.2 Capital Gains on Transfer of Capital Assets being Unlisted Equity Shares, Unlisted Preference Shares, Unlisted Units of Business Trust:

Short-term capital gains:

If a capital asset is sold within 24 months from the date of purchase, the gains are treated as short-term. As per the provisions of the Act, STCG shall be subject

to tax as per the applicable slab rates (plus applicable surcharge and cess).

Long-term capital gains:

If the capital asset is sold after holding it for more than 24 months, the gains are treated as long-term. LTCG on capital assets is subject to 12.5 per cent tax (plus applicable surcharge and cess) without indexation benefit.

5.3 Capital Gains on Transfer of Capital Asset being Debt Mutual Funds, Market Linked Debentures, Unlisted Bonds, and Unlisted Debentures:

As per the provisions of section 50AA of the Act, gains from the transfer of capital assets shall be deemed to be STCG irrespective of the period of holding of capital assets, and the gains shall be subject to tax as per the applicable slab rates (plus applicable surcharge and cess).

5.4 Capital Gains on Transfer of Capital Assets being Listed Bonds and Debentures:

Short-term capital gains: If a capital asset is sold within 12 months from the date of purchase, the gains are treated as short-term. As per the provisions of the Act, STCG shall be subject to tax as per the applicable slab rates (plus applicable surcharge and cess).

Long-term capital gains: If the capital asset is sold after holding it for more than 12 months, the gains are treated as long-term. LTCG on capital assets is subject to 12.5 per cent tax (plus applicable surcharge and cess) without indexation benefit.

5.5 Capital Gains on Transfer of Capital Assets being Treasury Bills (T-Bills):

T-Bills are typically held for short durations (less than 1 year), so any sale of T-Bills before maturity will result in short-term capital gains. The capital gain from the sale of T-Bills will be subject to tax at the applicable slab rates (plus applicable surcharge and cess).

5.6 Capital Gain on Transfer of Capital Assets being Convertible Notes:

If the convertible note is sold within 24 months, the gain is treated as short-term and taxed at the applicable slab rates (plus applicable surcharge and cess).

If the convertible note is held for more than 24 months, the gain is considered long-term. LTCG on convertible notes is taxed at 12.5 per cent (plus applicable surcharge and cess) without the indexation benefit.

5.7 Capital Gains on Transfer of Capital Assets being GDRs or Bonds Purchased in Foreign Currency:

If capital assets are sold within 24 months, the gain is treated as short-term and shall be taxed at the applicable slab rates (plus applicable surcharge and cess).

If a capital asset is sold after holding for more than 24 months, the gain is treated as long-term. As per the provisions of section 115AC of the Act, LTCG shall be subject to tax at the rate of 12.5 per cent (plus applicable surcharge and cess) in the hands of non-residents without indexation benefit.

5.8 Rule 115A: Rate of Exchange for Conversion of INR to Foreign Currency and vice versa:

The proviso to Section 48 of the Act specifically applies to non-resident Indians. It prescribes the methodology of computation of capital gains arising from the transfer of capital assets, such as shares or debentures of an Indian company. The proviso states that capital gain shall be computed in foreign currency by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer, and the full value of the consideration as a result of the transfer into the same foreign currency that was initially used to purchase the said capital asset. The next step is to convert the foreign currency capital gain into Indian currency.

In this connection, the government has prescribed rule 115A of the Income-tax Rules, 1962 ("the Rules"), which deals with the rate of exchange for converting Indian currency into foreign currency and reconverting foreign currency into Indian currency for the purpose of computing capital gains under the first proviso of section 48. The rate of exchange shall be as follows:

- **For converting the cost of acquisition of the capital asset:** the average of the Telegraphic Transfer Buying Rate (TTBR) and Telegraphic Transfer Selling Rate (TTSR) of the foreign currency initially utilised in the purchase of the said asset, as on the date of its acquisition.

- **For converting expenditure incurred wholly and exclusively in connection with the transfer of the capital asset:** the average of the TTBR and TTSR of the foreign currency initially utilised in the purchase of the said asset, as on the date of transfer of the capital asset.

- **For converting the consideration as a result of the transfer:** the average of the TTBR and TTSR of the foreign currency initially utilised in the purchase of the said asset, as on the date of transfer of the capital asset.

- **For reconverting capital gains computed in the foreign currency into Indian currency:** the TTBR of such currency, as on the date of transfer of the capital asset.

TTBR, in relation to a foreign currency, means the rates of exchange adopted by the State Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer.

TTSR, in relation to a foreign currency, means the rate of exchange adopted by the State Bank of India for selling such currency where such currency is made available by that bank through telegraphic transfer.

5.9 Benefit under relevant DTAA:

It is pertinent to note that the way the article on capital gain is worded under certain DTAA, it can be interpreted that the capital gain on transfer / alienation of property (other than shares and immovable property) should be taxable only in the Country in which the alienator is a resident.

For example, Gains arising to the resident of UAE (as per India UAE DTAA) on the sale of units of mutual funds could be considered as non-taxable as per Article 13(5) of the India UAE DTAA subject to such individual holding Tax Residency Certificate and upon submission of Form 10F.

6. TAXABILITY OF DIVIDENDS

As per section 115A of the Act, dividends paid by Indian companies to non-residents are subject to tax at a rate of 20 per cent (plus applicable surcharge and cess) unless a lower rate is provided under the relevant DTAA. Thus, the dividend income shall be taxable in

India as per provisions of the Act or as per the relevant DTAA, whichever is more beneficial. It is important to note that the beneficial rate under the treaty is subject to the satisfaction of the additional requirement of MLI wherever treaties are impacted because of the signing of MLI by India.

In most of the DTAAs, the relevant Article on dividends has prescribed the beneficial tax rate of dividend (in the country of source – i.e., the country in which the company paying the dividends is a resident) for the beneficial owner (who is a resident of a country other than the country of source).

It is pertinent to note that as per Article 10 on Dividend in India Singapore DTAA, the tax rate on gross dividend paid / payable from an Indian Company derived by a Singapore resident has been prescribed at 10 per cent where the shareholding in a company is at least 25 per cent and 15 per cent in all other cases. However, Article 24 –Limitation of Relief of the India Singapore DTAA, limits / restricts the benefit of reduced/ beneficial rate in the source country to the extent of dividend remitted to or received in the country in which such individual is resident. The relevant extract of Article 24 of India-Singapore DTAA on Limitation of Relief has been reproduced below:

“Where this Agreement provides (with or without other conditions) that income from sources in a Contracting State shall be exempt from tax, or taxed at a reduced rate in that Contracting State and under the laws in force in the other Contracting State the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under this Agreement in the first-mentioned Contracting State shall apply to so much of the income as is remitted to or received in that other Contracting State.”

Therefore, one will have to be mindful and have to look into each case / situation carefully before availing of benefits under DTAA. In order to claim the beneficial tax rate of relevant DTAA with India (which is of utmost importance), non-resident individuals will have to mandatorily furnish the following details / documents:

- Tax Residency Certificate from the relevant authorities of the resident country and
- Form 10F (which is self-declaration — to be now

furnished on the Income-tax e-filing portal).

In case dividend income is chargeable to tax in the source country (after applying DTAA provisions) as well as in the country of residence, resulting in tax in both countries, then an individual (in the country where he is resident) is eligible to claim the credit of taxes paid by him in the country of source.

Practical issue:

One should be careful in filling the ITR Form for NRIs with respect to dividends received so that the correct tax rate of 20 per cent is applied and not the slab rates. Further, the surcharge on the dividend income is restricted to 15 per cent as per Part I of The First Schedule. Practically, the Department utility is capturing a higher surcharge rate (i.e., 25 per cent) if the dividend exceeds ₹2 crores.

Taxability on Buyback of shares

Prior to 1st October, 2024, the buyback of shares of an Indian company is presently subject to tax in the hands of the company at 20 per cent under Section 115QA and exempt in the hands of the shareholders under Section 10(34A).

As per the new provision introduced by the Finance Act, 2024, the sum paid by a domestic company for the purchase of its shares shall be treated as a dividend in the hands of shareholders.

The cost of acquisition of such shares bought back by the Company should be considered as capital loss and shall be allowed to be set off against capital gains of the shareholder for the same year or subsequent years as per the provisions of the Act.

Because of these new provisions introduced by the Finance Act, two heads of income, viz. capital gains and income from other sources, are involved. It becomes important to understand, especially in the case of non-residents, to decide which article of DTAA to be referred, i.e. Capital gains or dividends.

A view could be taken that the article on dividends should be referred and the benefit under relevant DTAA, wherever applicable, shall be given to the non-residents.

7. INSURANCE PROCEEDS

a. Life Insurance Proceeds: As per section 10(10D) of

the Act, any sum received under a life insurance policy, including bonus, is exempt from tax except the following:

- i. Any amount received under a Keyman insurance policy.
- ii. Any sum received under a life insurance policy issued on or after 1st April, 2003 but on or before 31st March, 2012 if the premium payable for any year during the term of the policy exceeds 20 per cent of the actual sum assured.
- iii. Any sum received under a life insurance policy issued on or after 1st April, 2012 if the premium payable for any year during the term of the policy exceeds 10 per cent of the actual sum assured.
- iv. Any sum received under a life insurance policy other than a Unit Linked Insurance Policy (ULIP) issued on or after 1st April, 2023 if the premium payable for any year during the term of the policy exceeds five lakh rupees.
- v. ULIP issued on or after 1st February, 2021 if the amount of premium payable for any of the previous years during the term of such policy exceeds two lakh and fifty thousand rupees.

However, the sum received as per clause ii to v in the event of the death of a person shall not be liable for tax.

Summary of Taxability of Life Insurance Proceeds:

Issuance of Policy	Premium in terms of percentage of sum assured	Taxability of sum received during Lifetime	Taxability of sum received on Death
Before 31 st March, 2003	No restriction	Exempt	Exempt
From 1 st April 2003 to 31 st March, 2012	20% or less	Exempt	Exempt
	More than 20%	Taxable	Exempt
On or After 1 st April, 2012	10% or less	Exempt	Exempt
	More than 10%	Taxable	Exempt
On or after 1 st April, 2023, having a premium of more than ₹ 5 lakh	NA	Taxable	Exempt
ULIP issued on or after 1 st February, 2021, having a premium of more than ₹2.5 lakh	NA	Taxable	Exempt

b. Proceeds from Insurance other than Life Insurance:

Where any person receives during the year any money or other asset under insurance from an insurer on account of the destruction of any asset as a result of a flood, typhoon, hurricane, cyclone, earthquake, other convulsions of nature, riot or civil disturbance, accidental fire or explosion, action by an enemy or action taken in combating an enemy, the same is covered by the provisions of section 45(1A) of the Act.

Any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" as per section 45(1A).

For the purpose of computing the profit or gain, the value of any money or fair market value of other assets on the date of receipt shall be deemed to be consideration. Further, the assessee shall be allowed the deduction of the cost of acquisition of the original asset (other than depreciable assets) from the money or value of the asset received from the insurer.

The above consideration shall be deemed to be income of the year in which such money or other asset was received.

The profit or gain shall be treated as LTCG if the period of holding the original asset is more than 24 months, or else the same shall be treated as STCG.

LTCG shall be subject to tax at the rate of 12.5 per cent, whereas STCG shall be subject to tax at the applicable slab rates (including applicable surcharge and cess).

8. CHAPTER XII-A: SPECIAL PROVISIONS RELATING TO CERTAIN INCOMES OF NON-RESIDENTS

This chapter deals with special provisions relating to the taxation of certain income of NRIs. These provisions aim to simplify the tax obligations of NRIs and provide certain benefits and exemptions to encourage investments in India.

Applying the provisions of this chapter is optional. An NRI can choose not to be governed by the provisions of this chapter by filing his ITR as per section 139 of the Act, declaring that the provisions of this chapter shall not apply to him for that assessment year.

For the purpose of understanding the tax implications

under this chapter, it is important to understand certain definitions:

- Foreign exchange assets: means the assets which the NRI has acquired in convertible foreign exchange (as declared by RBI), namely:

- Shares in an Indian Company;

- Debentures issued by or deposits with an Indian Company which is not a private company;

- Any security of the Central Government being promissory notes, bearer bonds, treasury bills, etc., as defined in section 2 of the Public Debt Act, 1944.

- Investment income: means any income derived from foreign exchange assets.

- Non-resident Indian: means an individual being a citizen of India or a person of Indian origin who is not a resident.

- “specified asset” means any of the following assets, namely:—

- (i) shares in an Indian company;

- (ii) debentures issued by an Indian company which is not a private company as defined in the Companies Act, 1956 (1 of 1956);

- (iii) deposits with an Indian company which is not a private company as defined in the Companies Act, 1956 (1 of 1956);

- (iv) any security of the Central Government as defined in clause (2) of section 2 of the Public Debt Act, 1944 (18 of 1944);

- (v) such other assets as the Central Government may specify in this behalf by notification in the Official Gazette.

a. Section 115D – Special provision for computation of total income under this chapter:

In computing the investment income of a NRI, no deduction of expenditure or allowance is allowed.

If the gross total income of the NRI consists of only investment income or long-term capital gain income from foreign exchange assets or both, no deduction will

be allowed under Chapter VI-A. Further, the benefits of indexation shall not be available.

b. Section 115E – Tax on Investment income and long term capital gain:

- Investment income – taxed at the rate of 20 per cent

- Long-term capital gain on foreign exchange asset: taxed at the rate of 12.5 per cent.

- Any other income: as per the normal provisions of the Act.

c. Section 115F – Exemption of long-term capital gain on foreign exchange assets:

- Where the NRI has, during the previous year, transferred foreign exchange assets resulting into LTCG, the gain shall be exempt from tax if the amount of gain is invested in any specified asset or national savings certificates within 6 months after the date of such transfer. Further, if the NRI has invested only part of the gain in the specified asset, then only the proportionate gain will be exempt from tax. In any case, the exemption shall not exceed the amount of gain that arises from the transfer of foreign exchange assets.

If the NRI opts for this Chapter, then he is not required to file an income tax return if his total income consists of only investment income or long-term capital gain or both, and the withholding tax has been deducted on such income.

Further, NRIs can continue to be assessed as per the provisions of this Chapter ever after becoming resident by furnishing a declaration in writing with his ITR, in respect of investment income (except investment income from shares of Indian company) from that year and for every subsequent year until the transfer or conversion into money of such asset.

CONCLUSION

As discussed in this article, the foreign exchange regulations with respect to the permissibility of non-residents investing in Indian non-debt securities and the tax laws covering the taxation of income of non-residents arising from investment in Indian securities are complex and need to be carefully understood before a non-resident makes investments in India securities. Further, implications on changes in residential status also need to be looked into carefully to appropriately comply with them. ■