NRI - INTERPLAY OF TAX AND FEMA ISSUES - RESIDENCE OF INDIVIDUALS UNDER THE INCOME-TAX ACT

GANESH RAJGOPALAN
Chartered Accountant

Editorial Note: *This article starts a series of articles on Income-tax and FEMA issues related to NRIs with a focus on the interplay thereof. Apart from a residential status definition under both Income-tax and FEMA, the series of articles will cover issues under both laws related to change of residence; investments, gifts and loans by NRIs; as well as transfers by them from India.*

1. PRELIMINARY

Countries exercise their sovereign right to tax based on whether the income arises in their country or whether a person has a close connection with that country. The taxation laws define that close connection — an extended period during which the person stays in a country, or has his domicile there, or any similar criteria. Given a sufficient territorial connection between the person sought to be charged and the country seeking to tax him, income tax may properly extend to that person in respect of his foreign income.[1]The Income-tax Act, 1961 (the "Act") imposes such comprehensive or full tax, on persons who are residents.

Section 5 of the Income-tax Act, 1961 (the "Act") provides for the scope of total income for persons. The scope differs according to the residential status of the person. A non-resident's total income consists of income received or deemed to be received in India in a previous year or income accruing, or arising, or deemed to accrue or arise in India in a previous year.

In contrast, the scope of the total income of a resident in India includes, apart from the income covered within the scope for non-residents, income accruing or arising outside India during such year. In effect, a resident is taxable on his global income. At the same time, the total income of a resident but not ordinarily resident, as defined in section 6(6) of the Act, excludes income accruing or arising outside India unless it is derived from a business controlled in or a profession set up in India.

2. RESIDENTIAL STATUS

A person is said to be resident in India per the rules in section 6 of the Act. The residential status for (a) individual, (b) company, (c) Hindu Undivided Family, firm or association of persons and (d) other persons is to be determined by different rules. The nationality aspect does not enter the determination of residential status under the Indian income-tax law.

A non-resident is a person who is not a resident [section 2(30)]. When a person may be said to be "not ordinarily resident" is provided in section 6(6). The residential status is to be determined for a previous year and applies to all income for that year that comes within the scope of total income applicable to the assessee. In other words, a person cannot be a resident for one part of the year and non-resident for the other part, as India does not recognise split residency. The effect of this provision is that a person's total income earned in a Financial Year is taxed basis his residential status in India, even if he may be resident of two countries due to his part stay in India. However, such a person can avail relief under a tax treaty by applying tie-breaking tests. It is not possible to have different residential status under the Act for different sources of income. Whether an assessee is a resident or non-resident is a question of fact.[2]

2.1 Tests for residence

There are two tests to determine if an individual is resident in India in any previous year. These tests are alternative and not cumulative.

According to the first test, an individual is said to be resident in India in any previous year if he is in India for a period or periods of 182 days or more [sec. 6(1)(a)]. The alternative test is an individual having within the four years preceding the previous year, been in India for a period or periods amounting in all to three hundred and

1 Wallace Bros. & Co Ltd vs. CIT (1948) 16 ITR 240 (PC).

2 Rai Bahadur Seth Teomal vs. CIT (1963) 48 ITR 170 (Cal).

sixty-five days or more, and is in India for a period or periods amounting in all to sixty days or more in that year [sec. 6(1)(c)].

Explanation 1 to section 6(1)(c) provides relaxation from the second test in some circumstances [discussed in paragraph 2.3 below].

2.2 Stay in India

The phrase "being in India" implies the individual's physical presence in the country[3] and nothing more. The intention and the purpose of his stay are irrelevant; the stay need not be in connection to earning income, which is sought to be taxed. Nor is it essential that he should stay at the same place. Stay may not be continuous: the individual's presence in India must be aggregated to ascertain whether the threshold is crossed.

How the number of days shall be counted has been contested. In an Advance Ruling, it was held that even a part of the day would be construed as a full day, and even though for some hours on the day of arrival and departure, the applicant can be said to have been out of India, both the days will be reckoned for ascertaining 182 days. [4]Contrarily, the Mumbai Tribunal, in this case,[5] noted that the period or periods in section 6(1) requires counting of days from the date of arrival of the assessee in India to the date he leaves India. The Tribunal relied upon section 9 of the General Clauses Act, 1897, which provides that the first day in a series of days is to be excluded if the word 'from' is used and held that the words 'from' and 'to' are to be inevitably used for ascertaining the period though these words are not mentioned in the statute, and accordingly, the date of arrival is not to be counted.

2.2.1 Involuntary stay

Section 6 does not limit an individual's freedom to arrange his physical presence in India such that he is not a resident in the previous year and his foreign income falls outside the Indian tax net. On the other hand, section 6 does not distinguish between a stay in India that is by choice and that is involuntary. However, the Delhi High Court held that, given that the Act provides a choice to be in India and be treated as a resident for taxation purposes, his presence in India against his will or without his consent should not ordinarily be counted. In that case, the assessee could not leave India as his passport was impounded by a government agency. The Court held that the fact that the impounding was found to be illegal and, therefore, was in the nature of illegal restraint, the days the assessee spent in India involuntarily should not be counted. At the same time, the Court cautioned that the ruling cannot be treated as a thumb rule to exclude every case of involuntary stay for section 6(1), and the exclusion has to be fact-dependent.

A similar relaxation has been provided to individuals who had come to India on a visit before 22nd March, 2020, and their stay is extended involuntarily due to the circumstances arising out of the Covid-19 pandemic to determine their residential status under section 6 of the Act during the previous year 2019-20.[6]

Representations for a similar general relaxation for the previous year 2020-21, in relation to an extended stay in India by individuals due to travel restrictions during the Covid pandemic resulting in their residence under section 6(1) was denied by the CBDT, which stipulated examining on a case-by-case basis for any relief.[7] According to that Circular, an individual with a forced stay in India would still have the benefit of applying treaty residence rules, which are more likely to determine residence in the other State. The Circular points out that even if an individual becomes a resident in the previous year 2020-21 due to his forced stay in the country, he will most likely become an ordinary resident in India and accordingly, his foreign source income shall not be taxable in India unless it is derived from a business controlled in India or a profession set up in India, so there would be no double taxation. The Circular states that if a person becomes a resident due to his forced stay during the previous year 2020-21, he would be entitled to credit for foreign taxes under rule 128 of the IT Rules, 1962.

2.2.2 Seafarers

Explanation 2 to section 6(1) and rule 126 were brought into the statute with effect from A.Y. 2015-16 to mitigate difficulty in determining the period of stay in India of an individual, being a citizen of India, who is a crew member on board a ship that spends some time in Indian territorial waters.

The provisions apply to an Indian citizen who is a member of the crew of a foreign-bound ship leaving India. The period of stay in India of such a person will exclude the

3 CIT vs. Avtar Singh Wadhwan (2001) 247 ITR 260 (Bom).

4 Advance Ruling in P. No. 7 of 1995, In re (1997) 223 ITR 462 (AAR).

5 Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang).

6 Circular No. 11 of 2020 dated 8th May, 2020.

7 Circular No. 2 of 2021 dated 3rd March, 2021.

period from the date of joining the ship to the date of signing off as per the Continuous Discharge Certificate. The "Continuous Discharge Certificate" shall have the meaning as per the Merchant Shipping (Continuous Discharge Certificate-cum-Seafarer's Identity Document) Rules, 2001, made under the Merchant Shipping Act, 1958. The days in Indian territorial waters by such a ship on an eligible voyage would fall within the period of joining and end dates in the Continuous Discharge Certificate and, thus, will not be treated as the period of stay in India of the concerned individual crew member.

An "eligible voyage" is defined in the rule to mean a voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where the voyage originated from any port in India, has as its destination any port outside India, and for the voyage originating from any port outside India, has as its destination any port in India. The rule has no application where both the port of origin and destination of a voyage are outside India or where the Indian citizen leaves India to join the ship at a port outside India and the ship is on a voyage with a destination outside India. In such cases, his presence in India will usually be determined based on entries in his passport.

Notably, Explanation 2 and Rule 126 are for the purposes of the entire clause (1) (and not limited to clause (a) in Explanation 1). The rule prescribes the manner of computing the period of days in India of a crew member of a foreign-bound ship leaving India and is not restricted to only Indian-registered ships. Accordingly, the rule applies even while computing the period of stay of 182 days and 60 days contained in clauses (1)(a) and (1)(c).

2.3 Relaxations

There are some relaxations to the alternative test for residence in section 6(1)(c), which provides for substituting the period of stay in India for 60 days in section 6(1)(c) for 182 days. Consequently, in cases where the relaxation is applicable, the threshold of stay in India for residence will be 182 days under both tests, making the alternative test redundant. These relaxations are discussed below.

2.3.1 Citizens leaving India [Explanation 1(a)]

Explanation 1(a) provides for substituting the period of stay in India for 60 days in section 6(1)(c) by 182 days if the assessee, being a citizen of India, leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment outside India. The relaxation in *Explanation 1(a)* applies to the previous year in which the assessee, being a citizen of India, leaves India.[8]

Under the Citizenship Act 1955, citizenship is possible by birth (section 3), by descent (section 4), by registration (section 5), by naturalisation (section 6) and by incorporation of territory (section 8). However, an Overseas Citizen of India under section 7A of that Act is not a citizen and is not covered under this clause.

(a) Citizens leaving India as a member of the crew of Indian ship

The relaxation under clause (a) of Explanation 1 is available only where the assessee leaves India as a crew member of an Indian ship as defined in section 3(18) of the Merchant Shipping Act, 1958. Relaxation is not available if the ship is other than an Indian ship. An individual who is not a citizen, too, is not eligible.

In this case,[9] the assessee claimed the benefit of relaxation under Explanation 1(a) as he had left India in that previous year as a crew member of an Indian ship and had spent 201 days outside India. However, the benefit was denied because the assessee had stayed in foreign waters while employed on the ship(s) for only 158 days, i.e., less than 182 days. However, the ruling requires reconsideration since there is no condition in that provision that the assessee should spend his entire days outside India on a ship to be eligible for relaxation. Explanation 1(a) provides only that the individual leaves India in that previous year as a member of a crew on an Indian ship for the sixty days in clause (1)(c) to be substituted by 182 days.

Explanation 2 to section 6(1) and rule 126 that provide for the manner of determining the period of stay in India of a crew member of a foreign bound ship leaving India would be relevant for Explanation 1(a) as well in ascertaining whether the thresholds of 60 days and 182 days in section 6(1) is crossed. Thus, an Indian ship leaving for a foreign destination would be an 'eligible voyage' under rule 126, and his period of stay in India will exclude the period from the date of joining the ship to the date of signing off as per the Continuous Discharge Certificate. Where the Indian ship does not qualify to be on an eligible voyage, the individual's period or periods in India will impliedly include the ship's presence in Indian territorial waters.

8 Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang), Addl DIT vs. Sudhir Choudrie [2017] 88 taxmann.com 570 (Delhi - Trib.).

9 Madhukar Vinayak Dhavale vs. Income-tax Officer (2011) 15 taxmann.com 36 (Pune).

(b) For the purposes of employment

The Kerala High Court held in this case[10] that no technical meaning is intended for the word "employment" used in the Explanation, and going abroad for the purposes of employment only meant that the visit and stay abroad should not be for other purposes such as a tourist, or medical treatment or studies or the like. Therefore, going abroad for employment means going abroad to take up employment or any avocation, including taking up one's own business or profession. The expression "for the purposes of employment" requires the intention of the individual to be seen, which can be demonstrated by the type of visa used to travel abroad.

In this case, where the assessee travelled abroad on a transit visa, business visa and tourist visa, it was held that the entire period of travel abroad could not be considered as 'going abroad for the purposes of employment'.[11] It was also held that multiple departures from India by the individual in a previous year could also qualify under this clause. The provision does not require him to leave India and be stationed outside the country as the section nowhere specifies that the assessee should leave India permanently to reside outside the country.

The requirement under clause (a) of Explanation 1 is not leaving India for employment, but it is leaving India for the purposes of employment outside India. For the Explanation, an individual need not be an unemployed person who leaves India for employment outside India. The relaxation under this clause is also available to an individual already employed and is leaving India on deputation.[12]

2.3.2 Citizen or person of Indian origin on a visit to India [Explanation 1(b)]

Explanation 1(b) to section 6(1)(c) provides for a concession for Indian citizens or persons of Indian origin who, being outside India, come on a visit to India in any previous year. In such cases, the prescribed period of 60 days in India to be considered a resident under clause (1)(c) is relaxed to 182 days. The objective behind this relaxation is to enable non-resident Indians who have made investments in India and who find it necessary to visit India frequently and stay here for the proper supervision and control of their investments to retain their status as non-resident.[13]

The expression "being outside India' has been examined judicially. Where the assessee has been a non-resident for many years, and during the years, he had far greater business engagements abroad than in India, it cannot be assumed that he did not come from outside of India.[14]It is not justified to look at the assessee's economic and legal connection with India (i.e. his centre of vital interest being in India) to assume that he did not come from outside of India.[15]When the assessee had migrated to a foreign country and pursued his higher education abroad, engaged in various business activities, set up his business interests and continued to live there with his family, his travels to India would be in the nature of visits, unless contrary brought on record.[16]

The expression 'visit' is not limited to a singular visit as contended by the Revenue but includes multiple visits.[17] The return to India by an individual on termination of his overseas employment is not a visit, and the relaxation in Explanation 1(b) is not available.[18]

In that case,[19] the assessee working abroad visited for 18 days during the year. Later that year, on termination of his employment, he returned to India and spent 59 days in the country. The Tribunal held that a visit to India does not mean that if he comes for one visit, then *Explanation* (*b*) to section 6(*1*) will be applicable irrespective of the fact that he came permanently to India during that previous year. Looking at the legislative intention, the status of the assessee cannot be taken as resident on the ground that he came on a visit to India and, therefore, the period of 60 days, as mentioned in 6(*1*)(*c*) should be extended to 182 days by ignoring his subsequent visit to India after completing the deputation outside India. The alternative contention of the assessee that, for the purpose of computing 60 days as mentioned in section 6(1)(*c*), the period of visit to India would be excluded was accepted.

2.3.3 Limiting the relaxation [Explanation 1(b)]

An amendment was brought in by the Finance Act 2020

10 CIT vs. O Abdul Razak (2011) 337 ITR 350 (Kerala).

11 K Sambasiva Rao vs. ITO (2014) 42 taxmann.com 115 (Hyderabad Trib.).

12 British Gas India P Ltd, In re (2006) 285 ITR 218 (AAR).

13 CBDT Circular No. 684 dated 10th June, 1994.

14 Suresh Nanda vs. Asstt. CIT [2012] 23 taxmann.com 386/53 SOT 322 (Delhi).

15 Addl Director of Income-tax vs. Sudhir Choudhrie (2017) 88 taxmann.com 570 (Delhi-Trib).

16 Pr. Commissioner of Income-tax vs. Binod Kumar Singh (2019) 107 taxmann.com 27 (Bombay).

17 Asstt. Commissioner of Income-tax vs. Sudhir Sareen (2015) 57 taxmann.com 121 (Delhi-Trib).

18 V. K. Ratti vs. Commissioner of Income-tax (2008) 299 ITR 295 (P&H); Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang); Smita Anand, In Re. (2014) 362 ITR 38 (AAR).

19 Manoj Kumar Reddy vs. Income-tax Officer (2009) 34 SOT 180 (Bang); affirmed in [2011] 12 taxmann.com 326 (Karnataka)

(effective from A.Y. 2021-22) to counter instances where individuals who actually carry out substantial economic activities from India manage their period of stay in India to remain a non-resident in perpetuity and not be required to declare their global income in India. The amendment restricts the relaxation in clause (b) in Explanation 1.

When a citizen or a person of Indian origin outside India who comes on a visit to India has a total income other than the income from foreign sources exceeding ₹15 lakhs during the previous year, the time period in India in section 6(1)(c) of 60 days is substituted with 120 days as against 182 days available before this amendment. The expression income from foreign sources is defined in Explanation to Section 6.

An individual who becomes a resident under this provision shall be not ordinarily resident under clause (6). The provision expands the scope of residence under the Act. It could result in cases of dual residence needing the application of the tie-breaker rule under the relevant tax treaty.

2.4 Deemed Resident [section 6(1A)]

A new category of deemed resident for individuals was introduced with effect from 1st April, 2021 to catch within the Indian tax net, Indian citizens who are "stateless persons", that is, those who arrange their affairs in such a fashion that they are not liable to tax in any country during a previous year. This arrangement is typically employed by high net-worth individuals to avoid paying taxes to any country / jurisdiction on income they earn. A citizen is as defined by the Citizenship Act 1955.

Under this clause, an individual who is a citizen of India, having a total income other than income from foreign sources exceeding ₹15 lakhs 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.[20] This clause, an additional rule of residence for individuals, shall not apply if the individual is resident under clause (1). Clause (1A) applies only where an Indian citizen is liable to tax by reason of the various connecting factors listed in the clause.

2.4.1 Liable to tax

The meaning of the term "liable to tax" in the context of treaties has been the subject of several court rulings.[21] Some rulings have found that a person is liable to tax even if there is no income-tax law in force for the time being if a potential liability to tax exists, irrespective of whether or not such a right is exercised.[22] To nullify such interpretation, a definition in section 2(29A) has been inserted by the Finance Act 2021 with effect from 1st April, 2021. The provision defines 'liable to tax' in relation to a person and with reference to a country to mean that there is an income-tax liability on such a person under an existing income-tax law in force of that country. The definition includes a person liable to tax even if he is subsequently exempted from such liability. Primarily, there should be an existing tax law in the other country imposing a tax liability on a person to be 'liable to tax'.

2.4.2 Connecting factors

For clause (1A) to apply, the individual should *not* be liable to tax in any other country by reason of the connecting factors listed. The clause is worded similarly to the treaty definition of residence: both refer to the person being 'liable to tax', which must be by reason of the specified connecting factors. Article 4(1) of the OECD and UN Models refers to domicile, residence, place of management or any other criterion of similar nature while in section 6(1A), connecting factors are residence, domicile or any other similar criteria.

There is a causal relationship between the listed factors and the extent of taxability that is required for the factors to become connecting factors. The OECD Commentary describes this condition of being liable to tax by reason of certain connecting factors as a comprehensive liability to tax — full tax liability — based on the taxpayers' personal attachment to the State concerned (the "State of residence"). What is necessary to qualify as a resident of a Contracting State is that the taxation of income in that State is because of one of these factors and not merely because income arises therein. This interpretation can be validly extended to residence under clause (1A).

The challenge to establish that the income tax that a person is liable in a foreign jurisdiction is by reason of domicile, residence or similar connecting factors is demonstrated by the Chiron Behring ruling.[23] In that case, the Tribunal held that a German KG (fiscally transparent

20 The expression "income from foreign sources" is defined in Explanation to section 6 and discussed under para 3.3.3 above.

21 Union of India vs. Azadi BachaoAndolan (2003) 263 ITR 706 (SC);

22 ADIT vs. Greem Emirate Shipping & Travels (2006) 100 ITD 203 (Mum).

23 ADIT vs. Chiron Behring GmbH & Co[2008] 24 SOT 278 (Mum), affirmed in DIT vs. Chiron Behring GmbH & Co. (2013) 29 taxmann.com 199 (Bom).

partnership)[24] was a resident of Germany and entitled to the India-Germany treaty since it was liable to trade tax in Germany (a tax covered under the India-Germany Treaty). Considering that the German trade tax is a non-personal tax levied on standing trade or business to the extent that it is run in Germany,[25] an examination of whether the KG was liable to that tax *by reason of domicile, residence or other connecting factors* was required to determine treaty residence which was not undertaken.

In conclusion, it is not enough that the assessee is liable to income taxation in the concerned country or territory for clause (1A) not to apply: an examination of that tax law is necessary to ascertain whether he is liable by reason of the connecting factors listed in section 6(1A).

2.5 Income from foreign sources

The expression' income from foreign sources' is found in the amendments to section 6 of the Act by the Finance Act 2020. The expression is relevant to apply the lower number of days in India in Explanation 1(b) to section 6(1)(c) in respect of citizens and persons of Indian origin being outside India coming on a visit to India and to the deemed residence provisions under section 6(1A). Explanation to section 6 defines income from foreign sources to mean income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India.[26]

Since the words used in Explanation 1(b) as well as clause (1A) are "having total income, other than the income from foreign sources exceeding ₹15 lakhs", total income as defined in section 2(45) and its scope in section 5 is relevant. Notably, income accruing or arising outside India and received in India is not included in the definition of income from foreign sources. Consequently, such income within the scope of the total income of a non-resident is not to be excluded from the threshold of ₹15 lakhs.

Total income is computed net of exemptions, set off typically. A question arises whether income exempted if the assessee is a non-resident is to be excluded while computing the threshold of ₹15 lakhs. The provisions are ambiguously worded. A harmonious interpretation could be that since the objective for determining the threshold is to ascertain whether an individual who is otherwise a non-resident is to be treated as a resident, such exemptions should not be considered, and the items of income should be included. This interpretation avoids a circular reference which arises otherwise. A similar question arises regarding items of income excluded due to treaty provisions. Since the residence under the Act is the foundational basis for ascertaining residence under a treaty, items of income excluded due to treaty provisions are not to be excluded for the same reason.

3. RESIDENT AND NOT ORDINARILY RESIDENT

"Not ordinarily resident" is a subcategory of residence available to individuals and HUFs. The scope of his total income is the same as that of resident assesses but excludes income accruing or arising outside India unless it is derived from a business controlled in or profession set up in India.

Under this provision, an individual should be a non-resident for nine years out of ten preceding years or during his seven 'previous years' preceding the previous year in question, and he was present in India in the aggregate for seven hundred and twenty-nine days or less [sec. 6(6)(a)]. An individual will be "not ordinarily resident" if he fulfils either of the two conditions. The Mumbai Tribunal, in this case,[27] rejected the Revenue's stand that the conditions in section 6(6)(a) are cumulative while interpreting section 6(6)(a) before its substitution by the Finance Act, 2003 based on the well-settled literal rule of interpretation as per which the language of the section should be construed as it exists. The Tribunal's conclusion that when one of these two conditions, as laid down in section 6(6)(*a*) is fulfilled, the resident status is that of not ordinarily resident, should extend to the substituted provisions based on their text.

A citizen of India or a PIO who becomes a resident for being in India for more than 120 days due to the provision inserted in clause (b) of Explanation 1 (vide Finance Act 2020) has the status of not ordinarily resident [sec. 6(6)(c)]. Likewise, a person who is deemed resident under section 6(1A) is not ordinarily resident [sec. 6(6)(d)]

4. RESIDENCE UNDER THE ACT – RELEVANCE FOR TREATIES[28]

Double tax avoidance agreements entered by India

24 A fiscally transparent partnership is a pass-through with its partners being liable to pay tax on its income.

25 *Gewerbesteuergesetz* (Trade Tax Law, GewStG), Sec. 2(1).

26 This expression is relevant for the amendment to clause (b) of Explanation 1 to section 6(1) as well as the deemed resident provisions inserted vide section 6(1A) [see para for discussion on this clause].

27 Satish Dattatray Dhawade vs. ITO (2009) 123 TTJ 797 (Mumbai).

28 The topic is covered only briefly here to give the reader a perspective of how residence under the Act can impact treaty application. A separate article dealing with treaty rules on residence is scheduled for publication.

are bilateral agreements modelled on the OECD Model Convention and the United Nations Model Convention. To access these benefits, the person should be a resident of one or either of the Contracting States (i.e., parties to the double tax avoidance agreement) (Article 1 of the OECD / UN Model). Article 4 of the OECD Model states as follows: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, ……..." Thus, residential status under the domestic tax law is relevant to accessing a double tax avoidance agreement and being eligible for the reliefs available.

5. RESIDENCE UNDER THE ACT VERSUS TAX TREATIES

In treaty cases where the person is a resident of both Contracting States concerning a treaty between them, the dual treaty residence is resolved through tie-breaker rules, and that person is deemed a resident of one of the States. A question arises whether a person deemed to be a resident of the other Contracting State under a treaty is also to be treated as a non-resident for the Act, and consequently, his income and taxes are to be computed as applicable to non-residents. This question and the discussion below are relevant for individuals and other persons.

The question gains significance since there are variations in computing income and its taxation for non-residents compared to residents. Such variations are found under several sections of the Act apart from the scope of total income under section 5. Some instances are the computing capital gains on transfer of shares in foreign currency and without indexation (section 48), tax rate on unlisted equity shares (sec.112(1)), computing basic exemption of ₹1 lakh from short-term and long-term capital gains on listed shares (sections 111A and 112A), flat concessional tax rate on gross dividends, interest, royalty and fees for technical services without deductions, different slabs of maximum amount not chargeable to tax for senior citizens in the First Schedule to Finance Acts. Some of these provisions are more beneficial to residents, some to non-residents, and some depend on the facts of the case.

The argument for adopting treaty residence for residential status under the Act is that under section 90, more beneficial treaty provisions have to be adopted in preference to the provisions under the Act. However, such treatment is debatable for several reasons, as discussed below:

Firstly, the text of the provisions under the Act and in Article 4 dealing with residence in tax treaties militate against such substitution. Article 4 on residence states that such determination is "for the purposes of the Convention" and not generally. Section 6 of the Act is also "for the purposes of the Act" when a person is resident, non-resident or not ordinarily resident.

The literature on treaty residence is also overwhelmingly against substituting residential status under domestic law with treaty residence. Klaus Vogel states that since the person is "deemed" to be non-resident only in regard to the application of the treaty's distributive rules, he continues to be generally subject to those taxations and procedures of the "losing State" which apply to taxpayers who are residents thereof.[29]According to Phillip Baker,[30] Article 4 determines the residence of a person for the purposes of the Convention and does not directly affect the domestic law status of that person. He refers to a situation of a person who is a resident of both States A and B, under their respective domestic laws. Even though under the tie-breaker rules of the A-B Treaty, he is a resident of State A for the purposes of the Convention, he does not cease to be a resident of State B under its domestic law.

Courts have held that section 4 (charging provisions) and 5 (scope provisions) of the Act are made subject to the provisions of the Act, which means that they are subject to the provisions of section 90 of the Act and, by necessary implication, they are subject to the terms of tax treaties notified under section 90.[31] However, section 6, containing the provisions for determining residence under the Act, is for the purposes of the Act and is not subject to section 90 and, by implication, treaty provisions.

The mandate in section 90(2) to adopt the provisions of the Act to the extent they are more beneficial to the assessee than the treaty provisions may, at first glance, enable the substitution of treaty residence as the residential status under the Act but deserves to be rejected. The sub-section envisages a comparison of the charge of income, its computation and the tax rate under

29 Klaus Vogel on Double Tax Conventions, Third Edn, Article 4, m.no. 13-13a.

30 Phillip Baker on Double Tax Conventions, October, 2010 Sweet & Maxwell, Editor's Commentary on Article 4, para 4B.02.

31 CIT vs. Visakhapatnam Port Trust (1983) 16 Taxman 72 (Andhra Pradesh) approved in Union of India vs. Azadi Bachao Andolan (2003) 132 Taxman 373 (SC).

the Act to be compared with the same criteria under the relevant treaty *qua* a source of income.[32]The charge, computation and tax rate qua an income source under the Act, and the distributive rules in the relevant treaty *follow* from the residential status of the person under the Act and the treaty, respectively. Though section 90(2) refers to its application in relation to an assessee to whom a treaty applies, the application is not at an aggregate level of tax outcome qua the assessee.

The determination of treaty residence requires the person to be liable to tax in a Contracting State by reason of connecting factors (which includes residence under its tax law). Residence under the Act is a prerequisite for determining treaty residence. The objective of determining treaty residence is to enable the operation of distributive articles, which allocate taxing rights to one or the other Contracting State based on such residence, as well as to ascertain the State that will grant relief for eliminating double taxation.

Further, tie-breaker rules to determine treaty residence are to be applied to the facts during the period when the taxpayer's residence affects tax liability, which may be less than an entire taxable period.[33] The substitution with treaty residence of a person for computing his income and tax cannot be for a part of the previous year where there is split residency for treaty purposes.

Lastly, income-tax return forms and the guidelines issued by the CBDT also do not support substituting the residence under the Act with treaty residence. The forms and the guidelines require only residential status under the Act to be declared by the assessee. None of the return forms require assessees to fill in his treaty residence.

To conclude, a person's residential status under the Act does not change due to the determination of treaty residence unless a provision in the Act deems such treatment like in some countries.[34]

6. CONCLUSION

Residence is one of the essential concepts in determining the scope of taxation of a person. The term affects the scope of taxation under the Act as well as the ability of a taxpayer to access a double tax avoidance agreement. Rules for residence for an individual depend on his physical presence in India. The tests prescribed in section 6(1) and the relaxations available for citizens and persons of Indian origin form the canvas for determining residence under the Act. A long list of judicial precedents must be kept in sight while determining the residential status under the Act.

Newer amendments to the residence rules by limiting the concession available to citizens and persons of Indian origin on visits to India must also be considered. A deemed residential status for Indian citizens who are not liable to comprehensive or full tax liability in any other country brings to the fore the importance of understanding foreign tax laws. It also throws up interpretative challenges for the practitioner.

The meaning of residence under tax treaties necessarily refers to the meaning under domestic law, but they serve different purposes and operate independently in their own fields. It is debatable whether a person who is a treaty non-resident can be treated as a non-resident for the purposes of the Act and the tax consequences following such treatment.

Implications on NRs turning RNORs*	
Adverse to the assessee	**Beneficial to the assessee**
1. Limited increase in the scope of income – income from business controlled or profession set-up in India. 2. Concessional tax rates under Chapter XIIA and certain other exemptions are available only to NR and not to RNOR. 3. Can lead to the presumption that control and management of a firm, HUF, company, etc., in India. 4. Overall reduction in years of NOR relief to Returning NRIs. 5. Clearly within the tax compliance framework, including TDS obligations, tax return filing, etc.	1. Slab rates available for senior citizens, etc., would be available to NORs. 2. TDS Deduction is not as per Section 195 lowering rates in most cases. 3. Eligible to claim Foreign Tax Credit in India for doubly taxed incomes. 4. Can avail concessional tax rates under the DTAA where India is a source country and individual tie-breaks in favour of foreign jurisdiction. 5. Relaxation on reporting requirements (may not be required to file detailed ITR 2 as per extant provisions).
Neutral Points	
1. No Obligation to report Foreign Assets. 2. Assessee continues to be treated as NR for determining the AE relationship for transfer pricing regulations and for the purposes of Section 93. 3. It would not impact FEMA's non-residential status automatically.	

(*contributed by CA Kartik Badiani and CA Rutvik Sanghvi; NR – Non-resident, RNOR – Resident and Not Ordinarily Resident). ■

32 IBM World Trade Corpn vs. DDIT (2012) 20 taxmann.com 728 (Bang.)

33 OECD Model (2017 Update) Commentary on Article 4, para 10.

34 For example, Canada and the United Kingdom have provided in their domestic law that where a person is resident of another state for the purposes of a tax treaty, the person will be regarded as non-resident for the purposes of domestic law also.

RESIDENTIAL STATUS OF INDIVIDUALS – INTERPLAY WITH TAX TREATY

MAHESH G. NAYAK
Chartered Accountant

INTRODUCTION

This article is the second part of a series of articles on Income-tax and FEMA issues related to NRIs. The first article in the series focused on various issues related to the residence of individuals under the Income-tax Act, 1961 ('the Act'). In this article, the author seeks to analyse some of the key issues related to the determination of the residential status of an individual under a tax treaty ('DTAA'). Some of the issues covered in this article would be an interplay of tax residency under the tax treaty with the Act, the applicability of the treaty conditions to not ordinarily residents, tie breaker rule under tax treaty in case of dual residency, the role of tax residency certificate and split residency.

BACKGROUND

Article 1 of a DTAA typically provides the scope to whom it applies. For example, Article 1 of the India — Singapore DTAA provides as follows,

"This Agreement shall apply to persons who are residents of one or both of the Contracting States."

Therefore, in order to apply the provisions of the DTAA, one needs to be a resident of at least one of the Contracting States which are party to the relevant DTAA. If one does not satisfy Article 1, i.e., if one is not a resident of either of the Contracting States to DTAA, the provisions of the DTAA do not apply[1]. Therefore, the Article on Residential status is considered to be a gateway to a DTAA. Usually, Article 4 of the DTAA deals with residential status. While the broad structure and language of Article 4 in most DTAAs is similar, there are a few nuances in some DTAAs and therefore, it is advisable to check the language of the respective DTAA for determining the residential status. For example, the definition of 'resident' for the purposes of the DTAA in the India — Greece DTAA and India — Libya DTAA is not provided as a separate article but is a part of Article 2 dealing with the definition of various terms.

1 There are certain exceptions to this rule — application of the article on Mutual Agreement Procedure, application of the nationality Non-Discrimination article and application of non-territorial taxation of dividends.

DTAAs are agreements between Contracting States or jurisdictions, distributing the taxing rights amongst themselves. The distributive articles in the DTAA provide the rules for distributing the income between the country where the income is earned or paid (considered as source country) and the country of residence. Therefore, it is important to analyse, which country is the country of source and which country is the country of residence before one analyses the other articles of the DTAA.

In the subsequent paragraphs, the various issues of the article dealing with treaty residence have been discussed.

Generally, Article 4 of the DTAA, dealing with residence, contains 3 paragraphs — the first para deals with the specific definition of the term 'resident' for the purposes of the DTAA, the second para deals with the tie-breaker rule in case an individual is considered as resident of both the Contracting States in a particular DTAA and the third para deals with the tie-breaker rule in case a person, other than an individual is considered as resident of both the Contracting States in a particular DTAA.

ARTICLE 4(1) — INTERPLAY WITH DOMESTIC TAX LAW

Article 4(1) of the DTAA generally provides the rule for determining the residential status of a person. Article 4(1) of the OECD Model Convention 2017 provides as follows,

"For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein."

The UN Model Convention 2021 has similar language, except that it includes a person who is liable to tax in a

Contracting State by virtue of its place of incorporation as well. Similarly, the US Model Convention 2016 also includes a person who is liable to tax in a Contracting State on account of citizenship.

Language of Article 4(1) of India's DTAAs

In respect of the major DTAAs entered into by India, most of the DTAAs follow the OECD Model Convention[2], whereas some of the DTAAs[3] entered into by India only refer to the person being a resident under the respective domestic law without giving reference to the reason for such residence such as domicile, etc.

With the exception of the DTAAs with the UAE and Kuwait, Article 4(1) of all the major DTAAs entered into by India refers to the definition of residence under the domestic tax law to determine the residential status under the relevant DTAA. In other words, if one is considered a resident of a particular jurisdiction under the domestic tax law of that jurisdiction, such a person would also be considered as a resident of that jurisdiction for the purposes of the tax treaty.

As the UAE and Kuwait did not impose tax on individuals, the DTAAs entered into by India with these jurisdictions provided for a number of days stay in the respective jurisdiction for an individual to be considered as a resident of that jurisdiction for the purposes of the DTAA. For example, Article 4(1) of the India — UAE DTAA provides,

"For the purposes of this Agreement, the term 'resident of a Contracting State' means:

(a) In the case of India: any person who, under the laws of India, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in India in respect only of income from sources in India.

(b) In the case of the United Arab Emirates: an individual who is present in the UAE for a period or periods totalling in the aggregate at least 183 days in the calendar year concerned, and a company which is incorporated in the UAE and which is managed and controlled wholly in UAE."

2 India's DTAAs with Mauritius, the Netherlands, France, Germany, UK, UAE (in respect of Indian resident), Spain, South Africa, Japan, Portugal, Brazil and Canada.

3 India's DTAAs with Singapore and Australia.

Recently, the UAE introduced criteria for individuals to be considered as tax residents of the UAE. As per Cabinet Decision No. 85 of 2022 with Ministerial Decision No. 27 of 2023, individuals would be considered as tax residents of the UAE if they meet any one of the following conditions:

(a) The principal place of residence as well as the centre of financial and personal interests is situated in the UAE; or

(b) The individual was physically present in the UAE for a period of 183 days or more during a consecutive 12-month period; or

(c) The individual was physically present in the UAE for a period of 90 days or more in a consecutive 12-month period and the individual is a UAE national, UAE resident, or citizen of a GCC country and has a permanent place of residence in the UAE or business in the UAE.

While the UAE does not have a personal income tax, the compliance of above conditions is necessary for obtaining a tax residency certificate. As the India — UAE DTAA does not give reference to the domestic tax law of the UAE for determining treaty residence in the case of individuals and provides an objective number of days stay in the UAE criteria, there could be a scenario wherein a person is resident of the UAE under the domestic law but does not satisfy the test under the DTAA.

For example, Mr. A, a UAE national with a permanent home in the UAE, is in the UAE for 100 days during a particular year. As he satisfies the 90-day period specified in the Cabinet Decision, he would be considered a tax resident of the UAE under UAE laws. However, such a person may not be considered as a resident of the UAE for the purposes of the tax treaty as he is in the UAE for less than 183 days, leading to a peculiar mismatch.

Therefore, it is extremely important for one to read the exact language of the article while determining the tax residence of that DTAA.

Liable to tax

Article 4(1) of the DTAA treats a person as a treaty resident if he is **'liable to tax'** as a resident under the respective domestic tax law. In this regard, there has been a significant controversy in respect of the interpretation of the term **'liable to tax'**. There have been a plethora of decisions on this issue, especially in the context of the India — UAE DTAA. The question before the courts was

whether a person who is a resident of the UAE, which did not have a tax law, was liable to tax in the UAE as a resident and, therefore, eligible for the benefits of the India — UAE DTAA.

The AAR in the case of ***Cyril Eugene Periera vs. CIT (1999) 154 CTR 281***, held that as the taxpayer has no liability to pay tax in the UAE, he cannot be considered to be liable to tax in the UAE and, therefore, not eligible for the benefits of the India — UAE DTAA. However, the AAR in the cases of ***Mohsinally Alimohammed Rafik, In re (1995) 213 ITR 317*** and ***Abdul Razak A. Meman, In re (2005) 276 ITR 306***, has distinguished between 'subject to tax' and 'liable to tax' and has held that so long as there exists, sufficient nexus between the taxpayer and the jurisdiction, and so long as the jurisdiction has the right to tax such taxpayer (even though it may not choose to do so), such taxpayer would be considered as a resident of that jurisdiction. This view has also been upheld by the Supreme Court in the case of ***Union of India vs. Azadi Bachao Andolan (2003) 263 ITR 706*** and interpreted specifically by the Mumbai ITAT in the case of ***ADIT vs. Green Emirate Shipping & Travels (2006) 286 ITR 60***. It may be noted that the distinction between liable to tax and subject to tax is also provided by the OECD in its Model Commentary to the Convention.

While this issue was somewhat settled, the controversy has once again reignited by the introduction of the meaning of 'liable to tax' given by the Finance Act 2020. Section 2(29A) of the Act, as introduced by the Finance Act 2020, provides as follows,

""liable to tax", in relation to a person and with reference to a country, means that there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country;"

Therefore, the Act now provides that a person is liable to tax if there is tax liability on such a person even though such person may not necessarily be subject to tax, on account of an exemption in that jurisdiction. One may argue that the definition under the Act should have no consequence to a term under the DTAA. However, Article 3(2) of the OECD Model (as is present in most Indian DTAAs) provides that unless the context otherwise requires, a term not defined in the DTAA can be interpreted under the domestic tax law of the jurisdiction. Further, Explanation 4 to section 90 of the Act provides as follows:

"Explanation 4.—For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government."

In other words, unless the context otherwise requires, the meaning of a term under the Act may be used to interpret the meaning of the same term under the DTAA as well if such term is not already defined in the DTAA. Now, the question of whether, in a particular case, what would be the context and whether the context in the DTAA requires another meaning than as provided in the Act is a topic in itself and would need to be examined by the courts.

The main issue to be addressed is whether an individual resident of the UAE would now be considered as a resident of UAE under the India — UAE DTAA. In this regard, it is important to note that the decisions mentioned above are in respect of the DTAA before it was amended in 2007. Prior to its modification, Article 4(1) of the DTAA defined the term 'resident' as one who was liable to tax under domestic law by reason of residence, domicile, etc. However, the present DTAA, as discussed above, refers to objective criteria of number of days stay in the UAE and therefore, this controversy may not be relevant to the India — UAE DTAA.

This controversy, however, may be relevant for the interpretation of the DTAAs wherein there is no tax on individuals, and the residence article in the DTAA gives reference to the domestic tax law.

TAX RESIDENCY CERTIFICATE ('TRC')

The question arises is whether a TRC would be sufficient for an individual to claim the benefit of the tax treaty. There are certain judicial precedents, especially in the context of the India — Mauritius DTAA, by virtue of the CBDT Circular No. 789 dated 13th April, 2000, that TRC is sufficient to claim the benefit of the DTAA. In the view of the author, while a TRC issued by the tax authorities of a particular jurisdiction would be sufficient to claim that the person is a resident, the taxpayer may still need to satisfy other tests, including anti-avoidance rules in the Act and DTAA to claim the benefit of the DTAA along with the TRC. Section 90(4) of the Act, which requires TRC to be obtained to provide the benefit of the DTAA, simply

states that a person is not entitled to treaty benefit in the absence of a TRC, and it does not state that TRC is the only condition for obtaining treaty benefit.

Further, one may also need to evaluate the TRC as well as the specific language of Article 4(1) in the relevant DTAA before concluding that TRC is sufficient to claim treaty residence. For example, if the UAE authorities provide a TRC stating that the person is a taxpayer under the domestic provisions of the UAE, such TRC may not even satisfy the treaty residence conditions, depending on the facts and circumstances.

The Cabinet Decision, as discussed above, recognises this particular issue and states that if the relevant DTAA between UAE and a particular jurisdiction specifies criteria for the determination of treaty residency, the TRC would need to be issued to the individual considering such criteria and not the general criteria provided in the UAE domestic law.

Now, another question that arises is whether the benefit of the DTAA (assuming that other measures for obtaining the benefit are satisfied) can be granted even in the absence of a TRC. In this case, one may refer to the Ahmedabad Tribunal in the case of ***Skaps Industries India (P.) Ltd. vs. ITO [2018] 94 taxmann.com 448***, wherein it was held as follows,

*"**9.** Whatever may have been the intention of the lawmakers and whatever the words employed in Section 90(4) may prima facie suggest, the ground reality is that as the things stand now, this provision cannot be construed as a limitation to the superiority of treaty over the domestic law. It can only be pressed into service as a provision beneficial to the assessee. The manner in which it can be construed as a beneficial provision to the assessee is that once this provision is complied with in the sense that the assessee furnishes the tax residency certificate in the prescribed format, the Assessing Officer is denuded of the powers to requisition further details in support of the claim of the assessee for the related treaty benefits. …..*

***10**….. Our research did not indicate any judicial precedent which has approved the interpretation in the manner sought to be canvassed before us i.e. Section 90(4) being treated as a limitation to the treaty superiority contemplated under section 90(2), and that issue is an open issue as on now. In the light of this position, and in the light of our foregoing analysis which leads us to the conclusion that Section 90(4), in the absence of a non-obstante clause, cannot be read as a limitation to the treaty superiority under Section 90(2), we are of the considered view that an eligible assessee cannot be declined the treaty protection under section 90(2) on the ground that the said assessee has not been able to furnish a Tax Residency Certificate in the prescribed form."*

Therefore, the ITAT held that section 90(4) of the Act does not override the DTAA. In a recent decision, the Hyderabad Tribunal in the case of ***Sreenivasa Reddy Cheemalamarri vs. ITO [2020] TS-158-ITAT-2020*** has also followed the ruling of the Ahmedabad Tribunal of Skaps (supra). A similar view has also been taken by the Hyderabad ITAT in the cases of ***Vamsee Krishna Kundurthi vs. ITO (2021) 190 ITD 68*** and ***Ranjit Kumar Vuppu vs. ITO (2021) 190 ITD 455***.

In the case of individuals, the treaty residence for most of the major DTAAs is linked to residential status under domestic tax law and the number of days stay is a condition for determining the residential status under most domestic tax laws. Therefore, one may be able to substantiate on the basis of documents such as a passport which provide the number of days stay in a particular jurisdiction. However, a Chartered Accountant issuing a certificate under Form 15CB may not be able to take such a position as the form specifically asks one to state whether TRC has been obtained.

SECOND SENTENCE OF ARTICLE 4(1)

The second sentence of Article 4(1) of the OECD/ UN Model Convention excludes a person, as being a resident of a particular jurisdiction under the DTAA, who is liable to tax only in respect of income from sources in that jurisdiction. This sentence is found in only a few major DTAAs entered into by India[4].

The objective of this sentence is to exclude those taxpayers as being treaty residents of a particular jurisdiction, wherein they are not subject to comprehensive taxation. The first question which arises is whether the second sentence would apply in the case of a person who is a resident of a country, which follows a territorial basis of taxation, i.e. income is taxed in that country only when received in or remitted to that country. For example, Mr. A is a tax resident of State A, which follows a territorial basis of taxation, like Singapore [although India — Singapore DTAA does not contain the second sentence

4 India's DTAAs with Germany, UK, USA, UAE, Australia, Spain, South Africa and Portugal.

of Article 4(1)]. If India — State A DTAA contains the second sentence in Article 4(1), the question that arises is whether Mr. A would be considered as a resident of State A for the purposes of the DTAA. In this regard, in the view of the author, the objective of the second sentence is to exclude individuals who are not subject to comprehensive tax liability and not to exclude countries where the tax system is territorial. In other words, so long as Mr. A is subject to comprehensive taxation in State A, the second sentence should not apply and Mr. A should be considered as a treaty resident of State A for the DTAA. The OECD Commentary also states the same view[5].

An interesting decision on this would be the recent Hyderabad ITAT decision in the case of ***Jenendra Kumar Jain vs. ITO (2023) 147 taxmmann.com 320***. In the said case, the taxpayer, who was transferred from India to the USA during the year, opted to be taxed as a 'resident alien' under USA domestic tax law, i.e. only income from sources in the USA would be taxable in the USA. In this regard, the ITAT held that as the taxpayer was taxed in the USA, not on the basis of residence but on the basis of source, such taxpayer would not be considered as a resident of the USA for the purposes of the India — USA DTAA.

The next question which arises is whether the second sentence would apply in the case of an individual who is considered as a not ordinarily resident ('RNOR') under section 6(6) of the Act. For example, whether a person would be considered as a resident of India under the DTAA and thus can access the Indian DTAAs when such a person is considered as a deemed resident but RNOR of India under section 6(1A) of the Act. In the view of the author, the second sentence does not apply in the case of an RNOR as the RNOR is not liable to tax only in respect of sources in India. Such a person may be taxable on worldwide income, if such income is, say, earned through a profession which is set up in India.

Another interesting issue arises is whether the second sentence applies in the case of third-country DTAAs after the application of a tie-breaker rule (explained in detail in the subsequent paras). Let us take the example of Mr. A, who is a resident of India and the UK under the respective domestic tax laws and is considered as a resident of the UK under the tie-breaker rule in Article 4(2) of the India — UK DTAA. In case Mr. A earns income from a third country, say Australia, the question arises is whether the India — Australia DTAA can be applied. In this regard, para 8.2 of the OECD Model Commentary on Article 4, 2017, provides as follows,

"…It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States…."

Therefore, the OECD suggests that in the above example, as India would not be able to tax the entire income (being the loser State in the tie-breaker test under the India — UK DTAA), Mr. A would not be subject to comprehensive taxation in India and therefore, one cannot apply the India — Australia DTAA or any other Indian DTAAs which contain the second sentence in Article 4(1).

However, this view of the OECD has been discarded by various experts. In the view of the author as well, the above view may not be the correct view as the residential status in the DTAA is only 'for the purposes of the Convention' and therefore, cannot be applied for any other purpose. As also explained in the first part of this series, the tie-breaker test has no relevance to residential status under the Act, and a person resident under the Act will continue being a resident under the Act even if such person is considered as a resident of another jurisdiction under a DTAA. In the above example, Mr. A continues to be a resident of India under the Act[6] as well and, therefore, should be eligible to access Indian DTAAs.

ARTICLE 4(2) – TIE-BREAKER TEST

If an individual is a resident of both the Contracting States to a DTAA under the respective domestic tax laws (and therefore, under Article 4(1) of the DTAA), one would need to determine treaty residency by applying the tie-breaker rule. Article 4(2) provides in the case of a dual resident; the treaty residency would be determined as follows:

A. The jurisdiction in which the taxpayer has a permanent home available to him ('permanent home test'),

B. If he has a permanent home in both jurisdictions, the jurisdiction with which his personal and economic relations are closer (centre of vital interests) ('centre of vital interests test'),

5 Refer Para 8.3 of the OECD Model Commentary on Article 4, 2017.

6 In contrast with the domestic tax law of Canada and UK wherein domestic residency is amended if under the tie-breaker rule in a DTAA, the taxpayer is considered as resident of another jurisdiction.

C. If his centre of vital interest cannot be determined, or if he does not have a permanent home in either jurisdiction, the jurisdiction in which he has a habitual abode ('habitual abode test'),

D. If he has a habitual abode in both or neither jurisdiction, the jurisdiction of which he is a national ('nationality test'),

E. If he is a national of both or neither jurisdiction, the jurisdiction as mutually agreed by the competent authorities of both jurisdictions.

The language of Article 4(2) is clear regarding the order to be followed while determining the treaty residency in the case of dual residents. It is important to note that some of the conditions are subjective in nature and are used to determine which jurisdiction has a closer tie to the taxpayer. Therefore, one needs to consider all the facts holistically and carefully while applying the various tie-breaker tests to determine treaty residence in such situations.

PERMANENT HOME TEST

Generally, a permanent home test is satisfied if the taxpayer has a place of residence available to him in a particular jurisdiction. The availability of the home cannot be for a short period but needs to be for a long time to be considered as permanent. However, the OECD Commentary as well as a plethora of judgements have held that it is not necessary that the home should be owned by the taxpayer. Even a home taken on rent would be considered as a permanent home of the taxpayer if he has a right to use such a property at his convenience. Similarly, the parents' property would also be considered as a permanent home as the taxpayer would have a right to stay at the said property. Another example could be that of a hotel. While generally, a hotel may not be considered a permanent home, if the facts suggest that accommodation would always be available to the taxpayer as a matter of right, it may be considered a permanent home. On the other hand, even if a person owns a particular residential property in a particular jurisdiction, it may not be considered a permanent home if the taxpayer has given the said property on rent and the taxpayer does not have the right to use the property at any given time[7].

CENTRE OF VITAL INTERESTS TEST

The centre of Vital Interests generally refers to the social and economic connections of the taxpayer to a particular jurisdiction. Examples of social interests would be where the family of the taxpayer is located, where the children of the taxpayer attend school, and where his friends are. Similarly, examples of economic interests would be a place of employment, a place where major assets are kept, etc. This is a difficult test to substantiate as there is a significant amount of subjectivity involved. Moreover, there could be situations wherein the personal interests may be located in a particular jurisdiction, whereas the economic interests may be located in the other jurisdiction. In such a situation, one may not be able to conclude the tie-breaker test on the basis of the centre of vital interests test as no specific weightage is given to either of the nature of interests.

HABITUAL ABODE TEST

The habitual abode test is another subjective test that seeks to determine where the taxpayer seeks to reside for a longer period. This could be on the basis of the number of days stay (if the difference in the number of days stay is significantly at variation between the jurisdictions) or on the intention of the taxpayer to spend a longer period of time. An example given in the OECD Model Commentary is that of a vacation home in a particular jurisdiction and the main property of residence in another jurisdiction. In such a situation, the jurisdiction where the vacation home is situated may not be considered to be the habitual abode of the taxpayer as the stay in such a property would always be for a limited period of time.

NATIONALITY TEST

Given the subjectivity involved in the other tie-breaker tests, in most situations, practically, the tiebreaker is determined by the jurisdiction where the taxpayer is a national. As India does not accept dual citizenship, the question of a taxpayer being a national of both jurisdictions and therefore, having the residential status be determined mutually by the competent authorities does not arise.

Timing of application of the tie-breaker tests

Having understood some of the nuances of the various tie-breaker tests, it is important to analyse the timing of the application of the tie-breaker tests, i.e. at what point in time does the tie-breaker test have to be applied? Unlike the basic residence test based on the number of days, which applies in respect of a particular year, as the tie-breaker tests are driven by facts which are subjective and can change, this question of timing of application gains significant relevance.

Let us take the example of Mr. A who moved from India to Singapore in October 2023 as he got a job in Singapore.

7 Refer para 13 of OECD Model Commentary on Article 4, 2017.

Let us assume that for the period October to March, Mr. A, who has not sold his house in India, is staying in various hotels in Singapore and he takes an apartment on rent in the month of March 2024 after selling his property in India. Now, if Mr. A is a tax resident of India and Singapore and one is applying the tie-breaker rule, one may arrive at a different conclusion on treaty residence depending on when the tie-breaker rule is applied. For example, if one applies in October 2023, he has a permanent home only in India, whereas if one applies in March 2024, he has a permanent home only in Singapore. In the author's view, one would need to apply the tie-breaker rule when one is seeking to tax the income, i.e. when the income is earned or received, as the case may be. This would be in line with the application of the DTAA as a whole, which would need to be applied when one is taxing the said income, as DTAAs allocate the taxing rights between the jurisdictions.

Split Residency

The above example is a classic case of split residency wherein a person can be considered as a resident of different jurisdictions within the same fiscal year. This issue is also common where the tax year differs in the jurisdictions involved. For example, India follows April to March as the tax year, whereas Singapore follows January to December. Let us take the example of Mr. A, who moved to Singapore for the purpose of employment along with his family in January 2023. He has not come back to India after moving to Singapore. He qualifies as a tax resident of Singapore for the calendar year 2023 under the domestic tax law. He has a permanent home only in Singapore. In such a situation, Mr. A qualifies as a tax resident of India for the period April 2022 to March 2023 and as a tax resident of Singapore for the period January 2023 to December 2023. In such a situation, in respect of income earned till December 2022, Mr. A is a resident of India and not of Singapore, and therefore, in such a scenario, Mr. A is a treaty resident of India under the India — Singapore DTAA for the period April 2022 to December 2022. In respect of the income earned from January 2023 to March 2023, Mr. A will be considered as a resident of India as well as Singapore under the domestic tax law. However, as he has a permanent home available only in Singapore, he would be considered as a treaty resident of Singapore during such a period. Therefore, for income earned from April 2022 till December 2022, Mr. A is a treaty resident of India, whereas from January 2023 till March 2023, he is a treaty resident of Singapore.

This principle of split residency finds support in the OECD Model Commentary[8] as well as various judicial precedents[9].

CONCLUSION

The above discussions only strengthen the case that one cannot determine the residential status under the Act as well as the DTAA together, as while the definitions may be linked to each other, there are certain nuances wherein there is divergence in applying the principles. For example, the concept of split residency does not apply to residential status under the Act. Similarly, under the Act, the residential status of a person does not change depending on the income, whereas in the case of a treaty, the treaty residence may be different for each stream of income (in many cases for the same stream of income as well) depending on the timing of application of the treaty residence. Further, each DTAA has its own unique nuances and language used and therefore, it is important that one analyses the specific language of the treaty while interpreting the same. ■

8 Refer Para 10 of the OECD Model Commentary on Article 4, 2017.

9 Refer the decisions of the Delhi ITAT in the case of Sameer Malhotra (2023) 146 taxmann.com 158 and of the Bangalore ITAT in the case of Shri Kumar Sanjeev Ranjan (2019) 104 taxmann.com 183.

DECODING RESIDENTIAL STATUS UNDER FEMA

RAJESH P. SHAH
Chartered Accountant

INTRODUCTION

This article is the third part of a series on Income Tax and the Foreign Exchange Management Act (FEMA) issues related to NRIs. The first article focused on the provisions of the Income Tax Act, whereas the second one was on the applicability of the treaty on the definition of Residential Status. This article will focus on the definition of Residential status under FEMA regulation.

BACKGROUND

Many professionals get flooded with questions on cross-border transactions day in and day out from their resident and non-resident clients regarding the remittance and capital account transactions to be done by individuals and companies.

FEMA governs the financial aspects of a cross-border transaction. As far as the individuals are concerned, the fundamental issue is determining their residential status under FEMA.

In India, the residential status of an individual is determined under the Income-tax Act as well as under FEMA. People at large get confused in deciding the status under both statutes as the criteria for determination and their impact are pretty different.

We shall try to decode the definition of a RESIDENT under FEMA.

An Individual can be a resident under the Income-tax Act, and a non-resident under FEMA and vice versa. An individual can simultaneously be a non-resident or a resident under both Acts.

Also, under FEMA, a split residency is permitted, meaning a person can be a resident for part of the year and a non-resident for another part and vice versa. However, under the Income-tax Act, a person is either a resident or a non-resident for the entire financial year.

Thus, many permutations and combinations are possible. This leads to further complications in practical application.

The definition of "Resident" for an individual under FEMA is similar to that of erstwhile FERA, as both emphasise on a person's intention. However, FEMA has included the number of days stay in India (more than 182 days) in the preceding financial year as one of the criteria for determining the residential status.

DEFINITION

A person resident in India is defined u/s 2(v) of FEMA, as follow:

"person resident in India" means —

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than—

(a) for or on taking up employment in India, or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India;

Whereas,
(w) "person resident outside India" means a person who is not resident in India;

From the above definition, it is clear that section 2(v) defines an individual to be resident in India if he resides in India for more than one hundred and eighty-two days during the course of the preceding financial year, except where he has gone out of India or who stays outside India, (a) for or on taking up employment outside India, or (b) for carrying on outside India a business or vocation outside India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period. Thus, a person falling under the above exceptions will not be considered a person resident in India even though his stay in India exceeded 182 days in the preceding financial year. This can give rise to a split residency. Consider an individual who leaves India for employment on 1st November, 2023. He can be considered a non-resident under FEMA from that date and would be a resident from 1st April, 2023 till 31st October, 2023. The exceptions will be operative as he is leaving for employment. Hence, although his stay in India during FY 2022-2023 exceeded 183 days, he would be regarded as non-resident w.e.f. 1st November, 2023.

Similarly, in case of a person resident outside India who is coming back to India to take up employment or for carrying on business or vocation in India or for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period, such person would be regarded as a person resident in India from the day he comes to India even if his stay in the preceding financial year in India was less than 183 days.

There is another school of thought, and according to which a person can become non-resident from the date he leaves India for employment, business / vocation or an uncertain period; however, to determine the residential status of an individual returning to India, one has to look at the physical stay of that person in the preceding financial year along with the intentions, such as employment, business / vocation or stay for an uncertain period. This view is applicable in the case of the purchase of immovable property in India as per the Press Release by the Government of India dated 1st February, 2009. As per the said Press Release, to be considered as a person resident in India, **a person has not only to satisfy the condition of the period of stay in India (being more than 182 days during the preceding financial year) but also his purpose of stay as well as the type of Indian visa granted to him should indicate the intention to stay in India for an uncertain period**.

In this regard, to be eligible, the intention to stay has to be unambiguously established with supporting documentation, including a visa.

Section 7(1) of the Limited Liability Partnership Act, 2008 (LLP Act) stipulates that every LLP should have two designated partners who are individuals, and at least one of them shall be a resident in India. The Explanation further provides that the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding year. Thus, an individual must satisfy the 182-day stay criteria to become a designated partner in an LLP.

Determination of the Residential Status of an individual based on his stay in India in the preceding FY may pose serious challenges, as one has to wait for the entire year to become a resident of India that is too subject to stay in the preceding FY of 183 days or more. Therefore, except for buying properties or becoming a designated partner in an LLP, the earlier view seems more practical and workable, i.e., an individual becomes a resident of India from the date he arrives for employment, business/ vocation, or stay for an uncertain period.

This view is strengthened by the provisions of Para 7 of Schedule 1 of FEMA Notification 5 (R)/2016 - RB – dated 1st April, 2016, which provides that NRE accounts should be re-designated as resident accounts or the funds held in these accounts may be transferred to the RFC accounts **immediately upon the return of the account holder to India for taking up employment or for carrying on business or vocation or for any other purpose indicating intention to stay in India for an uncertain period.**

From the above, it is clear that significant focus is being put on the intention of the person going abroad or returning to India.

Thus, we find that determining the residential status of a returning Indian is challenging. One needs to interpret the

same in the context in which it is to be determined.

It is interesting to note that section 2(w) of the FEMA defines "person resident outside India" as a person who is not resident in India. Thus, it does not define the term "non-resident", but for all practical purposes, the term "person resident outside India" is equated to "non-resident of India." Similarly, the term "Non-Resident of India" (NRI) is not defined in FEMA, but various notifications / Master Directions define the term. For example, Para 2(vi) of the FEMA Notification 5 (R)/2016 - RB – dated 1st April, 2016, as well as defines 'Non-Resident Indian (NRI)' as a **person** resident outside India who is a citizen of India. Rule 2(aj) of the FEMA Non-Debt Instruments Rules, 2019[1] defines 'Non-Resident Indian (NRI)' as an **individual** resident outside India who is a citizen of India.

ILLUSTRATION

Let's understand the concept of the Residential Status of an Individual under FEMA with the help of some examples:

1. Mr Raj leaves India for employment on 26th May, 2021. His stay during the preceding Financial Year, i.e., 2020–2021, was 365 days.

Will he be a non-resident as per FEMA?

Answer: Residence for an individual under FEMA has been defined u/s 2(v)(i).

An individual is considered an Indian resident if he has been in India in the preceding financial year for more than 182 days.

To determine the residential status of Mr. Raj as of 26th May, 2021, we need to check if in the preceding year, i.e. 2020–21, his stay in India was more than 182 days.

As in preceding year Mr. Raj was in India for more than 182 days; he is a resident of India as on 26th May, 2021 as per FEMA.

However, on 26th May, 2021, Mr Raj went outside India for employment and therefore fell under one of the exclusions in the definition of "person resident in India" hence, he is a Non-resident of India from 26th May, 2021.

2. If Mr Raj returns to India on 31st July, 2023 for employment, what would be his residential status under FEMA for FY 2023–24? (You may assume his stay in India during the FY 2022–2023 period to be less than 182 days).

Answer: To determine the residential status as per FEMA law for the financial year 2023–24, we need to check if his stay in India in the preceding year i.e. 2022–23 was more than 182 days. As in the preceding year, Mr. Raj was in India for less than 183 days. He is a Non-resident as per FEMA till July 2023, after which he shall become a Resident if he intends to stay in India for employment.

However, if Mr Raj intends to buy a property in India, he must complete a stay in India of 183 days or more in the preceding FY. Assuming Mr. Raj's stay in India during the FY 2023–2024 exceeds 182 days, he can buy a property in the FY 2024–2025.

From the above, it is clear that one needs to apply the test of stay in India as well as the intention of a person depending upon the context for which one determines the residential status.

RESIDENTIAL STATUS OF A STUDENT GOING ABROAD FOR STUDIES

RBI vide its Press Release 2003-2004/710. Circular No. 45 dated 8th December, 2003[2] has clarified that "taking into account the definition of resident under FEMA and the intention of the student to stay abroad for an uncertain period though not for permanent settlement, it has been decided to treat them henceforth as non-residents from the FEMA angle." The Circular further clarifies that "as non-residents, students will, in any case, be eligible for receiving remittances from India, as follows: (i) up to USD 100,000 from close relatives from India on self-declaration towards maintenance, which could include remittances towards their studies also, (ii) up to USD 1 million out of sale proceeds / balances in their account maintained with an AD in India, (iii) all other facilities available for NRIs under FEMA, (iv) educational and other loans which were availed (as residents in India) by students would be allowed to continue."

While taking up studies or further advanced courses, students may have to take up jobs or seek scholarships to

1 Also refer Para 2.18 of the Master Direction – Foreign Investment in India RBI/FED/2017-18/60 FED Master Direction No.11/2017-18 dated 4th January, 2018, updated up to 17th March, 2022

2 https://www.rbi.org.in/commonman/Upload/English/PressRelease/PDFs/40570.pdf and https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=2763

supplement income to meet their financial requirements abroad. As they have to earn and learn, their stay for educational purposes gets prolonged than what is intended while leaving India. Thus, the above clarification and NRI status will help students take up jobs and undertake various financial transactions as non-residents without violating FEMA provisions.

A few more examples of residential status are as follows:

Sr. No.	Purpose	Status	Reasons
1	A person Leaves India to take up employment for the first time.	A person Resident Outside India	Since he has left India for employment, he has become non-resident from the day he leaves India.
2	The student leaves for Australia to undertake a Master's degree course for three years.	A person Resident Outside India	As per RBI Circular No. 45 dated 8th December, 2003,
3	A person visits India as a tourist.	A person Resident Outside India	Since he is on a visit for a fixed or specific period.
4	A person goes to Brisbane to participate and represent India. His stay was extended for eight months.	A person Resident in India	Since he has gone for a fixed period and his coming back is confirmed.
5	A person has gone to the UK. She will return to India after the maternity case of her daughter.	A person Resident in India	Since the period of stay is definite and not uncertain.
6	A person has taken up American citizenship even though his wife and children are in India. He travels to India to meet his family and is in India for more than 250 days. However, he is employed in the USA and intends to be outside India.	A person Resident Outside India	Since he has no intention to stay in India for the uncertain period and is employed outside India.
7	A person is serving on board a ship flying the Indian National Flag and has not set up any residence, business, or profession outside India.	Person Resident in India	A ship with the Indian National Flag is considered a territory of India. He cannot be considered a person who proceeded outside India to take up employment and set up a business or profession.
8	A person employed with an Indian company undertakes export promotion tours to Singapore. He was in Singapore for approximately 201 days.	A person Resident in India	Since he is employed in India and has not gone to Singapore to take up employment or carry on business for an uncertain period, a visit abroad while exercising employment in India or a business visit cannot make a person non-resident. Also, export promotion tours typically are for a fixed duration; therefore, on all counts, that person will be regarded as a Resident of India.
9	A person leaves India for the US as he received a Green Card but has no employment or business, but he intends to settle or stay there for an uncertain period.	A person Resident Outside India	The receipt of a Green Card signifies the intention to stay outside India. The said intention is fortified with the person moving to such a country. Therefore, he will be regarded as a non-resident from the day he leaves India.
10	A person who is a foreign citizen of non-Indian origin sets up a proprietary concern in India on 1st June, 2019, to carry on business with the intention of settling in India.	A person Resident in India	Since a person is coming to India to set up Business or Vocation, he will be considered a resident in India.

OVERSEAS CITIZEN OF INDIA (OCI)

Another essential aspect to understand is OCI.

The Constitution of India does not allow holding dual citizenship.

However, to overcome the difficulty for various Indians settled abroad who have taken foreign citizenship (foreign passports), on 2nd December, 2005, the government launched the "Overseas Citizens of India" scheme. Registration as an OCI provides the registrant with a few benefits. An illustrative list is stated below:

- A multiple entry / multi-purpose life-long visa for visiting India.

• OCI may be granted Indian citizenship after five years from the date of registration, provided they stay in India for one year before making the application and are subject to renouncing the citizenship of another country. Employment is allowed to an OCI in all areas except mountaineering, missionary and research work and other work requiring PAP / RAP (PAP - Protected Area Permit, RAP - Restricted Area Permit).

A foreign national is eligible for registration as an OCI holder if one falls under any of the below criteria:

• Who was eligible to become a citizen of India on 26th January, 1950** or

• Was a citizen of India on or at any time after 26th January, 1950 or

• Belonged to a territory that became part of India after 15th August, 1947

• Person of Indian Origin card holders are deemed to be OCI.

Children and grandchildren, including minor children of the above-referred persons, are also eligible for registration as an OCI, provided their country of citizenship allows the same in some form or other under local laws and are eligible for registration as an OCI.

However, if the applicant had ever been a citizen of Pakistan or Bangladesh, he would not be eligible for registration as an OCI.

• A spouse of foreign origin of a citizen of India or spouse of foreign origin of an OCI card holder registered and whose marriage has been registered and subsisted for a continuous period of not less than two years immediately preceding the application's presentation would be eligible to obtain registration as an OCI.

For eligibility for registration as OCI, such spouse shall be subjected to prior security clearance from a competent authority in India.

**Any person who, or whose parents or grandparents were born in India as defined in the Government of India Act, 1935 (as originally enacted), and who was ordinarily residing in any country outside India was eligible to become a citizen of India on 26th January, 1950. An OCI card holder is eligible to visit India without obtaining a VISA.

PERSON OF INDIAN ORIGIN (PIO)

A PIO means a foreign citizen (except a national of Pakistan, Afghanistan, Bangladesh, China, Iran, Bhutan, Sri Lanka, and Nepal):

• who at any time held an Indian passport; Or

• who or either of their parents / grandparents/great grandparents were born and permanently resident in India as defined in the Government of India Act, 1935 and other territories that became part of India thereafter, provided neither was at any time a citizen of any of the countries above (as referred above); Or

• who is a spouse of a citizen of India or a PIO.

A TRANSITION FROM PIO CARD TO OCI CARD

Earlier, the "PIO Card Scheme" was in place. The PIO card scheme has been withdrawn vide Gazette Notification No. 25024/9/2014 F. I dated 9th January, 2015. Further, vide Gazette Notification No 26011/01/2014IC. I dated 9th January, 2015; all existing PIO card holders are deemed OCI card holders. Therefore, no separate authentication of the existing PIO card as an OCI card is necessary. Henceforth, applicants may only apply for an OCI Card, as the PIO Card scheme no longer exists. Current PIO cardholders may apply for OCI cards instead of their PIO cards.

CONCLUSION

The residential status under FEMA is often misconstrued due to the insertion of a number of days' conditions, similar to the definition under the Income-tax Act. However, it is essential to note that the impact of residential status under FEMA is from the regulatory perspective, not the revenue perspective. Some situations lead to different residential statuses as explained in the article above; however, from the perspective of FEMA, the person's intention is of utmost importance. It is also noteworthy that intentions need to be justifiable / verifiable from the documentary evidence such as type of visa, employment letter, hiring of an apartment, etc., and it should not be merely a thought by a person that he intends to stay in or out of the country. If the intention, coupled with the number of days of stay, is examined correctly, the residential status can be obtained for a particular person for a given period. As stated earlier, applying the criteria of stay vs. intentions will be relevant in the context in which one seeks to apply the provisions. ■

IMMOVABLE PROPERTY TRANSACTIONS: DIRECT TAX AND FEMA ISSUES FOR NRIS

NAMRATA R. DEDHIA
Chartered Accountant

INTRODUCTION

This article is the fourth part of a series on "Income Tax and Foreign Exchange Management Act (FEMA) issues related to NRIs". The first article focused on the provisions of the Income Tax Act, whereas the second one was on the applicability of the treaty on the definition of Residential Status. The third one was focused on the Residential Status under FEMA Regulations and this one deals with the "Immovable property Transactions – Direct Tax and FEMA issues for NRIs.

BACKGROUND

Immovable property refers to any asset, which is attached to the earth and is immobile, and includes land. Typically, the term "immovable property" is used to mean land and/or buildings attached to the land. Owning an immovable property, especially a residential house, in India has often been considered an aspirational goal. The lure of owning a property in India also attracts Non-resident Indians ("NRIs"), who have moved out of India but have an investible surplus available with them. Additionally, many NRIs also inherit ancestral or family properties and continue to hold them and enjoy the passive income therefrom. As these NRIs identify better or alternative opportunities outside India, the properties are sold, and sale proceeds are sought to be repatriated outside India.

This article seeks to touch upon the tax and FEMA aspects of the various transactions surrounding investment in Immovable Property by NRIs ranging from investment and passive income to sale and repatriation of the proceeds.

TAXABILITY OF INCOME FROM IMMOVABLE PROPERTIES

As a thumb rule, rent income or passive income arising from an immovable property is taxable in India. Rent income received by the owner of a property from the letting out of any building or land appurtenant thereto is generally taxable under the head "Income from House Property", irrespective of whether the property in question is a residential property or a commercial one. In fact, section 22 of the Income-tax Act seeks to tax the Annual Value of such property as "Income from House Property", which is determined on the basis of the higher of the actual rent received or receivable for a property or the sum for which the property might reasonably be expected to be let. Thus, a property is taxed on the basis of its capacity to earn rent even though it is not actually let out or generating rent income.

Section 23, however, provides for considering the Annual Value as Nil in case of up to two properties, which are occupied by the owner for his own residence or which cannot be so occupied by the owner on account of his employment, business or profession is carried on at any other place and he has to reside at that other place in a building which is not owned by him. Where the NRI owns more than two properties which have not been let out, then, he can opt for the Annual Value of two of the properties to be considered as Nil and the Annual Value of the remaining properties will be computed as if they have been let out. Further, if the property is used or occupied by the owner for the purposes of any business or profession carried out by the owner and the profits of such business or profession are chargeable to income-tax, then, its Annual Value is not taxable.

If, however, that leasing or renting of the property is only one of the elements of a composite contract, under which various services are provided, then, the entire income from such composite services is taxable as business income[1]. For instance, leasing of shops by a mall or renting of rooms by a hotel. When the rent income is taxable as Income from House Property, only specific deductions are allowable from the Annual Value in respect of municipal taxes paid, standard deduction of 30 per cent and interest on borrowings. As against this, in case of income taxable as business income, the taxpayer can claim any expense incurred for the purposes of the business, including depreciation on capital expenditure.

1 Krome Planet Interiors (P.) Ltd. 265 Taxman 308 (Bom HC); Plaza Hotels (P) Ltd. 265 Taxman 90 (Bom HC); City Centre Mall Nashik Pvt. Ltd. 424 ITR 85 (Bom HC)

The tax rate on income from the property for NRI in either case would be the applicable slab rate.

In the case of jointly owned properties, the income from the property would be taxable in the hands of all the owners in the ratio of their ownership. If the deed does not mention the ratio of ownership of the property between the joint owners, it would be assumed to be an equal share of each joint owner[2]. If, however, the name of any joint owner is added merely for convenience and such joint owner has neither paid for any of the purchase consideration nor has any source of income to do so, then, it would be appropriate to consider the entire income as taxable in the hands of the remaining owners[3], following the principle laid down by the Apex Court that in the context of section 22, owner is a person who is entitled to receive income from the property in his own right[4].

If the immovable property in question is simply plot of land, without any building thereon, then the charge under section 22 would not be triggered and the income from the land would instead be taxable as "Income from Other Sources" under section 56. Any expenses incurred to earn the said income can be claimed as a deduction under section 57 from the said income. The income from the land would, however, be exempt under section 10(1) if it is an agricultural income in terms of section 2(1A), which refers to rent or revenue derived from land in India used for agricultural purposes; income derived from the land by agriculture, or by the performance of any process by the cultivator or receiver of rent-in-kind to render the produce fit to be taken to the market, or sale of the produce by the cultivator or receiver of rent-in-kind; as also income derived from a building on or in the immediate vicinity of the land, subject to certain conditions.

TAXABILITY OF CAPITAL GAINS

The gains arising from the sale or transfer of immovable property, i.e., land or building or both, are taxable under section 45 as Capital Gains, classified as short-term or long-term depending on the period for which the property was held. Where the property is held by the owner for a period of more than twenty-four months immediately preceding the date of its sale or transfer, it is considered a long-term asset and the gains are taxable as Long-Term Capital Gains ("LTCG"). Where the period of holding does not exceed twenty-four months, the property is treated as a short-term asset, with the gains taxable as Short-Term Capital Gains ("STCG"). In the case of non-residents, STCG is included in the total income for the period and taxable as per the applicable slab rate, whereas LTCG is taxable under section 112 at a rate of 20 per cent, excluding applicable surcharge and cess.

The term "transfer" includes the transfer of immovable property on account of compulsory acquisition, redevelopment of old property, or even receipt of the insurance claim on account of damage to or destruction of the property, but does not include the transfer of property under a gift, will, irrevocable trust or distribution upon the partition of a Hindu Undivided Family ("HUF"). In the case of a property transferred by way of a gift, will, irrevocable trust or distribution upon the partition of an HUF and similar other situations as enumerated in section 47, the Capital Gains is taxable only in the event of a final sale or transfer and at the point of taxability, the amount of gain is computed with reference to the purchase price for the previous owner.

Further, the period of holding of the previous owner is also included while determining whether the gain on the property is Long Term or Short Term.

Section 48 lays down the computation of the amount of Capital Gain as under —

Sale Consideration
Less: Expenses incurred wholly and exclusively in connection with the transfer
Less: Cost of Acquisition
Less: Cost of Improvement
Taxable Capital Gain

As per the second proviso to section 48, in case the property is a long-term asset, the cost of acquisition and cost of improvement are indexed for the period of holding as per the cost inflation index notified by the Central Government in relation to each year. Thus, LTCG is computed with reference to a stepped-up cost, allowing for rising costs.

The various elements relevant to the computation of gains are discussed hereunder —

Sale Consideration: The transaction price at which the property is sold shall be considered to be the sale consideration, including the value of any consideration

2 Saiyad Abdulla v. Ahmad AIR 1929 All 817

3 Ajit Kumar Roy 252 ITR 468 (Cal. HC)

4 Podar Cement (P.) Ltd. 226 ITR 625 (SC)

in kind. In a situation where a property is sold at a consideration, which is lower than the value adopted or assessed for the purposes of payment of stamp duty, section 50C would come into play, requiring that such value adopted or assessed for stamp duty payment should be assumed to be the full value of sale consideration and the capital gains should accordingly be calculated with reference to such higher value.

Expenses incurred wholly and exclusively in connection with the transfer: In claiming deduction of the expenses from sale consideration, attention should be paid to the requirement that such expenses are "incurred wholly and exclusively in connection with the transfer." Expenses such as transfer fees paid to society, brokerage expenses, and legal expenses connected to the transfer such as fees for drafting of the agreement, would be allowable expenses. Further, in the case of non-residents, expenses incurred on travel to India as well as stay if incurred specifically for the purposes of executing and registering the sale agreements can also be considered as incurred wholly and exclusively in connection with the transfer.

Cost of Acquisition: As a general rule, the actual purchase price paid for acquiring a property would constitute the cost of acquisition of the property. It would include the expenses incurred at the time of purchase of the property towards stamp duty, registration fee, and brokerage. However, any payment made at the time of purchase towards recurring expenses, which form part of the purchase price, such as advance maintenance for a certain period or outstanding property taxes or electricity charges, etc. would not form part of the cost of acquisition.

The cost inflation index used for indexation of the cost follows FY 2001–02 as the base year with the index for the base year set at 100. Thus, if any property was purchased prior to 1st April, 2001, its cost cannot be indexed beyond FY 2001–02. To address this issue, in case of properties purchased by the taxpayer or the previous owner (in case of property acquired through gift, will, etc.) prior to 1st April, 2001, Section 55(2)(b) allows the taxpayer the option to adopt its original purchase price or its fair market value as on 1st April, 2001 as the Cost of Acquisition. This fair market value as of 1st April, 2001, however, cannot exceed the value of the property adopted or assessed for the purpose of payment of stamp duty as of 1st April, 2001. Where the property was purchased prior to 1st April, 2001, the original purchase cost would usually be lower than the fair market value as of 1st April, 2001. The option provided in Section 55(2)(b) would, therefore, let the taxpayer adopt the higher value as the cost of acquisition (subject to the cap of stamp duty value as on 1st April, 2001) and index it from FY 2001–02 till the year of sale. Thus, when computing capital gains in respect of an immovable property purchased by the taxpayer or the previous owner prior to 1st April, 2001, a valuation report determining the fair market value of the property as on 1st April, 2001 as well as its value for the purposes of stamp duty on the same date shall be required to be obtained.

Often, in case of ancestral properties acquired by way of inheritance, will or such other modes, the details of original purchase cost of the property are not available, making it difficult to compute the capital gains. Section 55(3) provides that in cases where purchase cost of the previous owner cannot be ascertained, the fair market value of the property as on the date on which the previous owner became the owner of the property shall be considered as the Cost of Acquisition of the previous owner.

Cost of Improvement: Any cost that has been incurred by the taxpayer or the previous owner towards making additions or alteration to the property, which is capital in nature is considered as cost of improvement and is allowable as a deduction while computing the amount of capital gains. Examples of cost of improvement include cost incurred towards adding a room or a floor to an existing property, fencing a plot of land to secure its perimeter, installation of lift, incurring expenses to make the property habitable, incurring expenses to clear the legal title of a property, which is under dispute, etc. However, expenses such as routine repairs and renovation expenses, modifications to furniture, aesthetic expenses, etc. would not be considered as Cost of Improvement. Any cost of improvement incurred prior to 1st April, 2001 is not to be considered in the computation. This restriction is in line with the fact that the taxpayer has an option to adopt the fair market value as on 1st April, 2001 as the Cost of Acquisition, which would take into account any improvements done to the property prior to 1st April, 2001 and thus, separate deductions need not be claimed for such cost of improvements. Further, any expenditure that can be claimed as a deduction in computation of income under any other head of income, cannot be claimed as a Cost of Improvement.

In case of the purchase of property, while it was under construction, the determination of the period of holding and the year from which indexation should be allowed can be debatable. The date of allotment of the future property to the taxpayer by the builder, phase-

wise payment towards the purchase cost, the date of registration of the sale agreement and the date of possession would fall in different years in such cases, leading to significant differences in the computation of the amount of taxable capital gain depending on when the property is said to be acquired by the taxpayer. Several judicial pronouncements[5] have held that where the taxpayer has been allotted a specific identified property and such allotment is final, subject only to the payment of the consideration, then, the date of allotment is to be considered as the date of acquisition of the property and the period of holding should be calculated from the date of allotment. Similarly, in the case of allotment of property along with shares in the co-operative society prior to the completion of construction or physical possession of the property, it has been held that the date of allotment should be considered as the date of acquisition of the property[6]. In fact, in the context of whether acquisition of a flat under the self-financing scheme of the Delhi Development Authority shall be considered as construction for the purposes of sections 54 and 54F, the CBDT Circular No. 471 dated 15th October, 1986 states that "*The allottee gets title to the property on the issuance of the allotment letter and the payment of instalments is only a follow-up action and taking the delivery of possession is only a formality.*"

Further, payments for an under-construction property are made by taxpayers over several years starting from the date of allotment in a phase-wise manner. It has been held by the Courts that the benefit of indexation in such cases should be allowed on the basis of payment[7], i.e., payment made in each year should be indexed from that year till the date of sale of the property. In fact, in the case of *Charanbir Singh Jolly v. 8th ITO 5 SOT 89* and thereafter, in *Smt. Lata G. Rohra v. DCIT 21 SOT 541* the Mumbai Tribunal has held that indexation for the entire purchase cost of the property should be allowed from the year in which the first instalment was paid by the assessee. While the ratio of aforesaid judgements has not been further appealed against and is, thus, valid, indexation of the entire cost from the year of first payment irrespective of date of actual payments may be considered to be an aggressive tax position and open to litigation.

However, this view is supported by the form of return of income. The form of return of income does not provide mechanism to index cost of acquisition with reference to payments made in various years. Therefore, if an assessee chooses to index cost of acquisition with reference to years in which instalments of purchase price are paid then such instalments will need to be reported in the form of return of income as cost of improvement which is technically not correct.

Where the property in question is an agricultural land, one would need to examine whether the same is a "rural" agricultural land or an "urban" agricultural land, as is referred to in common parlance. The former is excluded from the definition of a capital asset under section 2(14) and thus, gains arising from its sale would not give rise to taxable Capital Gains. An "urban" agricultural land, however, does not enjoy such an exclusion and would be subject to capital gains taxation like any other property. The distinction between "rural" or "urban" agricultural land is drawn on the basis of the location of the land with reference to local limits of municipalities and the population of such municipalities as per the latest census. Accordingly, agricultural land which is situated within any of the following areas shall be considered to be an "urban" agricultural land and thus, included within the definition of capital asset —

i) Within the jurisdiction of a municipality or any such governing body, having a population exceeding 10,000, or

ii) Within 2 km of the local limits of a municipality or any such governing body, having a population exceeding 10,000 but not exceeding 1,00,000, or

iii) Within 6 km of the local limits of a municipality or any such governing body, having a population exceeding 1,00,000 but not exceeding 10,00,000, or

iv) Within 8 km of the local limits of a municipality or any such governing body, having a population exceeding 10,00,000.

EXEMPTIONS FROM CAPITAL GAINS

The Income-tax Act contains certain beneficial provisions to provide relief from tax on the capital gains upon reinvestment into certain specified assets if the conditions laid down in those provisions are satisfied. A summary of the relevant exemption provisions applicable for capital gain arising on the sale of immovable property is given in the table below —

5 Praveen Gupta v. ACIT 137 TTJ 307 (Delhi – Trib.); CIT v. S.R.Jeyashankar 228 Taxman 289 (Mad.); Vinod Kumar Jain v. CIT 195 Taxman 174 (Punjab & Haryana)

6 CIT v. Anilaben Upendra Shah 262 ITR 657 (Guj.); CIT v. Jindas Panchand Gandhi 279 ITR 552 (Guj.)

7 Praveen Gupta (supra); ACIT v. Michelle N. Sanghvi 98 taxmann.com 495 (Mumbai-Trib.); Ms. Renu Khurana v. ACIT 149 taxmann.com 160 (Delhi-Trib.)

Section	Nature of Gain	Type of New Asset	Amount to be reinvested for full exemption	Time period for reinvestment	Lock-in period for New Asset	Capital Gain Deposit Account Scheme	Other provisions
54	LTCG on transfer of residential property	One residential property in India	Amount of Capital Gains	Purchase of new property within 1 year before, or 2 years after date of transfer; or Completion of construction of new property within 3 years after date of transfer	3 years from purchase or construction, failing which cost of the new asset shall be reduced by the amount of exemption already claimed	To be deposited before the date of filing / due date of filing the return of income	• Taxability in case of unutilised balance in CG Deposit Account • One time option to small taxpayers having LTCG less than ₹ 2 crores • Exemption capped at ₹ 10 crores
54D	Gain on compulsory acquisition of land or building or rights therein, forming part of industrial undertaking	Any other land or building or rights therein	Amount of Capital Gains	Purchase or construction within 3 years from date of transfer	3 years from purchase or construction, failing which cost of the new asset shall be reduced by the amount of exemption already claimed	To be deposited before the date of filing / due date of filing the return of income	• Use of asset for 2 years immediately prior to the date of transfer for business of the industrial undertaking • Taxability in case of unutilised balance in CG Deposit Account
54EC	LTCG on transfer of land or building or both	Specified Bonds issued by NHAI, RECL or as maybe notified	Amount of Capital Gains, subject to a maximum of ₹ 50 lakhs	Within 6 months after the date of transfer	5 years. Transfer of New Asset or monetisation other than by way of transfer within the lock-in period will result in revocation of exemption in the year of such transfer or monetisation	Not Applicable	• Interest received on Bonds is taxable. • No deduction can be claimed under section 80C in respect of the investment in bonds
54F	LTCG on transfer of any asset other than a residential property	One residential property in India	Full amount of net sale consideration. Proportionate exemption is allowed in case of lower reinvestment	Purchase of new property within 1 year before, or 2 years after date of transfer; or Completion of construction of new property within 3 years after date of transfer	3 years from purchase or construction, failing which the amount of exemption already claimed shall be deemed to be LTCG in the year of transfer of new asset	To be deposited before the date of filing / due date of filing the return of income	• Taxability in case of unutilised balance in CG Deposit Account • Added condition relating to ownership of residential house on the date of transfer of original asset or purchase or construction of one more residential house within 1 year / 3 years after the date of transfer - withdrawal of exemption in case of violation of condition. • Exemption capped at ₹ 10 crores

INCOME UNDER SECTION 56(2)(X)

Section 56(2)(x) seeks to bring into the tax net, any transactions of receipt of money or movable or immovable property without consideration or for inadequate consideration. Where any person receives an immovable property having a stamp duty value exceeding ₹50 thousand without consideration, the stamp duty value of such property is deemed to be an income of the recipient. Similarly, where a person purchases an immovable property at a consideration lower than its stamp duty value, where the difference is more than the higher of ₹50 thousand or 10 per cent of actual consideration, then, such difference between the actual consideration and stamp duty value of the property is deemed to be the income of the recipient. In other words, if any person, including a non-resident, is purchasing an immovable property in India for a value lower than its stamp duty value, then, the difference is assumed to be a benefit to the purchaser and sought to be taxed in the hands of the purchaser.

This provision intends to target property transactions that are intentionally undervalued so as to reduce the burden of stamp duty and involve cash payments. However, practically, the price of any transaction varies depending on various factors which may not reflect in the stamp duty value of the property, and it is likely that the actual transaction may genuinely take place at a value lower than the stamp duty value. To address such situations, the provisions allow a safe harbour of higher ₹50 thousand or 10 per cent of the actual consideration. If the difference in the consideration and the stamp duty value is within this safe harbour, then, it will not have any implication for the purchaser. However, if the difference exceeds the safe harbour limit, then, the entire difference will be treated as income of the purchaser.

In practice, parties may agree upon the consideration for property sale when the initial token or advance is given and enter into an agreement or MOU to document the same, but the actual registration of the sale agreement may take place subsequently after a gap, by which time the stamp duty value of the property may have increased. In such a case, the first proviso to section 56(2)(x) allows for stamp duty value as on the date of the initial agreement or MOU to be adopted provided the advance or token is paid on or before that date by account payee cheque or bank draft or electronically. Thus, if for any reason the registration of the final sale deed is delayed, the purchaser will not have to suffer taxation merely due to an increase in the stamp duty value of the property during the period of delay.

TAXABILITY UNDER A TAX TREATY

Article 6 of the OECD Model Convention deals with Income from Immovable Property, while Paragraph 1 of Article 13 deals with Gains from alienation of Immovable Property. Both these articles give the right to tax the income and capital gains relating to immovable property to the Source State where such property is situated. This is considering the fact that there is always a close economic connection between the source of income relating to immovable property and the State of source[8]. Further, the definition of the concept of immovable property as also the manner of taxation and computation is left to the Source State to decide. This helps to remove any ambiguity regarding the classification of an asset as immovable property.

Thus, in the case of NRIs having income or capital gains from immovable property in India, the manner of taxation and computation would be determined as per the domestic tax laws, which have been briefly discussed above. The NRIs can then offer to tax or report these incomes in their Residence State and claim credit for the taxes paid in India as per the provisions of the applicable tax treaty and domestic tax laws of the state of residence.

TAX DEDUCTION AT SOURCE

Section 195 requires any person making payment to a non-resident or a foreign company of any sum chargeable to tax under the Act, to deduct tax at source on such payment and deposit the same with the Government. Unlike the TDS provisions applicable in case of rent payments or property purchases amongst residents, Section 195 does not provide a fixed rate of TDS. Thus, the person making payment in respect of income from property or sale consideration to the non-resident would be required to deduct tax at source as per the applicable rate of tax on the respective transactions. In order to do so, the payer would have to obtain a Tax Deduction Account Number ("TAN"), which is often not required in case of property transactions between residents. Additionally, the payer would also have to file quarterly TDS statements in Form 27Q so as to enable the NRI to get credit of tax deducted.

As discussed earlier, the income from property, computed after claiming deductions, would be taxable for the NRI at the applicable slab rates. However, the tax would be required to be deducted at source by the payer on the entire rental income at the rate of 30 per cent as per the residuary entries for "other income" under Serial No. (1)

8 Paragraph 1 of Commentary on Article 6

(b) of Part II of the Finance Act. Further, STCG on transfer of property would also be taxable at the applicable slab rates, while LTCG would be taxable at a rate of 20 per cent plus applicable surcharge and cess. The person making the payment to the NRI in respect of the sale of the property would not be in a position to conclusively determine either the slab rate applicable to the NRI or the computation of taxable capital gains. Consequently, the payer would not be in a position to determine the appropriate rate at which the TDS obligation should be discharged.

In the above scenarios, the payer or the NRI payee can make an application to the Assessing Officer under section 195(2) or section 197 to determine the sum chargeable to tax or the rate at which tax should be deducted at source, respectively. Based on the application made, the Assessing Officer would issue a certificate determining the sum chargeable to tax or the rate at which tax deduction should be done and the payer can deduct tax under section 195 accordingly.

While no time limit has been prescribed in the provisions for the Assessing Officer to deal with such an application and issue the certificates, a 30-day timeline was provided for this process in the Citizen's Charter 2014, which was further endorsed by the CBDT in its office memorandum of 26th July 2018. Thus, the overall process of making an application for lower or nil deduction of tax, responding to queries, if any, of the tax offices and obtaining the certificate can take from 5-8 weeks. In a time-sensitive transaction and considering the logistics of transacting with an NRI, the payer or the NRI payee may not be in a position to follow the process of obtaining a lower or nil deduction certificate. In such a scenario, the payer may deduct tax at source at the rate applicable to the transaction (20 per cent plus applicable surcharge and cess in case of LTCG on sale of property and 30 per cent plus applicable surcharge and cess in other cases) on the entire amount payable to the NRI, who would be required to claim a refund of the excess tax deducted by filing a return of income.

REPORTING OF HIGH-VALUE TRANSACTIONS

Section 285BA requires various reporting persons to file a statement of financial transactions ("SFT") to report certain transactions above the specified thresholds, referred to as high-value transactions, to the Income-tax authorities, which enables the latter to evaluate if the incomes reported by the persons transacting are in line with such high-value transactions and whether there could have been any tax evasion. One of the transactions required to be reported by the Registrar or Sub-Registrar is the purchase or sale of immovable property for an amount of ₹30 lakh or more or valued at ₹30 lakh or more by the stamp valuation authority. It is a common scenario where non-residents may not have filed a return of income in India for several years as they have negligible income less than the maximum amount not chargeable to tax, and consequently, no tax liability. However, if they have entered into a transaction of purchase or sale of immovable property, the same would be reported in the SFT and would reflect against the PAN of both the buyer and the seller. This would lead to the issuance of notice by the assessing officer to investigate the reason for non-filing of return of income even though a high-value transaction was entered into during the year. It is, thus, advisable for a person entering into any of the specified high-value transactions, including the purchase or sale of immovable property, to file a return of income for the year in which such transaction is undertaken, so as to avoid unnecessary proceedings merely on the premise of such a transaction.

INVESTMENT IN IMMOVABLE PROPERTY UNDER FEMA

Acquisition or transfer of immovable property by Non-residents in India is regulated by sub-sections 2(a), (4) and (5) of section 6 of the Foreign Exchange Management Act, 1999 ("FEMA") read with Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and is subject to applicable tax laws and other duties and levies in India.

NRIs and Overseas Citizens of India ("OCIs") have general permission to invest in immovable property in India subject to certain conditions and restrictions. They can purchase residential or commercial property, other than agricultural land, plantation property, or farmhouse. NRIs and OCIs can also receive an immovable property other than agricultural land, plantation property, or farmhouse as a gift from a relative as defined in section 2(77) of the Companies Act, 2013. A NRI or OCI can also receive any immovable property as inheritance from a resident or from any person, who had acquired the property in accordance with the laws in force.

Payment for the purchase of immovable property can be made in India through normal banking channels by way of inward remittance. It can also be made out of funds held by the NRI or OCI in their NRE, FCNR(B) or NRO accounts. However, the payment cannot be made

through travellers' cheques and foreign currency notes or any other mode.

A non-resident spouse of any NRI or OCI, who is not themselves an NRI or OCI, is permitted to acquire one immovable property in India, other than agricultural land, plantation property, or farmhouse jointly with their spouse, provided the marriage has been registered and has subsisted for a continuous period of at least 2 years immediately prior to acquiring the property. In such a case, the payment for the purchase can be made by the non-resident spouse, who is not a NRI or OCI either by way of inward remittance through normal banking channels or by debit to their non-resident account maintained as per the FEMA Act or rules thereunder.

SALE AND REPATRIATION OF FUNDS

The NRI or OCI can transfer the immovable property, other than agricultural land, plantation property, or farmhouse to a resident or another NRI or OCI. Transfer by way of gift can only be made to a relative as defined in section 2(77) of the Companies Act, 2013. Further, transfer of agricultural land, plantation property, or farmhouse can only be made to a person resident in India.

As a general rule, any person, who had acquired an immovable property when they were a resident in India or inherited from a person resident in India or their successor, requires RBI approval to remit the sales proceeds of the property. However, under the Foreign Exchange Management (Remittance of Assets) Regulations, 2016, NRIs and PIOs are permitted to remit up to USD 1 million per financial year, out of the sale proceeds of such assets in India. The limit of USD 1 million shall apply qua a financial year, irrespective of how many such assets may have been sold during the year.

In all other cases, the NRIs, OCIs and PIOs (in case of property acquired under the erstwhile Foreign Exchange Management (Acquisition and transfer of Immovable Property in India) Regulations, 2000, can repatriate the sale proceeds of immovable property outside India provided the following conditions are satisfied —

i) The property was acquired by the NRI / OCI / PIO as per the laws in force at the time of acquisition;

ii) The payment for the purchase of property was made by way of inward remittance through normal banking channels or out of balances in NRE / FCNR(B) account; and

iii) The repatriation of sale proceeds for residential property is restricted to not more than two properties.

In the case of point ii) above, if the NRI / OCI / PIO had acquired the property through housing loans availed in accordance with the applicable FEMA regulations, then the repayment ought to have been made by way of inward remittance through normal banking channels or out of balances in NRE / FCNR(B) account.

PROPERTIES IN INDIA BY CITIZENS OF NEIGHBOURING COUNTRIES

Citizens (including natural persons and legal entities) of certain countries — Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau, Hong Kong, and the Democratic People's Republic of Korea — cannot acquire or transfer immovable property in India, without the prior permission of RBI. They can, however, acquire the property on lease, which does not exceed 5 years. These restrictions do not apply in case of an OCI.

However, the regulations prescribe some relaxations in case of citizens of neighbouring countries Afghanistan, Bangladesh, or Pakistan, who belong to the minority communities in those countries, i.e., Hindus, Sikhs, Jains, Buddhists, Parsis and Christians. If such a person is residing in India and has been granted a Long-Term Visa ("LTV") by the Central Government, he can purchase only one residential immovable property in India for his own residence and only one immovable property for self-employment, subject to the following conditions —

i) The property should not be located in, and around restricted / protected areas notified by the Central Government and cantonment areas.

ii) A declaration should be submitted to the district Revenue Authority specifying the source of funds and that the person is residing in India on an LTV.

iii) The registration documents of the property should mention the nationality and the fact that such a person is on an LTV.

iv) The property of such a person may be attached/ confiscated in the event of his/ her indulgence in anti-India activities.

v) A copy of the documents of the property shall be submitted to the Deputy Commissioner of Police /

Foreigners Registration Office / Foreigners Regional Registration Office concerned and to the Ministry of Home Affairs (Foreigners Division).

vi) Sale of such property is permissible only after the person has acquired Indian citizenship. However, if the property is to be transferred before acquiring Indian citizenship, then, it would require the prior approval of the Deputy Commissioner of Police (DCP) / Foreigners Registration Office (FRO) / Foreigners Regional Registration Office (FRRO) concerned.

CONCLUSION

The acquisition and sale of immovable property in India by non-residents has several nuances under both the tax laws and FEMA. Several aspects discussed in the above article may have different implications depending on the facts of each case. For instance, in order to decide which payments can be included in the Cost of Acquisition or Cost of Improvement would require one to understand the nature of payments as well as their context. Similarly, as discussed in this article, the determination of the period of holding and indexation of cost can have its own complexities in cases of purchase of under-construction property with phase-wise payment and the conclusion can vary on the basis of the facts of the case. The aim of this article is to highlight the various aspects to be considered by individuals involved in property transactions, especially non-residents, and to bring about awareness regarding the applicable provisions and regulations so that the detailed facts of each case can be examined in light of these. ■

EMIGRATING RESIDENTS AND RETURNING NRIs

RUTVIK SANGHVI | BHAVYA GANDHI
Chartered Accountants

1. This article is a part of the series of articles on income-tax and FEMA issues faced by NRIs and deals with issues faced by individuals when they change their residential status. A resident who leaves India and turns non-resident is termed as a "Migrating Resident"; while a non-resident of India, who comes to India and becomes a resident of India is termed as a "Returning NRI" in this article.

2. Both Migrating Residents and Returning NRIs have to consider implications under income-tax and FEMA before taking any decision for change of residence. We have come across several instances where such a person has not taken due care before change of residence leading to unnecessary and avoidable legal issues. After the advent of the Black Money Act[1], there are instances where corrective action is quite difficult under law. Further, resolution of violations under FEMA can be difficult or costly to undertake.

3. Key to the above concern is the fact that residential status definitions under the Income-tax Act (ITA) and FEMA are separate and different. While under ITA, the definition is largely based on number of days stay of the individual in India; under FEMA, it is based on the purpose for which the person has come to, or left India, as the case may be. An important objective in advising persons who are migrating from India or returning to India, thus, is to determine the date on which the change in residence has been effected and purpose thereof. Any discrepancy in this can lead to assumption of incorrect residential status which can have adverse implications, some of which are as under:

a. Concealment of foreign income which should have been submitted to tax as well as non-disclosure of foreign incomes and assets, which can have severe implications under the Black Money Act;

b. Incorrect claim of benefits under the Double Tax Avoidance Agreements (DTAAs);

c. Holding assets or executing transactions which are in violation of FEMA.

4. The provisions of residential status under the ITA, the DTAA and under FEMA are dealt in detail in th preceding articles of this series — in the December 2023 and January and March 2024 editions, respectively, of *The Bombay Chartered Accountant Journal* (the Journal) — and hence, not repeated here. Readers will benefit by referring to those articles for issues covered therein. This article deals with income-tax and FEMA issues specifically for Migrating Residents and Returning NRIs[2] and is divided into three parts as follows:

Sr. No.	Topic
	Part-I
A.	**Migrating Residents**
A.1	Income-tax issues of Migrating Residents
A.2	FEMA issues of Migrating Residents
A.3	Change in Citizenship
	Part-II
B.	**Returning NRIs**
B.1	Income-tax issues of Returning NRIs
B.2	FEMA issues of Returning NRIs
C.	**Other relevant issues common to change of residential status**

Issues related to Returning NRIs and other relevant issues common to change of residential status will be covered in Part II of this Article in the upcoming issue of the Journal.

A. Migrating Residents

India has the world's largest overseas diaspora. In fact,

1 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

2 There is an overlap of several sections under different topics. To prevent repetition and focus on the relevant issues, the sections are not repeated completely. Only the applicable provisions or part thereof, which are relevant to the topic, are referred here.

every year, 25 lakh Indians migrate abroad.[3] While Indians shift and settle down abroad, it seldom happens that they eliminate their financial ties with India completely. The common reason being that either they continue to own assets or continue their businesses in India, or their relatives stay in India with whom they enter into transactions. Hence, Migrating Residents generally have a continuing link with India even after they have left India. This can create issues under income-tax and FEMA, which are analysed in detail below.

A.1 Income-tax issues relevant for Migrating Residents:

1. Continuing Residential status under ITA: An issue that Migrating Residents need to keep in mind in particular is their residential status in the year of migration. Clause (a) of Explanation 1 to Section 6(1)(c) of the ITA provides a relief from the basic "60 + 365 days test"[4]. The relief is available only under two specific circumstances, i.e., a citizen who is leaving India during the relevant previous year for the purposes of employment abroad or as a crew member on an Indian ship. If a person does not fall under either of these circumstances, the "60 + 365 days test" test applies.

Hence, in such cases, if a person who was normally residing in India, stays in India for 60 days or more during the year of his or her departure, he or she will meet the "60 + 365 days test" and consequently, be a resident for the whole previous year under ITA and will be classified as ROR. In such cases, following implications should be noted:

1.1 As a resident, scope of total income under Section 5 of the ITA includes all incomes accruing or arising within or outside India. Hence, foreign incomes would be prima facie taxable, subject to relief under the relevant DTAA. **However, in the year of migration, even treaty benefits may not be available as the Migrating Resident may not be considered as a resident of the other country.** Further, the exposure is not just regarding tax, interest and penalty under the Income-tax Act on concealment of income, but also the penal provisions under the Black Money Act for non-disclosure of foreign incomes and assets.

1.2 **The issue gets compounded for a Migrating Resident who would otherwise not need to file a tax return but is now required to file a tax return as they would generally have a foreign bank account abroad.** A common example is of students who are leaving India. Fourth proviso to Section 139(1) provides that those persons who are resident and ordinarily resident of India and hold or are beneficiary of any foreign asset are required to file their tax return in India even if they are not required to file a tax return otherwise. The same issue can come up for senior citizens or spouses who generally are not filing tax returns, but now need to do so in the year they are moving abroad. It should be noted that this requirement has no relief even if such person is termed as a non-resident for the purposes of the treaty under the relevant DTAA. Such an error can lead to harsh penalties under the Black Money Act for non-disclosure of foreign incomes and assets.

Hence, persons migrating abroad should be careful about their residential status in the year of migration.

1.3 Deemed Resident: Another instance where a Migrating Resident may still be considered as a resident under the ITA is due to the application of Section 6 (1A) of the ITA. This sub-section provides for an individual to be deemed as a resident of India if such individual, being a citizen of India, has total income other than income from foreign sources exceeding ₹15 lakhs during the previous year and is not liable to tax in any other country or territory by reason of domicile or residence or any other criteria of similar nature. While such deemed residents are considered as Resident but Not Ordinarily Resident as per Section 6(6)(d) of the ITA, their foreign incomes derived from a profession setup in India, or a business controlled from India are covered within the scope of income liable to tax in India. Readers can refer to the December 2023 edition of the Journal for an exposition on this provision.

1.4 Recording the change in status: On a person turning non-resident, his or her status should be correctly selected in the tax returns filed starting from the relevant assessment year of change in residence. It should be noted that the change in status recorded in the tax return does not automatically update the person's status on the income-tax portal. Hence, such status should be changed on the income-tax portal also. Further, as of now, there seems to be no linking between the status updated in the tax return filed or on the income-tax portal with that recorded as per the local ward in the income-tax department. Hence, one should always

3 https://www.moneycontrol.com/news/immigration/immigration-where-are-indians-moving-why-are-hnis-leaving-india-12011811.html

4 "60 + 365 days test" means that the individual has stayed in India for 60 days or more during the relevant previous year and for 365 days or more during the four preceding years.

ensure that such change is recorded in the local ward and the PAN is shifted to a ward which deals with non-residents. This will ensure that the status has been recorded in all manners with the tax department. This can be quite useful when the department issues notices to such persons.

2. Impact on change of residential status under ITA: On change of residence, following are the important changes to keep in mind as far as ITA is concerned:

Particulars	ROR	NOR	NR
Scope of Total Income[5]	Global incomes taxable	Indian-sourced incomes are taxable. Foreign-sourced income are taxable only if derived from a business controlled in India or profession set up in India. Incomes being received for the first time in India are also taxable.	Only Indian-sourced incomes taxable. Foreign-sourced incomes are not taxable at all. Incomes being received for the first time in India are also taxable.
Set-off of capital gains, dividend, etc., against unexhausted basic exemption limit	Allowed[6]		Not allowed
Dividend	Taxed at the applicable slab rate.		Taxed @ 20%[7] plus applicable surcharge & cess. (No set-off against unexhausted basic exemption, as stated above. No benefit of lower slab rate since special rate is mentioned.)
LTCG on unlisted securities and shares of	20% with indexation[8]		10% without the benefit of indexation and forex fluctuation[9]
a company, not being a company in which public are substantially interested			
Withholding tax under ITA where the person is recipient of income	Generally, at lower rates		Generally, at a higher rate unless treaty relief availed
Access to Indian DTAAs	Available as Resident of India under the DTAA		Available if he is a resident of such host country as per the DTAA
FCNR Interest[10]	Taxable	Not taxable	
NRE Interest[11]	Exempt if the person is non-resident under FEMA		
Benefits provided to senior citizens — higher basic exemption limit, non-applicability of advance tax in certain situations, higher deduction for medical premium u/s. 80D, deduction u/s. 80TTB, etc.	Available		Not available

3. Transfer Pricing: Transfer Pricing triggers in case of a transaction which can give rise to income (or imputed income) between associated enterprises (parties related to each other as per Section 92 of the Income-tax Act), of which at least one party is a non-resident. All such transactions must be on an arm's length basis. The implications under Transfer Pricing on the shift of a person from India can lead to unnecessary complications. However, in some cases, such an implication may be unavoidable. Thus, the incomes earned by a Migrating Resident from his related enterprises in India and other International transactions with such enterprises would be subject to Transfer Pricing. There is no threshold on application of Transfer Pricing provisions.

5 Section 5 of ITA.
6 Proviso to Section 112(1)(a) and Proviso to Section 112A (2) of ITA.
7 Section 115A(1)(A)
8 Section 112(1)(a)(ii)
9 Section 112(1)(c)(iii)
10 Section 10(15)(iv)(fa)
11 Section 10(4)(ii)

Having considered the issues under the ITA, a Migrating Resident would need to study the impact of the DTAA, too, especially with regard to reliefs available. A detailed study of residential status as per the DTAA has been dealt with in the January 2024 issue of the Journal. Here, we focus on the issues a Migrating Resident needs to be concerned about:

4. Treaty relief:

4.1 A person can access DTAA if he is a resident of at least one of the Contracting States. To consider a person as resident of a Contracting State, DTAAs generally refer to the residential status of the person under domestic tax laws of the respective country. While there are different permutations possible, one important point to note is that while migrating abroad, there can be an overlapping period wherein the person is a resident of India as well as the foreign country during the same period. This leads to dual residency, for which tie-breaker tests are prescribed under Article 4(2) of the DTAA. There could also be a possibility of the concept of split residency under DTAA being applicable. Accordingly, the provisions of the DTAA can be applied. These provisions have been explained in detail in the second article of this series contained in the Journal's January edition.

4.2 A dual resident status under the treaty can lead to the person being able to claim the status of a non-resident of India as per the relevant treaty even though they are a resident as far as the ITA is concerned. While this would provide them benefits under the treaty as applicable to a non-resident of India, it would not change their status under the ITA. Such persons would still need to file their tax return as a resident of India, and they would be treated as a non-resident only as far as application of the benefits of treaty provisions is concerned.

4.3 It should be noted that the benefit of treaty provisions as a non-resident is not automatic and is subject to conditions on whether such person qualifies as a tax resident of the country of his new residence as per the definition of the respective DTAA. Further, as per Section 90(4), a tax residency certificate should be obtained from the foreign jurisdiction. At the same time, as per Section 90(5), Form 10F needs be submitted online.

4.4 Individuals who claim treaty benefits without proper substance in the country of residence risk exposure to denial of such benefits under the anti-avoidance rules of the treaty like Principal Purpose Test or those of the Act in the form of General Anti-Avoidance Rules (GAAR) where the main purpose of such change of residence was tax avoidance.

A.2 FEMA issues of Migrating Residents:

5. Residential status: The concept of residential status under FEMA has been dealt with in the March 2024 edition of the Journal. FEMA uses the terms "person resident in India"[12] and "person resident outside India"[13]. For simplicity, these terms are referred to as "resident" and "non-resident" in this article.

It is pertinent to note from the said article that only a claim that the person has left India — for or on employment, or for carrying on business or vocation, or under circumstances indicating his intention to stay outside India for an uncertain period — is not sufficient to be considered as a non-resident under FEMA. The facts and circumstances surrounding the claim are more important and should be backed up by documentation as well. For instance, leaving India for the purpose of business should be based on a type of visa which allows business activities and to support the purpose. Similarly, a person claiming to be leaving India for employment abroad should be backed up not only by an employment visa but also a valid employment contract; actual monthly salary payments (instead of just accounting entries); salary commensurate to the knowledge and experience of the person; compliance with labour and other applicable employment laws; etc. In essence, the intent and purpose should be backed by facts substantiated by documents which prove the bona fides of such intent.

6. Scope of FEMA: Once a person becomes non-resident under FEMA, such person's foreign assets and foreign transactions are outside FEMA purview except in a few circumstances. However, such person's assets and transactions in India would now come under the purview of FEMA. This can create issues in certain cases.

A common example of this is loans and advances between a Migrating Resident and his family members, companies, etc. On turning non-resident, the person generally does not realise that such fresh transactions can now be undertaken only as allowed under FEMA. A simple loan transaction can be a cause of unintended violations under FEMA — resolution for which is

12 As defined in Section 2(v) of FEMA

13 As defined in Section 2(w) of FEMA

generally not easy.

7. Existing Indian assets of migrating persons:

7.1 For a Migrating Resident, transacting with his or her own Indian assets after turning non-resident results in capital account transactions and, thus, can be undertaken only as permitted under FEMA. Section 6(5) of FEMA comes to the rescue in such a case. It allows a non-resident to continue holding Indian currency, Indian security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he or she was a resident of India. In essence, Section 6(5) of FEMA allows non-residents to continue holding their Indian assets which they acquired or owned when they were residents.

7.2 This also includes such assets or investments which cannot be otherwise owned or made by a non-resident. For instance, non-residents are not allowed to invest in an Indian company which is engaged in real estate trading. However, if a resident individual has invested in such a company and he later becomes a non-resident, he can continue holding such shares even after turning non-resident.

7.3 However, it should be noted that Section 6(5) permits only holding the existing assets. Any additional investment or transaction should conform with the FEMA provisions applicable to such non-residents.

Hence, if such an individual wants to make any further investment in the real estate trading company after turning a non-resident, he can do so only in compliance with FEMA. As investment by an NRI in an entity which undertakes real estate trading in India is not permitted under the NDI Rules[14], such further investment would not be allowed even if the migrating person owned stake in such an entity before they turned non-resident.

7.4 Further, incomes earned, or sale proceeds obtained, from such assets can be utilised only for purposes permissible to a non-resident. **Thus, incomes earned by a non-resident from assets he held as a resident cannot be utilised, for instance, to invest in a real estate trading company in India.** This is in contrast to Section 6(4) of FEMA which applies to Returning NRIs who are permitted to invest and utilise their incomes earned on their foreign assets covered under Section 6(4) or sale proceeds thereof without any approval from RBI even after they turn resident. This concept of Section 6(4) will be explained in detail in the second part of this article dealing with Returning NRIs.

7.5 Other assets: Section 6(5) of FEMA specifies only three assets: Indian currency, Indian security or any immovable property situated in India. A person would generally own several other assets. For instance, the person may have an interest in a partnership firm, LLP, AOPs or may own gold, jewellery, paintings, etc. There is no clarity provided in FEMA or its notifications and rules on continued holding of such other assets. **However, as a practice, a person is eligible to continue holding all the Indian assets after turning non-resident which he owned or held as a resident. In fact, even the business of all entities can continue.**

7.6 Repatriation of sale proceeds and incomes: On the migrating person turning non-resident, assets in India are considered to be held on a non-repatriable basis. That is, the sale proceeds obtained on transfer of such assets are not freely repatriable outside India. This is because transfer of an asset held in India by a non-resident is a capital account transaction and full remittance of sale proceeds of such assets covered under Section 6(5) is not specifically allowed.

However, separately, on turning non-resident, NRIs (including PIOs and OCI card holders) are allowed to remit up to USD 1 million per financial year from their funds lying in India[15]. It should be noted that such remittances can be only from one's own funds. Remittances in excess of this limit would be only under approval route and there are low chances of the RBI providing any relief in such cases. Thus, in essence, a Migrating Resident would have limited repatriability as far as sale proceeds of their assets in India covered under Section 6(5) are concerned.

Incomes generated from such investments, say dividend, interest, etc., can be freely repatriated from India without any limit as these are considered as they are current account transactions for which there are no limits on repatriation under FEMA for a non-resident.

7.7 Applicability of Section 6(5) of FEMA:

Section 6(5) of FEMA reads as under:

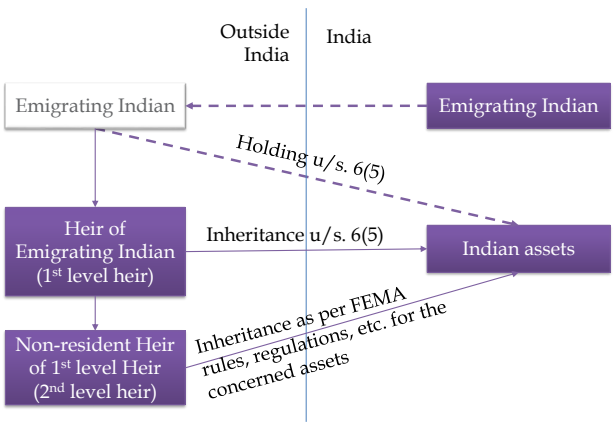
14 Non-debt Instrument Rules, 2019

15 Regulation 4(2) of Foreign Exchange Management (Remittance of Assets) Regulations, 2016

(5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

The first limb of Section 6(5) of FEMA allows non-residents to hold specified Indian assets which they owned or held as a resident. The second limb of Section 6(5) further allows the non-resident heir of such a migrating person also to inherit and hold such assets in India.

Thus, Section 6(5) allows both the Migrating Resident and his or her non-resident heirs to continue holding the Indian assets. It should be noted this provision covers only one level of inheritance, i.e., from the **migrating person** who has become non-resident **to his non-resident heir.** Later, if say the **heir of such non-resident heir** acquires such assets by way of inheritance, it is not covered under Section 6(5). The relevant notifications, rules, etc., under FEMA corresponding to the concerned assets need to be checked for the same. The permissibility for holding and inheritance under Section 6(5) can be summarised as follows:



An area of interpretation arises on a plain reading of the second limb of Section 6(5) which suggests that it covers inheritance by a non-resident heir only from a resident as the phrase reads as "a person who *was resident* in India". However, the intention is to cover **inheritance by a non-resident heir from another non-resident who had acquired the Indian assets when he *was resident* and later turned non-resident.** Hence, if a non-resident acquires any asset in India by way of inheritance from a resident, the relevant notifications, rules, etc., under FEMA corresponding to the concerned assets need to be checked if they are permitted. For instance, if a non-resident is going to acquire an immovable property situated in India from a resident, it needs to be checked whether such inheritance is permitted under the NDI Rules[16]. Under Rule 24(c) of NDI Rules, an individual, who is non-resident, is permitted to acquire an immovable property situated in India by way of inheritance only if such person is an NRI or OCI cardholder. Hence, in this case, if the non-resident is an NRI or OCI cardholder, only then he is permitted to inherit an immovable property situated in India from a resident. This case will not be covered under Section 6(5).

Apart from the general relief under Section 6(5) of FEMA, there are certain specific assets and transactions which are dealt with separately under the notifications as explained below.

7.8 Bank and Demat Accounts: Bank and demat accounts normally held by persons staying in India are Resident accounts. When a resident individual turns non-resident, he is required[17] to designate all his bank and demat accounts to Non-Resident (Ordinary) account - NRO account. One must note that there is no specific procedure under FEMA for a person to claim or to even intimate to the authorities that they have turned non-resident on migrating abroad. Unlike OCI card, there is no NRI card. Further, there is no concept of a certificate under FEMA like a Tax Residency Certificate under ITA. The simplest manner this claim can be put forward is by designating their bank account as a Non-Resident (Ordinary) account (NRO) account. Thus, it is important that a Migrating Resident does not delay in designating their bank account as an NRO account. This becomes the primary account of the person for Indian transactions and investments. It should be noted that banks will ask for related documents which substantiate the change in residential status of the individual for designating the account as NRO. **In fact, the redesignation of account as NRO is the most widely accepted recognition of a person as an NRI under FEMA, and therefore, it is important for the Migrating Resident to intimate his banker about the change of residential status.**

Once the Migrating Resident becomes a non-resident as per FEMA, they are permitted to open different type of

16 Non-debt Instrument Rules, 2019

17 Para 9(a) of Schedule III to FEMA Notification No. 5(R)/2016-RB. FEM (Deposit) Regulations, 2016.

accounts like NRE account, FCNR account, etc., which provide permission to hold foreign currency in India, flexibility of making inward and outward remittances without limit or compliances, etc. Once a person becomes non-resident, he can take benefit of opening such accounts. (The provisions pertaining to the same will be dealt with in detail in the upcoming parts of this series of articles.)

7.9 Loans:

i. Loan taken by a Migrating Resident from bank: If a loan is taken by a resident from a bank and he later turns non-resident, the loan can be continued. This is subject to terms and conditions as specified by RBI, which have not been notified. However, in practice, banks are allowing non-residents to continue the loans taken by them when they were residents.

ii. Loan between resident individuals: Where a loan is given by one resident individual to another, FEMA would not apply. If the lender becomes a non-resident later, repayment of the same can be done by the resident borrower to the NRO account of the lender. There is no rule or provision in FEMA for a situation where the borrower becomes a non-resident. However, in such case, the borrower can repay the loan from his Indian or foreign funds. It should not be an issue.

7.10 Immovable properties: NRIs and OCIs are permitted to acquire immovable property in India, except agricultural land, farmhouse or plantation property[18]. However, what if a person owned such property as a resident and later turned non-resident. Section 6(5) covers any type of immovable property which was acquired or held as a resident. Hence, one can continue holding any immovable property after turning non-resident including agricultural land.

7.11 Insurance: Almost every Migrating Resident would have existing insurance contracts covering both life and medical risks. While there is no specific clarification on continuance of such policies, a Migrating Resident can take recourse to the Master Direction on Insurance[19] which provides that for life insurance policies denominated in rupees issued to non-residents, funds held in NRO accounts can also be accepted towards payment of premiums apart from their other accounts. Settlement of claims on such life insurance policies will happen in foreign currency in proportion to the amount of premiums paid in foreign currency in relation to the total amount of premiums paid. Balance would only be in rupees by credit to the NRO account of the beneficiary. This would also apply in cases of death claims being settled in favour of residents outside India who are assignees or nominees on such policies.

7.12 PPF account: Non-residents are not permitted to open PPF accounts. However, residents who hold PPF account and turn NRIs (and not OCIs) are permitted to deposit funds in the same and continue the account till its maturity on a non-repatriation basis.[20] While extension is not permitted, as a practice, the account is permitted to be held after maturity but additional contributions are not allowed.

7.13 Privately held investments: Migrating person who holds investments in entities like unlisted companies, LLPs, partnership firms, etc. should intimate such entities about change in residential status.

8. Remittance facilities for non-residents: The remittance facilities for non-residents are generally higher and more flexible than for residents. These will be dealt with in detail in the upcoming editions of the Journal. However, an important point pertaining to the year of migration is highlighted below.

The bank, broker, etc., should be intimated about the change in residential status. Once the resident accounts are designated as NRO, the remittance facilities available for non-residents can be utilised.

One must note that, conservatively, the remittance facilities are to be considered for a full financial year and hence cannot be utilised as applicable for residents as well as non-residents in the same financial year. For instance, let's say, a resident individual has utilised the maximum LRS limit of USD 250,000 available to him. In the same year, he migrates abroad and wishes to remit USD 1 million as a non-resident under FEMA. However, since the person had already remitted USD 250,000 during the year, albeit as a resident, he cannot remit another USD 1 million after turning non-resident. He can remit only up to USD 750,000 during that year. From the next financial year, the person can remit up to USD 1 million per year.

18 Rule 24(a) of FEM (Non-debt Instruments) Rules, 2019

19 FED Master Direction No. 9/ 2015-16 - last updated on 7th December, 2021

20 Notification GSR 585(E) issued by Ministry of Finance dated 25th July 2003.

9. Foreign assets directly held by Migrating Residents:

9.1 More and more residents today own assets abroad. Generally, a resident individual could be holding overseas investment by way of Overseas Direct Investment (ODI), Overseas Portfolio Investment (OPI) or an Immovable Property (IP) abroad as per the Overseas Investment Rules, 2022. Let us consider that such an individual migrates abroad. Does FEMA apply to these foreign assets after such person becomes a non-resident? There is no express provision in the law or any clarification from RBI regarding applicability of FEMA in such cases.

9.2 The general rule is that FEMA does not apply to the foreign assets and foreign transactions of a non-resident. Hence, prima facie, where an individual turns non-resident, his foreign assets are out of FEMA purview. Thus, foreign investments and foreign immovable property obtained under the LRS route would go out of the purview of FEMA once a person turns non-resident.

9.3 However, there is a grey area for investments made under the ODI route by resident individuals. This is because investments under the LRS-ODI route stand on a footing different from other foreign assets of resident individuals. Many Resident Individuals set up companies abroad under the LRS-ODI route[21], establish their overseas business and then migrate abroad. What gets missed out is to determine whether FEMA continues to apply even after they have turned non-resident.

Under LRS-ODI route, the investment and disinvestment need to be done as per pricing guidelines; all incomes earned on the investment and the sale proceeds thereof need to be repatriated to India within 90 days; reporting of every investment or disinvestment is required, etc. It is not clear whether these disinvestment norms and reporting requirements continue to apply after the person turns non-resident.

It is understood that when an intimation is provided that all the residents owning the foreign entity under the LRS-ODI route have turned non-resident, the RBI suspends the associated UIN[22] but does not cancel it. This is done so that there is no trigger from the system for filing of Annual Performance Report (APR). In case the Migrating Residents decide to return to India in future and turn resident again, the suspension on the UIN would be removed and compliance requirements would restart.

Apart from the compliance requirements, there are other rules that apply to investments under the LRS-ODI Route like pricing guidelines, repatriation of incomes and disinvestment proceeds, reporting of modifications in the investment, etc. There is no clarity on whether these rules continue to apply to such overseas investments once the Migrating Resident turns non-resident. One view is that in such a case the Resident should follow the applicable ODI rules. This is because the facility provided for making investments abroad under ODI route is with the underlying purpose that incomes and gains earned on such foreign investments would be repatriated back to India as and when due. Another reason seems to be that when the investment is made under LRS-ODI, the individual has used foreign exchange reserves of India and therefore, he or she is required to give the account of use of such funds till the investment is divested and compliances are completed. The alternate view is that FEMA does not apply to a foreign asset held by a non-resident individual. Hence, no compliance with rules under FEMA is required. Both views can be considered valid. However, without any clarification under the law, one should seek clarification from the RBI and then proceed in the alternate case.

10. Overseas Direct Investment (ODI) made by Indian entities of Migrating Residents: One more common structure is where the Indian entities owned by resident individuals make ODI in foreign entities. Later, the individuals migrate abroad. Since they have turned non-residents, FEMA does not apply to such individuals. However, sometimes these non-residents also consider that their overseas entities are also free from FEMA provisions.

Hence, they enter into several transactions like borrowing funds from such foreign entity, directing such entity to undertake portfolio investments, utilise the funds lying in such entity for personal purposes of the shareholders or directors, etc. All such transactions are not permitted under the ODI guidelines. **It should be noted that once an investment is made in a foreign entity under ODI route by an Indian entity, the ODI guidelines need to be followed by the foreign entity irrespective of the residential status of its ultimate beneficial owners. Such a foreign entity can only do the specified business for which it has been**

21 Route adopted for overseas direct investment by Resident Individuals as per Rule 13 of Overseas Investment Rules, 2022 or as per erstwhile Reg. 20A of FEM (Transfer or Issue Of Any Foreign Security) Regulations, 2004.

22 Unique Identification Number provided for each ODI investment.

set up abroad. Thus, if such an entity enters into any transaction outside its business requirements, it would be considered as a violation under FEMA.

A.3. Change of citizenship — FEMA & Income-tax issues: Apart from change of residence, a few Migrating Residents also end up changing their citizenship. Such people obtain citizenship of foreign countries for varied reasons: to avail better opportunities in such countries; to avoid regular visa issues, for ease of entry in other countries, etc. Since India does not allow dual citizenship, such people need to revoke their Indian citizenship. Between 2018 to June 2023, close to 8,40,000 people renounced their Indian citizenship.[23] Further, India has allowed such individuals access to a special class of benefits as an Overseas Citizen of India. Several benefits have been conferred to OCI cardholders under FEMA and are treated almost at par with NRIs (who are Indian citizens but non-resident of India). The concepts of PIO and OCI have been explained in detail in the March edition of the Journal. Further, Indian residents and those coming on a visit to India, who have obtained foreign citizenship, also need to keep certain issues in mind. These issues are highlighted below.

11. OCI vs PIO card: It should be noted that the PIO scheme has been replaced with OCI scheme. Under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, Foreign Exchange Management (Debt Instruments) Regulations, 2019 and Foreign Exchange Management (Borrowing & Lending) Regulations, 2018, only OCIs are recognised and not PIOs. Hence, this creates issues for borrowing and lending, investments in India, etc., if the individual, though of Indian origin, has not obtained an OCI card. An important point that may not miss the attention of PIOs is that **inheritance** of immovable properties and Indian securities is also permitted under these notifications only to OCI Cardholders and not PIOs. **Most PIOs should be eligible for OCI status and hence, they should obtain OCI cards if they have, or will have, financial links with India.**

12. Applicability of Section 6(1A) of the ITA: Section 6(1A) of the Income-tax Act which deems persons as Not Ordinarily Residents under certain circumstances applies only to Indian citizens. Hence, it does not apply to those who are not Indian citizens.

13. Leaving for the purpose of employment abroad: The benefit of leaving for employment outside India provided under Expl. 1(a) of Section 6(1)(c) is available only to Indian citizens. Hence, a person who is not an Indian citizen, cannot take this benefit.

14. Donations: Indian charitable trusts are not allowed to accept donations from foreign citizens unless they have obtained approval under the Foreign Contribution Regulation Act (FCRA). This prohibition is irrespective of whether the person is a PIO or an OCI. While it is a violation for the trust to accept the donation, even the donor should keep this in mind to not be a party to any contravention. At the same time, **the FCRA prohibition does not apply to a non-resident who is a citizen of India. Hence, NRIs can continue to donate to Indian charitable trusts.**

15. Citizenship-based taxation: In certain countries like the USA, the domestic tax laws have citizenship-based taxation whereby its citizens are taxed on their global incomes, irrespective of where they stay during the year. Even green card holders are taxed in a similar manner in the USA. Such persons when they return to India become dual residents on account of their physical stay in India and their foreign citizenship. Hence, such persons will be liable to tax on their global incomes both in India and the foreign country. Several issues of Double Tax and foreign tax credit arise in such cases and hence, proper planning is required.

16. Relief of disclosure of foreign assets: There is a limited and conditional relief from reporting of foreign assets under Schedule FA of the income-tax return forms for foreign citizens who have become tax residents while they are in India on a business, employment or student visa.

The above analysis intends to highlight the various issues that a Migrating Resident should be aware of. They should not be considered as a comprehensive list of issues that apply to a Migrating Resident. Issues relevant to "Returning NRIs" and other relevant but common issues of concern related to change of residence including inheritance tax, anti-avoidance rules under ITA, succession planning, documentation and record-keeping, etc., will be dealt with in the forthcoming issue of the Journal as Part II of this article. ■

23 Answer by Ministry of External Affairs in Rajya Sabha to Question No. 2466 dated 10th August, 2023

EMIGRATING RESIDENTS AND RETURNING NRIs – PART-II

RUTVIK SANGHVI | BHAVYA GANDHI
Chartered Accountants

This article is part of the ongoing series of articles dealing with Income-tax and FEMA issues related to NRIs. This is the second part of the two-part article on the interplay of Income-tax and FEMA issues for Emigrating Residents and Returning NRIs. Part-I of this article was published in the June 2024 edition of the BCAS Journal. It dealt with concepts and controversies related to migrating residents and change of citizenship. One can refer to Paragraphs 1 to 4 at the start of Part-I for introductory points in relation to movement from one country to another. Part-II — this part — is in continuation to Part-I and covers issues related to Returning NRIs. At the end of this article certain considerations which are common to both sets of people — migrating residents and returning NRIs — are also dealt with in Para C.

B. Returning NRIs

A recent survey highlights that at least 60 per cent of NRIs in the US, UK, Canada, Australia, and Singapore are considering returning to India after retirement[1] . Apart from retirement, there are several other reasons due to which NRIs return to settle back in India — to stay with family members in India; due to their or their family members' health reasons; citizenship issues in the foreign country; political instability in the foreign country; etc. In our experience, some of them are also returning for new and better business opportunities which are available in India now.

Under FEMA, there are different and overlapping classifications for non-residents like Non-resident Indian (NRI), Persons of Indian Origin (PIO), and Overseas Citizen of India (OCI) cardholders. This article covers all such people and collectively refers to all non-residents of India who come to India and become Indian residents as "Returning NRIs." Such persons, if they are foreign citizens, should also refer to Para 11 to 16 in Part-I of this Article[2] , which covers issues pertaining to change of citizenship.

The Income-tax and FEMA issues pertaining to Returning NRIs are explained in detail below:

B.1 Income-tax issues of Returning NRIs

17.1[3] Residential status

If a Returning NRI is determined to be Resident & Ordinarily Resident (ROR), their global incomes are taxable in India. Further, such a person needs to disclose all their foreign assets (including those which were acquired when the person was non-resident) and foreign incomes in their tax return. Any non-compliance exposes the person not only to interest and penalties under the Income-tax Act, but also the penal provisions under the Black Money Act[4] for non-disclosure of foreign incomes and assets. Therefore, the first and foremost step under the Income-tax Act is to ascertain the residential status of the individual. Section 6, sub-sections (1), (1A) and (6), are relevant to determine the residential status of individuals.

17.2 In the case of Returning NRIs, the individual is coming back for good. He is not coming on a visit to India. Hence, the relief pertaining to "being outside India and coming on a visit to India" provided under Explanation 2 to Section 6(1)(c) of the Income-tax Act (ITA) is not available. Consequently, the relief of staying up to 181 days in India is not available to them. In other words, the basic "60 + 365 days test"[5] applies to Returning NRIs, and if it is met, the individual becomes a resident u/s.

1 https://retirement.outlookindia.com/plan/news/60-of-nris-consider-returning-to-india-after-retirement-sbnri-survey

2 Refer June 2024 issue of the BCAJ – 56 (2024) 251 BCAJ

3 The paragraph references continue from Part-I of this article

4 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

5 "60 + 365 days test" means that the individual has stayed in India for 60 days or more during the relevant previous year and for 365 days or more during the four preceding years

6(1) of the ITA. A couple of nuances pertaining to this were dealt with in detail in the December edition of the BCAS Journal. For completeness's sake, they are briefly touched upon below:

a. Benefit of visit not allowed:

A person returned to India after resigning from her employment in China. The Authority for Advance Rulings (AAR) held[6] that relief under Expl. 2 to S. 6(1)(c) of the ITA will not be available to her since the facts and circumstances show that the reason for coming to India is not just a visit. Hence, the "60 + 365 days test" test will apply.

b. Is hair-splitting between visit and permanent stay allowed during the same year?

Karnataka High Court has held[7] that when the individual – being outside India, was on a visit to India – such stay should be tested against the 182-day test and not considered for the "60 + 365 days test." Later, during the year, if the person returns to India, only the stay after such return needs to be considered for the "60 + 365 days test." However, in the decision by AAR referred to herein above in sub-para (a), the hair-splitting between a visit and a permanent stay in India was not allowed. Hence, hair-splitting of a person's stay between 'visit' and 'permanent stay' during the same year is litigious.

17.3 If the person was a non-resident of India in 9 out of the preceding 10 previous years; or if his or her stay in India in the preceding 7 years was less than 729 days, such an individual would be Resident but Not Ordinarily Resident ("RNOR"). These provisions of Section 6(6)(a) of the ITA have been explained in detail in the December 2023 edition of the *BCAJ*. In general, before the amendments by the Finance Act 2020, a returning Indian could claim RNOR status for 2 or even 3 years if one of the above tests of Section 6(6)(a) is met. The amendments by the Finance Act 2020 have diluted the RNOR status for Returning NRIs. This is explained in detail below.

17.4 If an individual does not become a resident, u/s. 6(1), one should also consider the provisions of Section 6(1A) wherein an Indian Citizen is considered a resident under specific circumstances[8], where he is not liable to tax in any other country by reason of residence, domicile, or any other criteria of similar nature. If an individual becomes a resident by virtue of Section 6(1A), he is always considered as RNOR as per Section 6(6)(d).

Individuals who are covered u/s. 6(1A) become deemed RNORs. Even if they do not visit India for a single day, they are residents but not ordinarily residents under the ITA. This has an impact when they return to India for good. Let us say, an Indian citizen, Mr Kumar has been employed and staying in Oman since 2010. Mr Kumar came on visits to India totalling a period of 65 days every year with clarity that he would remain a non-resident of India due to relief available of a visit to India as per clause (b) to Explanation 1 to Section 6(1)(c). On 1st April, 2024, he retired and came back to India for good. In the absence of Section 6(1A), he would have been a non-resident since 2010. Hence, after returning to India, he would have been RNOR for at least the first two years.

However, Oman does not tax individuals. Post Finance Act 2020, as per Section 6(1A), such an Indian citizen would be RNOR and not NR for the PYs 2020-21, 2022-23, 2023-24. This means he does not meet the first test u/s. 6(6)(a) of being NR for at least 9 years out of the last 10 years. The relief u/s. 6(6)(a) has thus been diluted due to Section 6(1A). In simple words, he will be ROR from PY 2024-25 and will be liable to Indian tax on his global income. Similar would be the situation for an Indian citizen or person of Indian origin[9] who visits India for 120 days or more during each year, and his stay in the preceding 4 years is 365 days or more. Such a person gets covered by the amended portion of clause (b) of Explanation 1 to Section 6(1)(c) and consequently would be RNOR as per Section 6(6)(c)[10].

17.5 Normally, a Returning NRI would be considered as RNOR if he had not spent more than 728 days during the preceding 7 years. This should be the case generally for 2 or even 3 years after a person returns to India. But for persons like Mr Kumar, who visits India every year and then settles in India, they may not meet the test of stay in India of less than 729 days during the preceding 7 years after the first year of returning to India. Hence, those individuals who stay abroad and are planning to settle in India need to be aware of the dilution of their RNOR status due to the provisions of Section 6 as amended vide Finance Act 2020.

6 Mrs. Smita Anand, China *[2014] 42 taxmann.com 366 (AAR - New Delhi)*

7 Director of Income-Tax, International Tax, Bangalore vs. Manoj Kumar Reddy Nare *[2011] 12 taxmann.com 326 (Karnataka)*

8 Where his or her income from sources within India exceeds ₹ 15 lakhs in that year(s).

9 A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India – Explanation to clause (e) of Section 115C of ITA.

10 Where his or her income from sources within India exceeds ₹ 15 lakhs in that year(s).

18 Disclosure and source of foreign assets

Since AY 2012-13, Indian residents (ROR) are required to disclose their assets located outside India in their Income-tax return form. This is required even if such a resident is otherwise not required to file a tax return. Returning NRIs would, in most cases, have savings, assets, and investments abroad when they come back. On becoming ROR, all such foreign assets need to be disclosed in the tax return. The person would have acquired these assets when he was staying abroad and was a non-resident. The source of funds for acquiring these assets is not required to be explained or disclosed in the tax return. However, practically, things are quite different.

There is 360-degree profiling by the regulators these days. The CBDT has formed Foreign Asset Investigation Units (FAIUs) in all the 14 investigation directorates across India. Their job is to analyse the plethora of information received by India from foreign jurisdictions under Automatic Exchange of Information (AEoI) agreements, CRS, DTAAs, etc. If they come across any red flags, they issue a notice asking for detailed information pertaining to each and every foreign asset held by the person since its acquisition. The red flags could be a variance between the data received by them vis-à-vis the foreign assets disclosed in the tax return by the assessee; or foreign assets disproportionate to the transactions or profile of the assessee, etc. They even ask for decades-old data and documents supporting such data. Hence, maintaining documents becomes particularly important.

In such cases, until and unless it is proven through documentary evidence that a foreign asset was acquired from bonafide sources, the matter is not closed. This becomes a big hassle. There are cases where the assessees did not retain their old bank statements and other documents. In fact, foreign banks and brokers do not provide old statements easily and they also charge heftily for obtaining old statements. Further, foreign banks and financial institutions do not retain records beyond a certain number of years, in which case, it becomes almost impossible to provide the documents to the officer. Hence, Indians who are staying abroad, whether they plan to return to India someday or not, should keep proper and complete data of all their assets. If and when they return to India, such a record would become important. Further, they need to maintain documents to justify their increase in net worth by their sources of incomes during the years when they were non-resident. If there is any violation in the disclosure of foreign assets; or if the officer is not satisfied with the explanation or documents, proceedings can be initiated under Section 10 of the Black Money Act[11] (BMA) and the harsh penal provisions of the BMA are also invoked in certain cases. This has happened in even bona fide cases where innocent errors are made in disclosing foreign assets.

19 Other Disclosures in ITR Form

Apart from foreign assets and incomes, other disclosures are also required to be made in the Income-tax return form, which are tabulated below:

Particulars	ROR	NOR	NR
Unlisted equity shares	To be disclosed of all companies.	To be disclosed only of Indian companies.	
Directorships	To be disclosed in all companies across the globe.	To be disclosed in all Indian companies & only in such foreign companies which have income accruing or deemed to be accruing in India.	
Schedule AL	Global assets.	Only Indian assets.	
Schedule FSI	Foreign-sourced incomes are included in the Total Income (largely relevant only for RORs.)		
Schedule EI	Incomes exempt under the Income-tax Act or DTAA.		

20 Treaty relief

Similar to migrating Indians, even for Returning NRIs, there can be an overlapping period wherein the person is a resident of India as well as of the country he is returning from. This leads to dual residency, for which tie-breaker tests are prescribed under Article 4(2) of the Double Tax Avoidance Agreement (DTAA). There could also be a possibility of the concept of split residency being applicable. Accordingly, the provisions of the DTAA can be applied. These provisions have been explained in detail in the second article of this series (January 2024 edition of the BCAJ). In essence, there could be benefits vide the DTAA in the foreign jurisdiction as well as in India. The credit of tax paid in a foreign jurisdiction as per the DTAA can be availed against the tax payable in India. Necessary forms will be required to be filed along with supporting documents to claim credit.

21 Continuing foreign employment or business

Many people continue their employment or business

11 Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

abroad after returning to India. This has become easier in today's globalised technology-driven era. In fact, the Covid lockdown saw many Indians stuck in India or coming back to India and continuing their foreign business or employment from India. However, it is pertinent to note that the economic activity is being done from India. It should be checked whether any income directly accrues in India on account of such activity due to specific provisions which can get triggered in such a case, of which the most common ones are explained below:

21.1 Salary: Section 9(1)(ii) deems the salary proportionate to the period when the employment was exercised from India to be accruing in India. Hence, even if a person is NR or NOR, the amount of salary proportionate to the days he exercises employment from India is deemed to accrue in India. This provision applies not only to Returning NRIs, but to everyone. Prima facie, the proportionate salary is taxable under ITA, and one should go under the applicable DTAA to claim relief, if any.

21.2 Place of Effective Management: A foreign company is considered as resident of India if its Place of Effective Management is, in substance, in India, during that year[12]. The CBDT has prescribed detailed guidelines through Circulars 6, 8 and 25 of 2017. It should be noted that this provision applies only to companies having a turnover of more than INR 50 crores during the financial year.

21.3 Business Connection and Permanent Establishment: When an individual works in India for a foreign entity, he may constitute a "Business Connection" of the foreign entity in India. In that case, the income pertaining to the activities carried out through such Business Connection is deemed to accrue in India[13] . Further, if there is a DTAA between India and the country where the entity is resident, generally, the business profits of the foreign entity would be taxable in India only if the foreign entity has a Permanent Establishment (PE) in India. Every DTAA has different criteria for determining whether there is a PE. Hence, it needs to be checked whether the individual constitutes a Business Connection of such entity in India, and if yes, whether he constitutes a PE of such entity in India as per the applicable DTAA. This can be possible in cases where the foreign company is run almost exclusively by the Returning NRI.

12 Section 6(2) of ITA
13 Section 9(1)(i) of ITA

B.2 FEMA issues regarding Returning NRIs

22 Residential status

The provisions pertaining to residential status under FEMA were dealt with in detail in the March 2024 edition of BCAJ. In essence, as per Section 2(1)(v) of FEMA, when a person comes to India for or on taking up employment in India; or for carrying on business or vocation in India; or under circumstances which indicate his intention to stay in India for an uncertain period — he becomes an Indian resident under FEMA. Hence, when a person comes to settle down in India for good, he or she becomes a resident under FEMA from the date of their return to India. This is because the person is coming to India in such circumstances, which indicates his intention to stay in India for an uncertain period. Hence, from the day a person returns to settle in India or for the purposes mentioned above, all provisions under FEMA meant for residents become applicable to such person.

23 Scope of FEMA as applicable to Returning NRIs

Apart from the assets and transactions covered u/s. 6(4) of FEMA and the balances in RFC accounts (explained in detail below), all other transactions outside India (whether in foreign currency or INR); all Indian transactions in foreign currency and all transactions with non-residents (whether in or outside India) come under the purview of FEMA. This can impact Indian transactions of the Returning NRI with other non-resident family members. As non-residents, they would have had the liberty to transfer funds between their NRO accounts. However, there will be several restrictions on transactions between a Returning NRI (who is now a resident individual) and a non-resident. Thus, gifts, loans and even payments made to or on behalf of non-residents can have implications under FEMA. Thus, a change of residence requires a change in mindset, as otherwise, Returning NRIs may end up committing violations under FEMA.

24 Holding foreign assets abroad

24.1 Background of FERA: Under FERA, as it was enacted, when a person became an Indian resident, he was required to liquidate all his foreign assets and bring the foreign exchange into India unless approval was obtained from RBI. This was liberalised in July 1992 when the Government of India issued six notifications granting exemptions from several different provisions of FERA to

the returning Indians. These notifications were covered with a press note and a circular issued by RBI in Sept. 1992 — ADMA Circular No. 51 dated 22nd September, 1992. It explained the notifications. A summary of all the provisions is that on return to India, the Returning NRI retain all his assets abroad — provided that the assets were not acquired in violation of FERA and that the person was a non-resident for at least one year before becoming resident. There was no need to make any declaration under FERA. He could change his assets in the sense that he could sell one asset and buy another. He could retain dividends / interest / rent and other incomes earned on the assets. He could reinvest these incomes or spend the same. He was at liberty to bring the assets to India or to retain them abroad. He could gift these assets to anyone. On death, his foreign assets would pass to his heirs without any restrictions. If the Returning NRI held shares in any company, the shares would be considered as his investments. The company could continue business abroad. One could say that FERA did not apply to such wealth of the person and the incomes generated on such wealth. The person was free to do anything with the same.

24.2 Provisions under FEMA: Under FEMA, unfortunately, such liberalisation has been provided in a very brief manner through Section 6(4), which is reproduced below:

"(4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India."

It is provided that any foreign currency, foreign security, and immovable property situated outside India which were acquired when the person was a non-resident, can be continued to be held or owned after becoming a resident.

24.3 Section 6(4) of FEMA does not clearly specify the transactions which are allowed as was quite apparent as per the circulars issued under FERA. On making a representation, RBI issued A.P. Dir Circular No. 90 dated 9th January, 2014, which prescribes the transactions covered u/s. 6(4). Those are as follows:

a. Foreign currency accounts opened and maintained by the Returning NRI when he or she was resident outside India.

b. Income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India.

c. Foreign exchange, including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

d. Returning NRIs may freely utilise all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of the Reserve Bank, provided the cost of such investments and / or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transaction is not in contravention to extant FEMA provisions.

Thus, such assets can be sold, and proceeds may even be reinvested abroad. There is no requirement to repatriate the income earned on these assets or sale proceeds thereof into India.

24.4 One can consider that broadly, the restrictions under FEMA do not apply to assets covered u/s. 6(4) of FEMA. One of the important clarifications in this regard pertains to overseas investments by resident individuals, which are allowed under the Overseas Investment Rules[14] (OI Rules) of FEMA only if specific conditions are met. However, when it comes to foreign assets covered u/s. 6(4), Rule 4(b)(iii) of the OI Rules clearly provides that the OI Rules do not apply to any overseas investment covered u/s. 6(4). It would thus also cover any asset or investment which a resident may otherwise either not be permitted to invest in; or permitted only within a certain limit; or only after fulfilling attendant conditions — under the OI Rules. For instance, resident individuals are not allowed to make Overseas Direct Investment in a foreign entity which is engaged in financial services activity. However, if a non-resident had invested in such a company abroad and later on, he or she becomes an

14 Foreign Exchange Management (Overseas Investment) Rules, 2022 – Notification No. G.S.R. 646(E) issued on 22nd August 2022.

Indian resident, such person can continue holding shares of the foreign company. The income thereon and the sale proceeds thereof can be retained abroad. If the individual wants to make any further investment in the foreign entity engaged in financial services activities out of funds lying in his Resident bank account in India, he or she will not be generally permitted to do so[15].

24.5 Other assets not specified u/s. 6(4) of FEMA: Section 6(4) specifies only three assets. Further, the circular also does not provide complete clarity. A person may own several other assets. For instance — the person can have an interest in a partnership firm or LLC or can own gold, jewellery, paintings, etc. As a practice, the RBI has taken a view since 1992 that a person is eligible to continue owning / holding all the foreign assets after turning resident, which he had acquired as a non-resident. This also includes such assets or investments which he could not have otherwise owned or made as a resident.

24.6 Insurance abroad: Returning NRIs may have different types of insurance policies issued by insurers in India as well as outside India. As explained above, funds covered under Section 6(4) of FEMA and lying abroad can be utilised for any purpose, including premium payment for insurance policies. FEMA provisions pertaining to s the utilisation of Indian funds for foreign insurance policies[16] by Returning NRIs are as follows:

a. Health insurance policy can be continued to be held by a Returning NRI provided the aggregate remittance including the amount of premium does not exceed the LRS limit.

b. Life insurance policy can be continued to be held by a Returning NRI if it was issued when he was a non-resident. Further, if the premium due on such policy is paid by remittance from India, the maturity proceeds or amount of any claim due on the policy should be repatriated to India within 7 days of receipt.

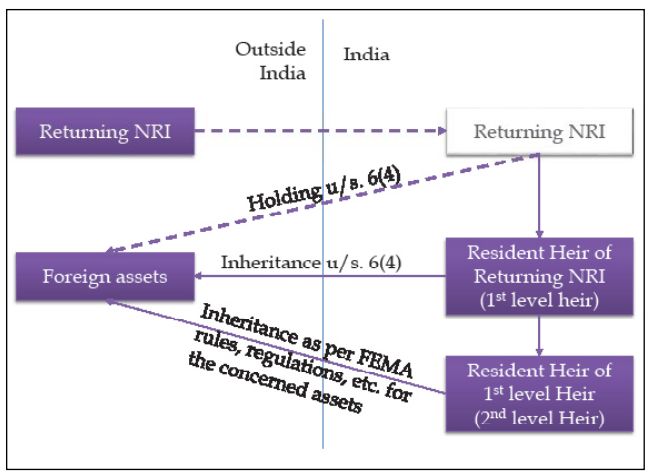
24.7 Loans abroad: If a person has taken a loan abroad as a non-resident and becomes a resident later, he can service such loans subject to such terms, conditions and limits as specified by RBI. In general, RBI has not objected to a Returning NRI using his or her foreign funds covered under Section 6(4) of FEMA to service such loan repayments.

24.8 Foreign currency: Returning NRIs may need to bring in foreign currency notes and coins into India. Notification No. FEMA 6(R)[17] provides that such person can bring into India without limit foreign exchange (other than unissued notes) from any place outside India. However, a declaration needs to be made to the Customs authorities.

24.9 Inheritance of assets covered under Section 6(4) of FEMA: The first limb of Section 6(4) allows residents to hold assets abroad which they had acquired as a non-resident. The second limb further allows a resident heir of such Returning NRI to inherit these foreign assets from him or her. This is in line with the reliefs provided through the circulars issued earlier under FERA. However, it should be noted that this provision covers only one level of inheritance, i.e., from the Returning NRI to his or her heir. Later, if a **resident heir of such heir** wants to inherit these foreign assets, it is not covered by Section 6(4). The relevant notifications, rules, etc. under FEMA corresponding to the concerned assets need to be checked for the same. A summary of the holding and inheritance of foreign assets under Section 6(4) of FEMA can be summarised as follows:

Exceptions to this rule are for overseas immovable properties[18] and foreign securities[19], inheritance for which is allowed up to any generation if the investment and holding of such foreign property were as per extant FEMA regulations.

It should be noted that there are several controversies



15 Refer Rule 13 of the OI Rules read with paragraph 1 of Schedule III to OI Rules.

16 Para 2 of Master Direction on Insurance - FED Master Direction No. 9/ 2015-16 - last updated on 7th December 2021.

17 Reg. 6(b) of Foreign Exchange Management (Export and import of currency) Regulations, 2015.

18 Rule 21(2)(i) of OI Rules.

19 Para 9(b) of Schedule III to FEMA Notification 5(R)/2016-RB – FEM (Deposit) Regulations,2016.

surrounding Section 6(4) of FEMA, including the interpretation of its second limb. We have not discussed all the controversies here, considering this is an article on a broader topic.

25 Impact on Indian assets

25.1 Bank and demat accounts: Returning NRIs need to designate their NRO bank and demat accounts as normal Resident accounts once they become residents[20]. There are some special types of accounts in which non-residents can hold funds like NRE, FCNR, etc. On becoming a resident, NRE accounts need to be closed; however, FCNR deposits are permitted to be continued till maturity. Funds in both these accounts can be either transferred to the Resident account (becomes non-repatriable) or to the RFC account (repatriability continues, and such funds remain out of FEMA purview). Returning NRIs are permitted to hold foreign exchange in India in RFC accounts. The funds lying in an RFC account can be remitted abroad without any restrictions and can be used or invested for any purpose. The provisions of FEMA do not apply to the same. The provisions for such accounts will be discussed in detail in the upcoming articles in this series of articles.

25.2 Loan from NRI / OCI to a resident: If an NRI / OCI has given a loan to a resident (as per the FEMA guidelines) and he becomes a resident later, the repayment may be made to the designated account of the lender maintained with a bank in India as per the RBI guidelines, at the option of the lender.

25.3 Privately held investments in India: There could be investments in Indian companies, LLP, partnership firms, etc., made by Returning NRIs when they were non-residents. The implications of such investments due to a change of residence are explained below:

25.3.1 Indian assets held on a non-repatriable basis: NRIs and OCIs are permitted to invest in India on a non-repatriable basis, which has minimal restrictions and no reporting requirements. In such cases, if the person becomes a resident of India, there is no change in the character of the holding. The investment was anyway treated at par with domestic investment and no reporting, etc., is required. Normally, there is no formal record to be kept by the investee entity regarding the residential status of the person if the investment is on a non-repatriation basis. However, if there is any such record maintained, the residential status should be updated therein.

25.3.2 Indian assets held on a repatriable basis: Let us say the person has made investments in India on a repatriable basis. As a non-resident, he can remit full sale proceeds abroad without any limit. Now, if such a person returns to India and becomes a resident, the resultant structure is that an Indian resident is holding an Indian asset. **The repatriable character of the investment is lost!** This is a particularly important provision. All investments held by a non-resident on a repatriable basis become non-repatriable from the day he becomes a resident. In fact, there is nothing like repatriable or non-repatriable investment for a resident. Every Indian asset of a resident is considered as a domestic investment. It is only assets covered under Section 6(4) and the funds transferred to the RFC account, which are free from FEMA. This becomes a critical point, which every Returning Indian should consider in advance. When a non-resident holding an investment in an Indian entity on a repatriable basis becomes a resident, he should intimate it to the entity, and the entity should record the shareholding of the person as domestic investment and not foreign investment.

25.3.3 Indian assets held through a foreign entity: Let us say, a non-resident invests in Indian assets on a repatriable basis. However, instead of investing in his personal name (as explained in the above para), the investment is made by his foreign entity. Thereafter, the person becomes an Indian resident. The resultant structure is that an Indian resident owns a foreign entity which has invested in India on a repatriable basis. This enables the following:

a. Holding in Foreign entity: The ownership in the foreign entity by the Returning NRI is covered under Section 6(4). He can thus continue to hold such investments.

b. Repatriability of Indian assets: The Indian assets continue to be held on a repatriable basis by the foreign entity. All incomes and sale proceeds therefrom can be remitted abroad by the foreign entity without any limit. Had the individual directly held Indian assets and became resident, the repatriable character would have been lost — as highlighted above in Para 25.3.2. However, one should consider the tax implications of such a structure, especially with regard to POEM, Transfer Pricing and

20 Para 9(b) of Schedule III to FEMA Notification 5(R)/2016-RB – FEM (Deposit) Regulations,2016.

Permanent Establishment provisions under the ITA, as explained in para 21 above.

26 Remittance facilities for resident individuals

Liberalised Remittance Scheme: LRS is the remittance facility available for resident individuals. The LRS limit of USD 250,000 per financial year is the ceiling for all current and capital account transactions covered under the Current Account Transaction Rules. Barring exceptions like exports and imports and certain relaxations[21] which are available in limited situations, the remittance facilities for a person resident in India under FEMA are constrained to the LRS limit. Returning NRIs should hence note that their remittances from India will be restricted to a considerable extent compared to what they were allowed as non-residents[22]. Even the liberty of remitting current incomes without any limit is not available for resident individuals.

27 Fresh incomes earned abroad

Let us say the individual earns fresh income abroad after becoming a resident – like salary, royalty or even receiving a gift of funds from a non-resident. A resident individual cannot retain such foreign exchange abroad. He is required to take all reasonable steps to realise the foreign exchange due or accrued to him and repatriate the same within 180 days of the date of receipt[23].

C. OTHER RELEVANT ISSUES COMMON TO CHANGE OF RESIDENTIAL STATUS

28 Change of Citizenship

Change of citizenship has several ramifications beyond change of residence, especially under FEMA. The issues to be kept in mind when a person has obtained foreign citizenship are elaborated in Para 11 to 16 in Part-I of this Article covered in the June 2024 issue of the BCAJ. Returning foreign citizens should consider the implications of the country of their citizenship on their move to India — especially where such countries are taxing them based on their citizenship, exit taxes and estate duty or inheritance tax — all of which are explained briefly below.

21 Like use of International Credit Card while being on a visit outside India; higher amount of remittance allowed for educational or medical expenses; or for acquisition of ESOPs, sweat equity, etc.

22 Please refer to Para 7.6 in Part-I of this article for USD 1 Million Scheme which is available to NRIs.

23 Section 8 of FEMA r.w. Regulation 7 of FEMA Notification 9(R)/2015-RB.

29 Change of residence for a short period

One can see that the scope of FEMA and the Income-tax Act changes drastically with the change of residential status. This article attempts to cover aspects where there is a change of residence for good. If the residential status of a person changes for a short period of time, caution should be exercised before taking the benefits of a change of residence. Consider a situation where a resident goes abroad; claims to be a non-resident under FEMA or the Income-tax Act; takes benefit of such change (for example, by remitting USD 1 million from India or taking a treaty benefit as a non-resident of India); and again, becomes an Indian resident — all within a short period of time. In such cases, the regulator or tax officer may question the whole arrangement and consider that the change in residence is not genuine. Action can be taken based on anti-tax avoidance provisions under the Act and relevant treaty (please refer to para 35 below). Hence, there should be clarity on residential status; bonafides of transactions and genuineness of arrangements. In fact, sometimes it is ideal and safe if benefits are availed of only after the person is certain about his or her change in residential status and it is maintained over a period of time.

30 Succession Planning

There are several laws which need to be considered for succession planning like the applicable succession laws, Sharia law in the case of Muslims, Trust laws in case of Trusts, FEMA for cross-border transactions & assets, corporate laws in case of securities, stamp duty laws, Income-tax laws, Inheritance / Estate Tax etc. Hence, succession planning from a holistic approach is especially important wherever the family members or the assets are spread over more than one country. In fact, FEMA itself contains several complexities regarding inheritance. There are only a few provisions specifically dealing with inheritance and gifts under FEMA. These provisions are spread over many notifications. For several assets and situations, provisions are completely missing. To top it all off, everything changes when a person shifts residence from one country to another. The whole succession planning exercise needs to be re-considered in such cases — especially due to FEMA provisions.

31 Inheritance Tax or Estate Duty

31.1 Migrating persons, as well as Returning NRIs, should consider the inheritance tax or Estate Duty laws

of the foreign jurisdiction. Different countries levy such taxes based on different criteria like citizenship, visa (green card in USA), domicile (UK), etc. In the USA, there is the Federal Estate Tax as well as the State Estate Tax. Residents of countries where such taxes or duties are applicable should have proper Estate Duty planning done. There have been cases where Estate Duty or Inheritance Tax is payable in the foreign country where a large amount of wealth was in the immovable properties which cannot be sold since the person is staying in the same. Further, if substantial wealth is situated in India, the limits on remittances abroad can also create a hindrance for paying such taxes. The following basic questions can be considered:

a. Applicability of such tax and the taxable events.

b. Connecting factors including domicile, citizenship, residence, etc.

c. Assets covered.

d. Thresholds applicable, if any, and tax rates.

e. Implications of gifts between family members.

f. Whether it applies to the inheritance of Indian assets received by the person on the death of his parents who are staying in India.

g. Treaties in relation to Double Taxation Relief for Estate Duties.

31.2 One common question asked is whether the Indian Government will bring in Estate Duties or Inheritance taxes. There is an unsupported fear in people's minds of such duties impacting their wealth leading them to create Trust structures for protecting their wealth from such duties. The Government has earlier been on record to state that no such Estate Duties are planned. Further, even if such duties are introduced, they would have enough anti-avoidance provisions to counteract against any planning undertaken by taxpayers.

32 Exit Tax: Some countries have a concept of Exit Tax to prevent loss of revenue, if any, upon change of residential status / citizenship. It is levied when a person revokes citizenship or visa (like revocation of citizenship or green card in the USA) or if a person shifts his residence to another country (like Departure Tax in Canada). One may carefully plan the timing of their change of residence to minimise the impact of such taxes wherever possible.

33 Transfer Pricing

In simple words, Transfer Pricing triggers in case of a transaction which can give rise to income (or imputed income) between associated enterprises, of which at least one party is a non-resident. On change of residence, the migrating resident's or Returning NRI's continuing transactions with associated enterprises may come under the purview of Transfer Pricing provisions. All such transactions must be on an arm's length basis. The implications under Transfer Pricing on the shift of a person from or to India should hence be considered.

34 Section 93 of ITA

Section 93 is a complex anti-avoidance provision which targets certain transfers of assets in a manner which leads to the income being earned by a non-resident, but the transferor still has the power to enjoy such incomes. The provision targets such transfers whereby incomes would have been chargeable to tax in the hands of the transferor if the transferor had earned such incomes directly. For example, a Returning NRI who transfers assets to another person before returning to India, but with a condition that income earned by such other person would be in control of the NRI, would be caught by this provision. There are several conditions and nuances in the provision, and one must note that any tax planning done before a change of residence can be impacted due to this provision.

35 Anti-tax avoidance provisions

While there are several Specific Anti Avoidance Rules (SAARs) prescribed under the Income-tax Act – POEM, Business Connection, Transfer Pricing, etc. – one should also consider General Anti Avoidance Rules (GAAR), which have been notified under Sections 95 to 102. GAAR would apply to an arrangement if it is regarded as an Impermissible Avoidance Arrangement (IAA). There are detailed provisions on the same. The ramifications of GAAR are massive. Once an arrangement is determined as IAA, the officer can treat the place of residence of such person at a place other than their claimed place of residence; ignore one or more transactions; deny benefits of a DTAA; recompute the income and tax of the assessee; and so on. While the Department has invoked GAAR in very few cases till now, it looks evident

that GAAR will be invoked more frequently in the times to come. Recently courts have decided on the matter of applicability of GAAR in certain situations. Further, after the advent of the Multi-Lateral Instrument, several treaties that India has entered with other countries and jurisdictions have brought in anti-tax avoidance provisions where the change of residence is only for the purposes of claiming treaty benefit. These include the broader Principal Purpose Test and amendment in the preamble to the treaty, as well as the specific anti-tax avoidance measures that are today part of many double-tax avoidance treaties that India has signed.

36 Documentation and record-keeping

Change of residence typically leads to several queries from the tax department or regulator — especially for Returning NRIs in relation to their foreign assets. They would like to know that the foreign assets of such a person were acquired in a bona fide manner as a non-resident. One can refer to para 18 above explaining the same. Therefore, full documentation should be maintained. A few key areas where documentation should be maintained are:

a. Calculation of number of days of stay in India in each year and determination of residential status.

b. Passport copies to substantiate travel details and number of days stayed in India.

c. Relevant documents for every foreign asset and transaction, especially the opening statements, along with an explanation of the source of funds (irrespective of residential status).

d. Tax returns and other documents filed in the foreign jurisdiction.

e. Disclosure of foreign assets including in case of joint ownership, nomination, authorised signatory, etc.

f. Employment contract, salary slips, visa, etc.

g. Details and documents substantiating the purpose of immigration or emigration.

37 Impact of other laws

37.1 **Transferring physical or movable assets from or into India:** While FEMA permits holding assets in or outside India migrating or returning individuals may plan to move valuable assets with them from or into India – like gold, jewellery, art, etc. One should consider the permissibility and limits under Baggage Rules, 2016 of the Customs Act, along with the disclosures required thereunder. Further, certain movable items like art and antiques, as well as those dealing with wildlife, etc., need to be imported or exported only as permitted under the relevant laws[24]. Similarly, a migrating resident needs to check the parallel provisions of the country to which they are migrating.

37.2 Indirect taxes: Indirect taxes have a significant impact, especially in a situation where the individual works in a personal capacity instead of employment. For instance, if Returning NRI continues working for a foreign entity as a consultant or in a similar manner, the applicability of GST and other indirect taxes needs to be checked.

37.3 Stamp duty laws: Certain individuals end up entering into gift deeds, powers of attorney, etc., on change of residence. Any document executed or brought within India can attract stamp duty. The stamp duty laws need to be checked before executing any such document. Similarly, the stamp duty law of the foreign country should also be considered.

37.4 Other laws: There are several other laws which could apply while executing a transaction or on account of a change of residence. It could be visa and citizenship rules; laws pertaining to family and marriage; labour, and social security regulations/ norms. These laws should be considered for India as well as the host country.

38 Geopolitical, Economical, and Cultural Considerations / Challenges

Moving base has its own set of challenges. Certain personal factors can be dealt with by the individual concerned to a large extent. However, such individuals should also appreciate that there are several factors which are beyond their control. These relate to the economic situation of the country they are moving to the cultural change they or their family members must deal with. Further, the global geopolitical environment

24 The Antiquities and Art Treasures Act, 1972 and The Wild Life (Protection) Act, 1972, etc.

has seen dramatic upheavals in the last decade. Apart from the economic and legal considerations, one should also keep the geopolitical developments in mind, especially in relation to India and the host country where they are migrating to or from.

Conclusion

One can see that a change of residence leads to a substantial change in the tax liability, compliances, and regulatory provisions applicable to the person. Further, the Income-tax and FEMA laws themselves have grey areas, with differing views between various stakeholders causing prolonged litigation. When we bring in laws of another country and their interplay with Indian laws to the same transaction or income, it leads to increasing complexities, contradictions, and uncertainties. When a person shifts residence from abroad to India or from India to abroad, the whole legal position surrounding the person takes a 180-degree turn. It is like turning the table halfway through in a game of chess! In such cases, it is ideal to consider all the legal implications in advance, so that informed decisions can be taken. Otherwise, it could happen that the person is "physically" moving to a particular location with several plans in mind, but "legally" spearing into uncharted territory with far-reaching consequences. ■

BANK ACCOUNTS AND REPATRIATION FACILITIES FOR NON-RESIDENTS

HARDIK MEHTA | ARWA MAHABLESHWARWALA
Chartered Accountants

In this article, we have discussed the rules and regulations related to NRO, NRE, FCNR and other accounts pertaining to Non-residents under Foreign Exchange Management Act, 1999 (FEMA).

BANK ACCOUNTS

Opening, holding and maintaining accounts in India by a person resident outside India is regulated in terms of 6 section 6(3) of the FEMA, 1999 read with Foreign Exchange Management (Deposit) Regulations, 2016 ('Deposit Regulations') issued vide Notification No. FEMA 5(R)/2016-RB dated 1st April, 2016, Master Direction - Deposits and Accounts FED Master Direction No. 14/2015-16 dated 1st January, 2016 and FAQs on Accounts in India by Non-residents, updated from time to time, provides further guidance on the same.

An Authorised Dealer (AD) bank is permitted to open in India the following types of accounts for persons resident outside India:

i) Non-Resident (External) Account Scheme (NRE account) for a **non-resident Indian (NRI)** – Schedule 1 of the Deposit Regulations;

ii) Foreign Currency (Non-Resident) Account Banks Scheme, (FCNR(B) account) for a **non-resident Indian** – Schedule 2 of the Deposit Regulations;

iii) Non-Resident (Ordinary) Account Scheme (NRO account) for **any person resident outside India** – Schedule 3 of the Deposit Regulations;

iv) Special Non-Resident Rupee Account (SNRR account) for **any person resident outside India** having a business interest in India – Schedule 4 of the Deposit Regulations;

v) Escrow Account for **resident or non-resident** acquirers – Schedule 5 of the Deposit Regulations.

Currently, a company or a body corporate, a proprietary concern or a firm in India may accept deposits from an NRI or PIO on a non-repatriation basis only[1] – Other conditions that apply to such deposits include:

• Deposit should be for a maximum maturity period of three years.

• Deposit can be received from NRO account only.

• Rate of interest should not exceed the ceiling rate prescribed under the Companies (Acceptance of Deposit) Rules, 2014 / NBFC guidelines / directions issued by RBI.

• Deposit shall not be utilised for relending (other than NBFC) or for undertaking agricultural/plantation activities or real estate business.

• The amount of deposits accepted shall not be allowed to be repatriated outside India.

Under the current regulations, a company or a body corporate is not permitted to accept any fresh deposits on repatriation basis from an NRI or PIO. However, it is only permitted to renew the deposits which had already been accepted under the erstwhile Notification.

KEY FEATURES OF NRE, FCNR (B) AND NRO ACCOUNTS

NRIs usually have majority of their earnings in foreign currency and thus their financial and investment objectives differ from residents. NRIs and PIOs are permitted to open and maintain accounts with authorised dealers and banks (including co-operative banks) authorised by the Reserve Bank to maintain such accounts. The major types of accounts that can be opened by an NRI[2] or PIO[3] in India include NRE, NRO and FCNR accounts. The key features of these accounts are as under:

NRE ACCOUNT

• This account is denominated in Indian rupees, wherein proceeds of remittances to India can be deposited in any

1 Refer Schedule 7 of the Deposit Regulations

permitted currency;
• The monies held in this account can be freely repatriated outside India;
• Current income in India like rent, dividend, pension, interest, etc. can be deposited subject to payment of income taxes;
• This account is subject to exchange rate fluctuations since the foreign currency earnings deposited into this account are converted into INR using the current exchange rate of the receiving bank;
• Interest income earned from the NRE account is tax-free.

NRO ACCOUNT

• A resident account needs to be redesignated as a NRO account when a person becomes non-resident. For this, the person becoming non-resident needs to submit the documentary evidences to prove his intentions to leave India for the purpose of employment, business or vocation or an uncertain period. Additionally, NRO account can be opened by a non-resident for any bonafide transactions. For further details, refer to the table below.

• This account allows you to receive remittances in any permitted currency from outside India through banking channels or permitted currency tendered by the account holder during his temporary visit to India or transfers from rupee accounts of non-resident banks;
• Repatriation from the NRO account can be done to the extent of USD 1 million for every financial year;
• Income earned in India in the form of interest, dividend, rent, etc. can be deposited into this account;
• This account is also subject to exchange rate fluctuations since the foreign currency deposited into this account are converted into INR using the current exchange rate of the receiving bank;
• Interest income earned from the NRO account is not tax-free.

ACCOUNT OPENED BY FOREIGN TOURISTS VISITING INDIA

• In case of a current / savings account opened by a foreign tourist visiting India with funds remitted from outside India in a specified manner or by sale of foreign exchange brought by him into India, the balance in the NRO account may be paid to the account holder at the time of his departure from India provided the account has been maintained for a period not exceeding six months and the account has not been credited with any local funds, other than interest accrued thereon.

FCNR ACCOUNT

• This is a term deposit account and not a savings account;
• Monies can be deposited in any currency permitted by RBI i.e., a foreign currency which is freely convertible;
• The deposits can range from a period of one to five years;
• The principal amount and interest earned from the deposits are fully repatriable;
• This account is not subject to exchange rate fluctuations since deposits and withdrawals are in foreign currency.
• Income earned from FCNR account is tax-free.

A tabulated comparison of the three accounts is provided below for your reference:

Particulars	NRE Account	FCNR (B) Account	NRO Account
Who can open an account	NRIs and PIOs (Individuals / entities of Pakistan and Bangladesh require prior RBI approval)		Any person resident outside India for putting through bonafide transactions in rupees. Individuals / entities of Pakistan nationality / origin and entities of Bangladesh origin require prior RBI approval.

2 A 'Non-resident Indian' (NRI) is a person resident outside India who is a citizen of India.

3 'Person of Indian Origin (PIO)' is a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan, or such other country as may be specified by the Central Government, satisfying the following conditions: [PIO will include an OCI cardholder]

a) Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

b) Who belonged to a territory that became part of India after the 15th day of August, 1947; or

c) Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b); or

d) Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c)

Particulars	NRE Account	FCNR (B) Account	NRO Account
			A Citizen of Bangladesh / Pakistan belonging to minority communities in those countries i.e., Hindus, Sikhs, Buddhists, Jains, Parsis, and Christians residing in India and who has been granted LTV* or whose application for LTV is under consideration, can open only one NRO account with an AD bank. * Long Term Visa
Type of Account	Savings, Current, Recurring, Fixed Deposit	Term Deposit only	Savings, Current, Recurring, Fixed Deposit
Period for fixed deposits permitted	From one to three years. However, banks are allowed to accept NRE deposits for a longer period i.e., above three years from their Asset-Liability point of view.	For terms not less than 1 year and not more than 5 years.	As applicable to resident accounts.
Permissible Credits	i. Inward remittance from outside India. ii. Proceeds of foreign currency/ bank notes tendered by account holder during his temporary visit to India. iii. Interest accruing on the account iv. Transfer from other NRE / FCNR(B) accounts. v. Maturity or sale proceeds of investments (if such investments were made from this account or through inward remittance). vi. Current income in India like rent, dividend, pension, interest, etc. is permissible subject to payment of taxes in India.		i. Inward remittances from outside India. ii. Legitimate dues in India. iii. Transfers from other NRO accounts. iv. Rupee gift / loan made by a resident to an NRI / PIO relative within the limits prescribed under LRS may be credited to the latter's NRO account.
	As a benchmark, credits to NRE / FCNR(B) account should be repatriable in nature.		
Permissible Debits	i. Local disbursements. ii. Remittance outside India. iii. Transfer to NRE / FCNR (B) accounts of the account holder or any other person eligible to maintain such account. iv. Permissible investments in India in shares / securities / commercial paper of an Indian company or for purchase of immovable property.		i. Local payments in rupees. ii. Transfers to other NRO accounts. iii. Remittance of current income abroad. iv. Settlement of charges on International Credit Cards. v. Repatriation under USD 1 million scheme is available only to NRIs and PIOs. vi. Funds can be transferred

Particulars	NRE Account	FCNR (B) Account	NRO Account
			to NRE account within this USD 1 million facility.
Permitted Joint Holding	May be held jointly in the names of two or more NRIs / PIOs. NRIs / PIOs can hold jointly with a resident relative on 'former or survivor' basis. The resident relative can operate the account as a PoA holder during the lifetime of the NRI / PIO account holder.		May be held jointly in the names of two or more NRIs / PIOs. May be held jointly with residents on 'former or survivor' basis.
Loans in India	AD can sanction loans in India to the **account holder / third parties without any limit,** subject to the usual margin requirements. The loan amount cannot be used for re-lending, carrying on agricultural / plantation activities or investment in real estate. In case of loan to account holder the loan can be used for personal purposes or for carrying on business activities or for making direct investments in India on non-repatriation or for acquiring a flat / house in India for his own residential use. In case of loan to third parties, loans can be given to resident individuals / firms / companies in India against the collateral		Loans against the deposits can be **granted in India to the account holder or third party** subject to usual norms and margin requirement. The loan amount cannot be used for relending, carrying on agricultural / plantation activities or investment in real estate. The term "loan" shall include all types of fund based / non-fund-based facilities.
	of fixed deposits held in NRE account. The loan should be utilised for personal purposes or for carrying out business activities. Also, there should be no direct or indirect foreign exchange consideration for the non-resident depositor agreeing to pledge his deposits to enable the resident individual / firm / company to obtain such facilities. These loans cannot be repatriated outside India and can be used in India only for the purposes specified in the regulations. The facility for premature withdrawal of deposits will not be available where loans against such deposits are availed of.		
Loans outside India	AD may allow their branches / correspondents outside India to grant loans to or in favour of non-resident depositor or to third parties at the request of depositor for bona fide purpose against the security of funds held in the NRE / FCNR (B) accounts in India. The term "loan" shall include all types of fund-based/ non-fund-based facilities.		Not permitted
Rate of Interest	There is no restriction on the rate of interest. It varies across banks and is generally based on the repo rate of RBI.		

Particulars	NRE Account	FCNR (B) Account	NRO Account
Operations by Power of Attorney in favour of a resident	Operations in the account in terms of PoA is restricted to withdrawals for permissible local payments or remittances to the account holder himself through normal banking channels. The PoA holder cannot repatriate outside India funds held in the account under any circumstances other than to the account holder himself, nor to make payment by way of gift to a resident on behalf of the account holder nor to transfer funds from the account to another NRE or FCNR(B) account.		Operations in the account in terms of PoA is restricted to withdrawals for permissible local payments in rupees, remittance of current income to the account holder outside India or remittance to the account holder himself through normal banking channels. While making remittances, the limits and conditions of repatriability will apply. The PoA holder cannot repatriate outside India funds held in the account under any circumstances other than to the account holder himself, nor to make payment by way of gift to a resident on behalf of the account holder nor to transfer funds from the account to another NRO account.

IMPACT OF CHANGE IN RESIDENTIAL STATUS

• All non-resident accounts i.e., NRE / NRO (wherein, you are the primary account holder) need to be converted / re-designated as resident accounts immediately upon the return of the account holder to India for taking up employment or return of the account holder to India for any purpose indicating his intention to stay in India for an uncertain period or upon change in the residential status. The account holder should provide appropriate documentation to the bank for conversion of NRE / NRO account into resident account.

• FCNR (B) deposits may be allowed to continue till maturity at the contracted rate of interest, if so desired by the account holder. Authorised Dealers should convert the FCNR(B) deposits on maturity into resident rupee deposit accounts or RFC accounts (if the depositor is eligible to open RFC account), at the option of the account holder.

With respect to the above, it would be relevant to refer to the compounding order **C.A. No. 4578 /2017 dated 30th January, 2018** in the matter of **Mr. Gaurav Bamania** for compounding of contravention of the provisions of the Foreign Exchange Management Act, 1999 (the FEMA) and the Regulations issued thereunder. The compounding was on account of violation on two grounds viz; payment of consideration towards investment in an Indian company by an NRI through a resident account and the applicant had not re-designated his existing account as a NRO account on becoming NRI. As per the RBI, there was a contravention of the provisions of Para 8(a) of Schedule 3 of FEMA 5 and Para 3 of Schedule 4 of FEMA 20, and applicant was required to apply for regularis ation of the contraventions subject to compounding. The RBI has quoted Para 8(a) of Schedule 3 of FEMA 5 in the compounding order which states as under:

"When a person resident in India leaves India for a country (other than Nepal or Bhutan) for taking up employment, or for carrying on business or vocation outside India or for any other purpose indicating his intention to stay outside India for an uncertain period, his existing account should be designated as a Non-Resident (Ordinary) account."

The matter was compounded in terms of the Foreign Exchange (Compounding Proceedings) Rules, 2000 and a sum of ₹26,530/- was levied as compounding fees by RBI as the amount of contravention involved was ₹56,850/-.

Further, it would also be useful to note the compounding

order **C.A. No. 85 /2019 dated 18th March, 2019** in the matter of **Mr. Thakorbhai Dahyabhai Patel** wherein the contravention sought to be compounded related to transfer of funds from NRE account to ordinary savings account thereby resulting in contravention of the provisions under Regulation 4(C) of Schedule 1 to Notification No. FEMA.5/2000-RB dated May 3, 2000, as amended from time to time. While the contravention was with respect to transfer of funds from NRE account to ordinary savings account, the same could have been mitigated if the applicant had converted / re-designated his ordinary savings account into NRE / NRO account after becoming a non-resident since the applicant, being a non-resident, is not eligible to open or maintain an ordinary savings account as per extant FEMA guidelines.

It would also be pertinent to note that the decision of the Hon'ble High Court of Delhi in the case of **Basant Kumar Sharma vs. Government of India [2013] 33 taxmann.com 282 (Delhi),** which has been rendered in the context of Section 2(p)(ii)(c) of the Foreign Exchange Regulations Act, 1973 ('FERA'). In this case, the petitioner was an NRI who had returned to India for exploratory purposes and the petitioner had approached State Bank of India ('SBI') to convert his subsisting NRE account into NRO account and also to obtain necessary approval from RBI for sale of his investments. The SBI informed him that after becoming a resident, he was not allowed to keep a NRE account and his NRE account would have to be re-designated as a 'Resident Account' under Section 2(p)(ii)(c) read with Regulation A.15 of the Foreign Exchange Manual. The Petitioner did not agree with the stand adopted by SBI that he was a 'Resident' since he had come to India for exploring possibilities of resettlement but had also kept the doors open for overseas relocation in case, he would find a job outside India. The Petitioner wrote to various authorities, which included RBI, and requested their intercession in this matter and after a series of communications with various authorities, the Petitioner filed a writ petition with the Hon'ble Delhi High Court. The Hon'ble Delhi High Court affirmed the view adopted by SBI that the Petitioner had attained the status of a Resident in India within the meaning of Section 2(p)(ii)(c) of the FERA since his stay in India was for an uncertain period and thus his NRE account was required to be re-designated as a Resident Account due to change in residential status.

The provisions of residential status under FEMA and key differences vis a vis the Income-tax Act, 1961 (ITA) is covered in detail in earlier issue of this series titled Residential Status of Individuals — Interplay With Tax Treaty published in January 2024.

A person can be Resident or Non-Resident under both ITA and FEMA or a person can be Resident under one Act and Non-Resident under the other Act. In such a scenario, it would be pertinent to analyse the impact of taxability of an individual under the ITA where his / her residential status is different under ITA and FEMA.

The interplay of residential status under ITA and FEMA comes into light at the time of claiming income tax exemption under Section 10(4)(ii) of the ITA for a person earning interest from his NRE account in India. As per Section 10(4)(ii) of the ITA, interest received on NRE account is exempt from tax in India, if the account holder is a Person Resident Outside India as defined under Section 2(w) of the FEMA or is a person who has been permitted by the Reserve Bank of India to maintain such account. Thus, the residential status under the ITA is not required to be looked into for claiming such exemption.

Say, an individual having NRE account in India when he was a Person Resident Outside India as per FEMA and a Non-Resident as per the ITA comes to India for good during December 2023. It would be important to dwell into the change in residential status under each Act to determine eligibility for exemption u/s 10(4)(ii) of the ITA with respect to interest received from NRE account. The individual becomes a person resident in India as per FEMA from December 2023 onwards, however, he would be regarded as a Non-Resident under the ITA during Financial Year 2023-24 (assuming his stay in India was below the threshold as required under ITA). In order to claim exemption from tax u/s 10(4)(ii) of the ITA, a person has to be resident outside India under FEMA. Thus, even though the individual is a Non-Resident under the ITA, he would be entitled to claim exemption under Section 10(4)(ii) of the ITA only up to December 2023 (i.e till he was a Person Resident Outside India as per FEMA), as he would become resident of India under FEMA from the date of his return for good. Further, such individual shall be required to redesignate his NRE account to resident account on account of change in his residential status under FEMA.

On the contrary, interest earned on FCNR account by a Non-Resident or Resident but Not Ordinarily Resident ('RNOR') under the ITA is exempt from tax under Section 10(15)(iv)(fa) of the ITA. Thus, the exemption from tax in this case is determined by a person's residential

status under the ITA and not under FEMA. If a Non-Resident holding FCNR account in India returns to India on a permanent basis in a particular financial year, he would become a Person Resident in India under FEMA immediately upon his return, but may continue to be a Non-Resident or RNOR under ITA for that particular year. Accordingly, such person can continue to claim exemption of tax for interest earned from FCNR account since the residential status under FEMA shall not impact his eligibility to claim exemption. The exemption can continue to be claimed till the residential status is RNOR and the deposit has not matured.

With respect to the above, we would like to draw your attention to the decision of the Hon'ble Chennai Tribunal in case of **Baba Shankar Rajesh vs. ACIT 180 ITD 160 (Chennai ITAT) [2019]** wherein Assessee was denied exemption under Section 10(4)(ii) of the ITA by the Hon'ble Tribunal on the ground that the Assessee was a 'Person Resident in India' under Section 2(v) of the FEMA as he was a Non-Resident who had come to India for taking up employment in India.

Another important decision was rendered by the Hon'ble Supreme Court of India in the case of **K. Ramullan vs. CIT 245 ITR 417 (SC) [2000]** in the context of Section 2(p) & (q) of the Foreign Exchange Regulation Act, 1973 ('FERA') which was in favour of the Assessee. The Assessee was earlier denied exemption under Section 10(4A) of the ITA by the High Court with respect to interest earned from NRE account and the Supreme Court set aside the order of the Hon'ble High Court holding that under erstwhile clause (c) casual stay with spouse should not be included and hence unless the stay was for uncertain period or with some permanence the Assessee was a 'Person Resident Outside India' under Section 2(q) of the FERA and was thus entitled to claim exemption under Section 10(4A) [erstwhile section] of the ITA.

Of course, determination of residential status under FEMA depends upon facts and circumstances of each case.

Furthermore, the following two types of accounts are also permitted to be opened by persons resident outside India for specific purposes as explained:

i) Special Non-Resident Rupee Account (SNRR Account)

Any PROI having a business interest in India may open, hold and maintain with an Authorised Dealer (AD Banks) in India, a SNRR account for the purpose of putting through bona fide transactions in rupees. SNRR accounts shall not earn any interest.

For the purpose of SNRR account, business interest, apart from generic business interest, shall include INR transactions relating to investments permitted under FEM (NDI Rules), 2019 and FEM (DI Regulations) 2019, import and export of goods and services, trade credit and ECB and business-related transactions outside International Financial Service Centre (IFSC) by IFSC units.

AD bank may maintain a separate SNRR account for each category of transactions or a single SNRR Account as per their discretion.

The tenure of the SNRR account should be concurrent to the tenure of the contract / period of operation / the business of the account holder and in no case should exceed seven years in case of generic business transactions.

SNRR account is often used by foreign entities to obtain income tax refunds on account of earning passive income from India or foreign entities undertaking turnkey projects in India. Earlier foreign entities were required to establish project offices (as regulated by RBI) in India to execute turnkey projects awarded to joint ventures between Indian entity and foreign entity also known as unincorporated joint venture. Now, with the introduction of the SNRR account, foreign companies can execute projects without establishing a project office in India.

ii) Escrow Account

Resident or non-resident acquirers may open, hold and maintain Escrow Account with ADs in India as permitted under Notification No. FEMA 5(R)/2016-RB. The account can be opened for acquisition/transfer of capital instruments / convertible notes in accordance with Foreign Exchange Management (Non-Debt Instrument) Rules, 2019.

The accounts shall be non-interest bearing. No fund / non-fund-based facility would be permitted against the balances in the account.

PPF AND SSY ACCOUNT FOR NRIS

The Ministry of Finance has issued updated guidelines for Public Provident Fund (PPF), Sukanya Samriddhi

Yojana (SSY), and other small savings schemes, effective from 1st October, 2024. One of the key changes under the new guidelines in relation to PPF accounts of NRIs are as under:

• For NRIs, PPF accounts which were opened under the Public Provident Fund Account Scheme, 1968 where Form H did not require the residency details of the account holder and the account holder became an NRI during the account's tenure, the Post Office Savings Account ('POSA') interest rate shall be granted to the account holder until 30th September, 2024. However, after this date, the interest on these accounts will drop to 0 per cent.

Further, it is pertinent to note that an NRI cannot open a new PPF account. If an account was opened by an individual while he / she was a resident who subsequently became an NRI, the account can continue until maturity. This rule has been there from quite some time, however, there have been cases where NRIs have even continued holding PPF accounts for another 5 years after completion of 15 years. In such cases, banks have denied interest in such accounts.

PPF interest is tax-free in India under Section 10(11) of the ITA for both residents and non-residents. However, the said PPF interest might be taxed in the residence country of the NRIs if it taxes its citizens / residents on their worldwide income.

Further, NRIs are not eligible to open and operate a Sukanya Samriddhi Yojana Account under the erstwhile Guidelines. There has been no change in this respect under the updated guidelines as well.

REMITTANCE FACILITIES UNDER FEMA

We have further discussed below the options available for persons resident outside in India to remit funds outside India under the Foreign Exchange Management (Remittance of Assets) Regulations, 2016 [Notification No. FEMA 13(R)/2016-RB dated 1st April, 2016]. As explained, current income in NRE and FCNR(B) account is freely repatriable outside India. For other balances and accounts pertaining to capital account transactions which are not repatriable in nature, the RBI has provided the following options:

i) Remittances by NRIs / PIOs:

Popularly known as USD 1 Million scheme / facility which covers only capital account transactions. ADs may allow ***NRIs / PIOs*** to remit up to USD one million per financial year:

• out of balances in their NRO accounts / sale proceeds of assets / assets acquired in India by way of inheritance / legacy;

• in respect of assets acquired under a deed of settlement made by either of his / her parents or a relative as defined in the Companies Act, 2013. The settlement should take effect on the death of the settler;

• in case settlement is done without retaining any life interest in the property i.e., during the lifetime of the owner / parent, it would be as remittance of balance in the NRO account;

The NRI or PIO should make such remittances out of balances held in the account arising from his / her legitimate receivables in India and not by borrowing from any other person or a transfer from any other NRO account.

Further, gift by a resident individual to an NRI / PIO after turning non-resident in a particular year may not be permitted under the Liberalised Remittance Scheme ('LRS') since such remittances under LRS are only permissible for resident individuals. However, such remittance can be made under the 1 million Dollar scheme by the residential individual after turning non-resident.

The prescribed limit of USD 1 million is not allowed to be exceeded. In case a higher amount is required to be remitted, approval shall be required from RBI. In our experience such approvals are given in very few / rare cases based on facts.

ii) Remittances by individuals not being NRIs/ PIOs:

ADs may allow remittance of assets by a ***foreign national*** where:

• the person has retired from employment in India (upto USD 1 million per financial year);

• the person has inherited from a person referred to in section 6(5) of the Act[4] (up to USD 1 million per financial year);

• the person is a non-resident widow / widower and has inherited assets from her / his deceased spouse, who was an Indian national resident in India (up to USD 1 million per financial year);

• the remittance is in respect of balances held in a bank account by a foreign student who has completed his / her studies (balance represents proceeds of remittances received from abroad through normal banking channels or out of stipend / scholarship received from the Government or any organisation in India).

• Salary income earned in India by individuals who do not permanently reside in India[5].

However, these facilities are not available for citizens of Nepal or Bhutan or a PIO.

iii) Repatriation of sale proceeds of immovable property:

A PIO/ NRI / OCI, in the event of sale of immovable property other than agricultural land / farmhouse / plantation property in India, may be allowed repatriation of the sale proceeds outside India provided:

• the immovable property was acquired by the seller in accordance with the provisions of the foreign exchange law in force at the time of acquisition;

• the amount for acquisition of the immovable property was paid in foreign exchange received through banking channels or out of funds held in FCNR(B) account or NRE account.

In the case of residential property, the repatriation of sale proceeds is restricted to a maximum of two such properties in the lifetime of the NRI / PIO. The non-resident seller shall be liable to TDS @ 20 per cent under Section 195 of the ITA on the sale consideration of the property. In such cases, non-resident sellers may apply for a Lower Deduction or Nil Deduction Certificate from the tax authorities under Section 197 of the ITA in order to minimise their tax liability and retain a higher portion of the sale proceeds. If the non-resident seller does not obtain a lower / nil deduction certificate, he / she can claim a refund by filing a return of income, in case the actual tax liability works out to be lower than the tax withheld by the buyer.

Further, the seller repatriating sale proceeds outside India may be required to obtain Form 15CB from the Chartered Account for repatriation of sale proceeds outside India.

Foreign Remittance by NRIs / OCIs — Compliances under ITA

The relevant provisions governing taxability of foreign remittances and the compliance requirements with respect to the same are provided under Section 195 of the ITA and Rule 37BB of the Income-tax Rules, 1962.

Section 195 of the ITA states that any person responsible for paying to a resident, not being a company or foreign company, any interest (excluding certain kinds of specified interest) or any other sum chargeable under the provisions of the ITA (not being the income under salaries) shall at the time of credit of such income to the payee in any specified mode, deduct income-tax thereon at the rates in force. **The provisions of Section 195 of the ITA are applicable only if the payment to non-residents is chargeable to tax in India.**

Further, Section 195(6) of the ITA requires reporting of any payment to a non-resident in Form 15CA / 15CB irrespective of whether such payments are chargeable to tax in India. Rule 37BB defines the manner to furnish information in Form 15CB and making declaration in Form 15CA. In terms of Rule 37BB, the information for payment to a non-resident is required to be provided in Form 15CA in four parts as under:

• Part A - For payment or aggregate of payments during

4 "person resident in India" means

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case— (a) for or on taking up employment outside India, or (b) for carrying on outside India a business or vocation outside India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than— (a) for or on taking up employment in India, or (b) for carrying on in India a business or vocation in India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India;

5 " As per Explanation to Regulation 5 of the Remittance of Asset Regulations, 2016, 'not permanently resident' means a person resident in India for employment of a specified duration (irrespective of length thereof) or for a specific job or assignment, the duration of which does not exceed three years.

the FY not exceeding ₹5,00,000.

• Part B - When a certificate from Assessing Officer is obtained u/s 197, or an order from an Assessing Officer is obtained u/s 195(2) or 195(3) of the ITA.

• Part C - For other payments chargeable under the provisions of the ITA - To be filed after obtaining a certificate in Form 15CB from a practicing Chartered Accountant.

• Part D - For payment of any sum which is not chargeable under the provisions of the ITA.

Form 15CA is a declaration by the remitter that contains all the information in respect of payments made to non-residents and Form 15CB is a Tax Determination Certificate in which the Chartered Accountant ('CA') examines a remittance with regard to chargeability provisions. These forms can be submitted both online and offline (bulk mode) through the e-filing portal. A CA who is registered on the e-filing portal and one who has been assigned Form 15CA, Part-C by the person responsible for making the payment is entitled to certify details in Form 15CB. The CA should also possess a Digital Signature Certificate (DSC) registered with the e-filing portal for e-verification of the submitted form.

Form 15CB has six sections to be filled before submitting the form which are as under:

1) Certificate
2) Remittee (Recipient) Details
3) Remittance (Fund Transfer) Details
4) Taxability under the Income-tax Act (without DTAA)
5) Taxability under the Income-tax act (with DTAA relief)
6) Accountant Details (CA's details)

The foreign remittances by NRI / OCI would generally comprise of payments to NRIs / foreign companies / OCIs / PIOs towards royalty, consultancy fees, business payments, etc., where the payment contains an income element or transfer from one's NRO bank account to NRE / foreign bank account i.e., transfer to own account. Sub-rule (3) of Rule 37BB of the Income-tax Rules, 1962 provides a specific exclusion for certain remittances under Current Account Transaction Rules, 2000 or remittances falling under the Specified List provided thereunder[6].

6 https://incometaxindia.gov.in/pages/rules/income-tax-rules-1962.aspx

The transfer from NRO to NRE / foreign bank account may fall within one of the purposes under the category of remittances which may not contain an income element and thus would not be chargeable to tax in India. Thus, there should not be any requirement of obtaining Form 15CB and reporting would only be required in Part D of Form 15CA. However, certain Authorised Dealer banks insist on furnishing Form 15CA along with Form 15CB for source of funds from which remittance is sought to be made in order to process the remittance. In such case, reporting would be required in Part C of Form 15 CA and the CA would be required to report the taxability of such remittance under Section 4 (which deals with taxability under ITA without DTAA) or Part D, Point No. 11 under Section 5 (which deals with taxability under the ITA with DTAA relief).

It may be noted that furnishing of inaccurate information or non-furnishing of Form 15CA can trigger penalty of sum of Rupees 1 lakh under section 271-I of the ITA. Thus, in order to avoid any future litigation and to be compliant from an income-tax perspective, it would be advisable to comply with the reporting obligation under Part C of Form 15CA and obtain Form 15CB from a CA at the time of making remittance from NRO account to NRE / foreign bank account.

When dealing with certification on taxability of funds from which remittance is sourced, a CA may need to bifurcate into separate certificates and also travel back several years. A CA must analyse the following aspects before issuing certificate for remittances from one's own NRO bank account to NRE account:

• Find out the source of funds lying in the NRO account by tracing them back to the incomes comprised therein which may trace back to several years;

• Income-tax returns filed by the NRI in India for the period concerned;

• Relevant year's Form 26AS and TDS certificates;

• Documents and issues pertaining to each type of income.

Third parties transferring money to NRE / NRO accounts of NRIs (for e.g., payment of rent or a sale consideration of an immovable property), may ask for certain documents from NRI before making transfers, such as a certificate under section 197 of the ITA from the Assessing Office

(AO) of NRI, undertaking/ bond from NRI, certificate from the CA in case of certain controversial issues. Further, such third-party payers shall be required to obtain Form 15CA / Form 15CB at the time of remittance to the NRI. NRIs should pre-empt such documentation requirements of tax authorities at the time of receiving remittances from third parties in their NRI / NRO account and thus obtain such documents in advance and keep them on their records, in case required to be furnished before tax authorities at the time of remittances / transfers by NRI's between their own accounts i.e., NRO to NRE. Such documentation may also be helpful to CA issuing Form 15CA / CB to the NRI in future for remittance between own accounts.

It is not possible nor intended to cover all aspects of the important topic of Bank Accounts in India by non residents and Repatriation of Funds. In view of the dynamic nature of FEMA and other laws, readers are well advised to get an updated information at the time of advising their clients and / or undertaking transactions relating to bank accounts or repatriation of funds outside India. ■

GIFTS AND LOANS — BY AND TO NON-RESIDENT INDIANS: PART I

HARSHAL BHUTA | NAISAR SHAH
Chartered Accountants

Editor's Note on NRI Series:
This is the 8th article in the ongoing NRI Series dealing with Income-tax and FEMA issues related to NRIs. This article is divided in two parts. The first part published here deals with important aspects of Gifts by and to NRIs. The second part will deal with important aspects of Loans by and to NRIs. 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.

INTRODUCTION

The Foreign Exchange Management Act (FEMA) of 1999 is a significant piece of legislation in India that governs foreign exchange transactions aimed at facilitating external trade and payments while ensuring the orderly development of the foreign exchange market.

Enacted on 1st June, 2000, FEMA replaced the earlier, more restrictive Foreign Exchange Regulation Act (FERA) of 1973, reflecting a shift toward a more liberalized economic framework. The Act establishes a regulatory structure for managing foreign exchange and balancing payments, providing clear guidelines for individuals and businesses engaged in such transactions.

It designates banks as authorized dealers, allowing them to facilitate foreign exchange operations. FEMA distinguishes between current account transactions and capital account transactions. Current account transactions, which include trade in goods and services, remittances, and other day-to-day financial operations, are generally permitted without prior approval, reflecting a more open approach to international commerce. In contrast, capital account transactions, which encompass foreign investments and loans, are subject to specific regulations. Furthermore, the Act includes provisions for enforcement through the Directorate of Enforcement, establishing penalties for violations.

This article will delve into the provisions governing gifting and loans involving Non-Resident Indians (NRIs), including the relevant implications under the Income Tax Act, 1961 (ITA) as applicable. Understanding these provisions is crucial for NRIs, as they navigate financial transactions across borders while remaining compliant with Indian tax laws. Further, within the gifting and loan sections, respectively, we will first deal with the FEMA provisions and, after that, Income Tax provisions dealing with gifting or loans as the case may be.

To start, it's essential to understand the definition of NRIs. The term NRI has been defined in several notifications issued under the Foreign Exchange Management Act (FEMA), as outlined in the table below:

Definition	Regulations
NRI means a person resident outside India who is a citizen of India.	FEM (Borrowing and Lending) Regulations, 2018
	FEM (Deposits) Regulations, 2016
	FEM (Remittance of Assets) Regulations, 2016
NRI means an individual resident outside India who is a citizen of India.	FEM (Non-Debt Instruments) Rules, 2019
	FEM (Debt Instruments) Regulations, 2019

In essence, the term NRI is defined in several notifications issued under the Foreign Exchange Management Act (FEMA) to refer specifically to an individual who holds Indian citizenship but resides outside of India. This definition captures a broad range of individuals who may live abroad for various reasons, including employment, business pursuits, education, or family commitments.

Further, kindly note that we are not dealing with the provisions concerning the overseas citizen of India cardholder ('OCIs') in this article. Overseas Citizen of India means an individual resident outside India who is registered as an overseas citizen of India cardholder under section 7(A) of the Citizenship Act, 1955.

FEMA ASPECT OF GIFTING

A. Gifting to and from NRIs

Let us briefly delve into whether the gifting transaction is a capital or a current account transaction. A capital account transaction means a transaction that alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India and includes transactions referred to in sub-section (3) of section 6[1]. A current account transaction means a transaction other than a capital account transaction and includes certain specified transactions. In our view, gifting transactions can be classified as either capital or current account transactions, depending on the specific circumstances. For instance, when an Indian resident receives a gift as bank inward remittance from a non-resident, this transaction does not change the resident's assets or liabilities in any foreign jurisdiction nor alters the assets or liabilities of a non-resident in India. As a result, it can be viewed as a current account transaction, primarily affecting the resident's income without altering any existing financial obligations abroad. On the other hand, if an Indian resident gifts the sum of money in the NRO account in India of a non-resident, this situation will be categorized as a capital account transaction since this impacts the non-resident's assets in India.

Now that we have clarified the meaning of the term NRI, we can proceed to explore the provisions under FEMA related to gifting various assets by individuals residing in India to NRIs, whether those assets are located in India or abroad. Understanding these provisions is essential for both residents and NRIs, as they outline the legal framework governing the transfer of gifts across borders. Under FEMA, certain guidelines specify how and what types of assets can be gifted, along with the necessary compliance requirements to ensure that these transactions adhere to regulatory standards.

A.1 FEMA Provisions — Gifting from PRI to NRI

a. Gifting of Equity Instruments of an Indian company

i. The expression equity instruments have been defined in Rule 2(k) of FEM (Non-debt Instruments) Rules, 2019 ('NDI Rules') as equity shares, compulsorily convertible preference shares, compulsorily convertible debentures, and share warrants issued by an Indian company.

ii. NDI Rules categorically include the provision concerning the transfer of equity instruments of an Indian company by or to a person resident outside India ('PROI')/ NRIs.

iii. Specifically, Rule 9(4) of NDI Rules provides that a person resident in India holding equity instruments of an Indian company is permitted to transfer the same by way of gift to PROI after seeking prior approval of RBI subject to the following conditions:

- The donee is eligible to hold such a security under the Schedules of these Rules;

- The gift does not exceed 5 per cent of the paid-up capital of the Indian company or each series of debentures or each mutual fund scheme [Paid-up capital is to be calculated basis the face value of shares of an Indian company.]

- The applicable sectoral cap in the Indian company is not breached;

- The donor and the donee shall be "relatives" within the meaning in clause (77) of section 2 of the Companies Act, 2013;

- The value of security to be transferred by the donor, together with any security transferred to any person residing outside India as a gift during the financial year, does not exceed the rupee equivalent of fifty thousand US Dollars [For the value of security, the fair value of an Indian company is required to be taken into consideration;]

- Such other conditions as considered necessary in the public interest by the Central Government.

1 Though the definition refers to section 6(3) of FEMA, section 6(3) of FEMA is omitted as of the date of this article. Instead, Section 6(2) and Section 6(2A) are amended to cover the erstwhile provisions of Section 6(3) of FEMA.

iv. Consequently, it is clear that when a Person Resident in India (PRI) intends to gift equity instruments to a Non-Resident Indian (NRI), this action is permitted only after obtaining prior approval from the Reserve Bank of India (RBI) and subject to satisfaction of terms and conditions as mentioned in Rule 9(4) of NDI Rules.

v. This leads us to a critical question under FEMA: does gifting equity instruments on a non-repatriable basis also necessitate prior approval from the RBI, considering the fact that non-repatriable is akin to domestic investment?

• Rule 9(4) of the Non-Debt Instruments (NDI) Rules does not clearly specify whether prior approval from the Reserve Bank of India (RBI) is required for either repatriable or non-repatriable transfers of equity instruments. Hence, the first perspective is that since Rule 9(4) of NDI Rules does not distinguish between repatriable and non-repatriable investments, even gifting of shares on a non-repatriable basis should be subjected to the terms and conditions specified in Rule 9(4) of NDI Rules.

• The second perspective is that non-repatriable investments are viewed as analogous to domestic investments, suggesting that they operate similarly to transactions conducted between two resident Indians. In this light, the gifting of equity instruments of an Indian company should be permitted under the automatic route, thereby eliminating the need for prior RBI approval. This interpretation aligns with the notion that since the funds remain within India's borders and are not intended for repatriation, the transaction should not pose risks to the foreign exchange regulations.

vi. Additionally, it is to be noted that LRS provisions do not apply in the case of gifting of equity instruments of Indian companies by PRI to NRI.

b. Gifting of other securities such as units of mutual fund, ETFs, etc

i. Schedule III of the NDI Rules addresses the sale of units of domestic mutual funds, whereas the FEMA (Debt Instruments) Regulations, 2019, focuses specifically on the purchase, sale, and redemption of specified securities. Neither of these regulations explicitly mentions the gifting of such units or securities. Further, the term 'transfer' is also not used under these provisions to permit the gifting of such assets. As a result, a question arises regarding whether these securities can be gifted to Non-Resident Indians (NRIs) under the automatic route.

ii. Given that the rules and regulations do not explicitly outline the provisions for gifting, it is prudent to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions. This approach helps mitigate the risk of violating FEMA provisions, ensuring compliance and legal clarity in the transaction process.

c. Gifting of immovable property in India

i. Acquisition and transfer of immovable property in India by an NRI is governed by the provisions of the NDI Rules.

ii. Rule 24(b) of NDI Rules permits NRI to acquire any immovable property in India (other than agricultural land or farmhouse in India) by way of a gift from a person resident in India who is a relative as defined in section 2(77) of Companies Act, 2013. Thus, NRI cannot receive agricultural land or farm house by way of a gift from PRI even if it is from a relative.

iii. The relative definition of the Companies Act, 2013 covers the following persons:

Act of 2013
Relative, with reference to any person, means anyone related to another, if—
(i) they are members of HUF; or
(ii) they are husband and wife; or
(iii) one person is related to the other in such manner as may be prescribed.
Act of 2013 (as prescribed)
Father (including step-father)
Mother (including step-mother)
Son (including step-son)
Son's wife
Daughter
Daughter's husband
Brother (including step-brothers)
Sister (including step-sisters)

iv. As a consequence, gifting by only relatives as covered above is permitted in the case of immovable property in India. Thus, if the resident grandfather wishes to gift immovable property to his NRI grandson, such gifting will not be permitted under the contours of FEMA.

v. This limitation on gifting can have significant implications for families, particularly when it comes to

wealth transfer and estate planning. For instance, if the resident grandfather wants to ensure that his grandson benefits from the property, he will not be able to gift property to his grandson.

vi. Additionally, it is to be noted that LRS provisions do not apply in the case of gifting of immovable properties by PRI to NRI.

d. Gifting of immovable property outside India

i. The acquisition and transfer of immovable property outside India are governed by the provisions set forth in the Foreign Exchange Management (Overseas Investments) Rules, 2022 ('OI Rules').

ii. This brings up an important question: are resident individuals permitted to transfer immovable property outside India to Non-Resident Indians (NRIs)?

iii. Rule 21 of the OI Rules specifically addresses the provisions related to the acquisition or transfer of immovable property located outside India. Within this rule, Rule 21(2)(iv) explicitly states that a person resident in India can transfer immovable property outside the country as a gift only to someone who is also a resident of India. This means that the recipient of the gift must reside in India to qualify for such a transfer. Consequently, gifting immovable property outside India by a resident individual to an NRI is not permitted within the framework of FEMA regulations.

e. Gifting of foreign equity capital

i. To determine whether gifting of foreign equity capital from a PRI to an NRI is allowed, it is essential to consider the provisions outlined in the OI Rules and the Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations'). Additionally, RBI has also issued Master Direction on Foreign Exchange Management (Overseas Investment) Directions, 2022, specifying/detailing certain provisions concerning overseas investments.

ii. Rule 2(e) of the OI Rules defines equity capital as equity shares, perpetual capital, or instruments that are irredeemable, as well as contributions to the non-debt capital of a foreign entity, specifically in the form of fully and compulsorily convertible instruments. Therefore, it primarily includes equity shares, compulsorily convertible preference shares, and compulsorily convertible debentures.

iii. Schedule III of the OI Rules addresses the provisions related to the acquisition of assets through gifts or inheritance. However, it does not explicitly mention the scenario where a Person Resident in India (PRI) gifts foreign securities to a Non-Resident Indian (NRI). This implied that PRI is not permitted to gift foreign equity capital to NRI under the automatic route. This interpretation is also supported by the Master Direction, which clearly states that resident individuals are prohibited from transferring any overseas investments as gifts to individuals residing outside India. The definition of the term 'overseas investment' includes financial commitment made in foreign equity capital.

f. Gifting through bank / cash transfers

i. Master Direction on Liberalised Remittance Scheme ('LRS Master Direction') outlines the provisions concerning gifting by PRIs to NRIs through bank transfers.

ii. As per the LRS Master Direction, a resident individual is permitted to remit up to USD 250,000 per FY as a gift to NRIs. Whereas, for rupee gifts, a resident individual is permitted to make a rupee gift to an NRI who is a relative (as defined in section 2(77) of the Companies Act) by way of a crossed cheque/ electronic transfer. However, it is to be noted that the gift amount should only be credited to the NRO account of the non-resident.

iii. A significant question arises regarding whether a resident individual who has opened an overseas bank account under LRS is permitted to gift funds from that account to a person residing outside India. This question involves two differing interpretations of the regulations. One perspective posits that when a resident individual gifts money from an overseas LRS bank account, it alters their overseas assets. This change is seen as a capital account transaction, which is subject to stricter regulations under FEMA. Since gifting is not explicitly allowed under FEMA for capital account transactions, this view concludes that such gifts cannot be made. Additionally, the LRS Master Direction states that funds in the LRS bank account should remain available for the resident individual's use, suggesting that any transfer of those funds, including gifting, would not be permissible. Conversely, another view is that LRS intends to allow the utilization of funds for both permitted capital account transactions and current account transactions. Thus, gifting being a permitted transaction under LRS, it should be permitted from overseas bank accounts too. For example, since residents are allowed to use their overseas LRS bank accounts to cover travel expenses,

it stands to reason that gifting funds from these accounts should also be acceptable.

iv. Furthermore, concerning the gifting of cash to any person resident outside India by the PRI, it is crucial to that emphasize PRI is not permitted to give cash gifts to individuals residing outside India while the PROI is present in India or abroad. This prohibition stems from Section 3(a) of FEMA, which specifically forbids any person who is not an authorized person from engaging in transactions involving foreign exchange. The term 'transfer' under FEMA encompasses a wide range of transactions, including gifting. This means that any act of gifting cash or other forms of foreign exchange to a non-resident is treated as a transfer and is, therefore, subject to the same restrictions.

v. Thus, in a nutshell, while gifts in foreign currency can be sent to any person resident outside India, irrespective of their relationship with the donor, rupee gifts are strictly limited to those individuals defined as relatives. Also, cash gifting is prohibited.

g. Gifting of movable assets such as jewelry, paintings, cars, etc

i. Given that the FEMA regulations do not clearly outline provisions for gifting such movable assets located either in India or outside India, it is prudent to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions. This approach helps mitigate the risk of violating FEMA provisions while ensuring compliance at the same time.

A.2 FEMA Provisions — Gifting from NRI to PRI

a. Gifting of Equity Instruments of an Indian Company

i. Rule 13 of NDI Rules, which specifically covers the provisions concerning the transfer of equity instruments by NRIs, does not contain any specific provision wherein NRIs are permitted to transfer by way of gift equity instruments of Indian companies to a person resident in India. However, Rule 9 of NDI Rules, which covers the transfer of equity instruments of an Indian company by or to a person resident outside India, covers the provision concerning the transfer of equity instruments of an Indian company by way of a gift from a person resident outside India to a person resident in India. Since NRIs are categorized as a person residing outside India, Rule 9 can also be said to apply to the aforesaid situation.

ii. Specifically, Rule 9(2) of NDI Rules provides that a person resident outside India holding equity instruments of an Indian company is permitted to transfer the same by way of sale or gift to PRI under automatic route subject to fulfillment of certain conditions such as pricing guidelines, compliance if repatriable investment, SEBI norms as applicable, etc.

iii. As a consequence, NRI is freely permitted to transfer equity instruments of an Indian company by way of a gift to PRI in accordance with FEMA rules and regulations.

b. Gifting of other securities such as units of mutual fund, ETFs, etc

i. As discussed in paragraph A.1.b, Schedule III of NDI Rules, as well as FEMA (Debt Instruments) Regulations, 2019, do not clearly outline provisions for gifting of these instruments. Hence, it is advisable to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions.

c. Gifting of immovable property in India

i. The acquisition and transfer of immovable property in India by non-resident Indians (NRIs) are regulated by the NDI Rules.

ii. According to Rule 24(d) of these rules, NRIs can transfer any immovable property in India to a resident person or transfer non-agricultural land, farmhouses, or plantation properties to another NRI.

iii. However, an important point of consideration is that Rule 24(d) does not explicitly mention whether transfers can occur through sale or gift. This ambiguity necessitates a closer examination of the term 'transfer' to determine if it encompasses gifts.

iv. Although the term 'transfer' is not defined in Rule 2 of the NDI Rules, Rule 2(2) states that terms not defined in the rules will carry the meanings assigned to them in relevant Acts, rules, and regulations. Thus, we need to check if 'transfer' is defined in the Foreign Exchange Management Act (FEMA). Section 2(ze) of FEMA defines 'transfer' to encompass various forms, including sale, purchase, exchange, mortgage, pledge, gift, loan, and any other method of transferring rights, title, possession, or lien. Therefore, gifts are included within the definition of 'transfer' under FEMA.

v. As a result, NRIs are allowed to transfer immovable property in India to any resident person in accordance with Rule 24(d) of the NDI Rules, along with Rule 2(2) and Section 2(ze) of FEMA.

d. Gifting of immovable property outside India

i. The acquisition and transfer of immovable property outside India are governed by the Foreign Exchange Management (Overseas Investments) Rules, 2022 (referred to as the OI Rules).

ii. Rule 21 of the OI Rules specifically addresses the acquisition and transfer of immovable property outside India. Notably, Rule 21(2)(ii) permits PRIs to acquire immovable property outside India from persons resident outside India (PROIs). However, this rule does not explicitly allow for acquisition through gifting from NRIs; it only permits acquisition through inheritance, purchase using RFC funds, or under the Liberalized Remittance Scheme (LRS), among other methods. Rule 21(2)(i) allows PRIs to acquire immovable property by gift, but only from other PRIs.

iii. Thus, it emerges that PRIs are not permitted to receive immovable property as a gift from NRIs.

e. Gifting of foreign equity capital

i. To determine whether gifting foreign equity capital from a person resident in India (PRI) to a Non-Resident Indian (NRI) is allowed, it is essential to consider the provisions outlined in the OI Rules and the Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations').

ii. Rule 2(e) of the OI Rules defines equity capital as equity shares, perpetual capital, or instruments that are irredeemable, as well as contributions to the non-debt capital of a foreign entity, specifically in the form of fully and compulsorily convertible instruments.

iii. Schedule III of the OI Rules outlines the provisions regarding how resident individuals can make overseas investments. It specifically allows resident individuals to acquire foreign securities as a gift from any person residing outside India. However, this acquisition is subject to the regulations established under the Foreign Contribution (Regulation) Act, 2010 (42 of 2010) and the associated rules and regulations.

iv. As a result, PRIs are permitted to receive foreign securities as a gift from NRIs.

f. Gifting through bank/ cash transfers

i. Under FEMA, there are no restrictions on receiving gifts via bank transfer by PRI from NRI. However, it is to be noted that PRI is not permitted to accept gifts from a person resident outside India/ NRI in their overseas bank account opened under the Liberalised Remittance Scheme since the LRS account can only be used for putting through all the transactions connected with or arising from remittances eligible under the LRS.

ii. Similar to what has been discussed in paragraph A.1.f.iv, gifting cash by NRI to PRI is not permitted.

g. Gifting of movable assets such as jewelry, paintings, cars, etc

i. Given that the FEMA regulations do not clearly outline provisions for gifting such movable assets located either in India or outside India, it is advisable to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions.

A.3 FEMA Provisions — Gifting between NRIs

a. Gifting of Equity Instruments of an Indian Company

i. Rule 13 of NDI Rules, which specifically covers the provisions concerning the transfer of equity instruments by NRIs, contains the provisions for gifting equity instruments to another NRI.

ii. Rule 13(3) of NDI Rules specifically permits NRI to transfer the equity instruments of an Indian Company to a person resident outside India (on a repatriable basis) by way of gift with prior RBI approval and subject to the following terms and conditions:

- The donee is eligible to hold such a security under the Schedules of these Rules;

- The gift does not exceed 5 per cent of the paid-up capital of the Indian company or each series of debentures or each mutual fund scheme [Paid-up capital is to be calculated basis the face value of shares of an Indian company.]

- The applicable sectoral cap in the Indian company is not breached;

• The donor and the donee shall be "relatives" within the meaning in clause (77) of section 2 of the Companies Act, 2013;

• The value of security to be transferred by the donor, together with any security transferred to any person residing outside India as a gift during the financial year, does not exceed the rupee equivalent of fifty thousand US Dollars [For the value of security, the fair value of an Indian company is required to be taken into consideration;]

• Such other conditions as considered necessary in the public interest by the Central Government.

iii. Further, as per Rule 13(4) of NDI Rules, NRI is permitted to transfer equity instruments of an Indian company to another NRI under the automatic route provided such NRI would hold shares on a non-repatriation basis.

iv. Hence, in a nutshell, for repatriable transfer of shares by way of gift, prior RBI approval is required whereas, in the case of non-repatriable transfers, RBI approval is not required.

b. Gifting of other securities such as units of mutual fund, ETFs, etc

i. As discussed in paragraph A.1.b, Schedule III of NDI Rules, as well as FEMA (Debt Instruments) Regulations, 2019, do not clearly outline provisions for gifting of these instruments. Hence, it is advisable to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions.

c. Gifting of immovable property in India

i. According to Rule 24(e) of NDI Rules, NRI is permitted to transfer any immovable property other than agricultural land or a farmhouse or plantation property to another NRI. However, an important point of consideration is that Rule 24(e) does not explicitly mention whether transfers can occur through sale or gift.

ii. As discussed in paragraph A.1.c, section 2(ze) of FEMA defines 'transfer' to encompass various forms, including sale, purchase, exchange, mortgage, pledge, gift, loan, and any other method of transferring rights, title, possession, or lien. Therefore, gifts are included within the definition of 'transfer' under FEMA.

iii. As a result, NRIs are allowed to transfer immovable property in India to another NRI in accordance with Rule 24(e) of the NDI Rules read with Rule 2(2) of NDI Rules and Section 2(ze) of FEMA. It is to be noted that the transfer of agricultural land or a farmhouse or plantation property by way of gift to another NRI is prohibited.

d. Gifting of immovable property outside India

i. This transaction falls outside the regulatory framework of FEMA, meaning it is not subject to its restrictions or requirements. As a result, it is permitted and can be carried out without any regulatory concerns or limitations imposed by FEMA.

e. Gifting of foreign equity capital

i. This transaction falls outside the regulatory framework of FEMA, meaning it is not subject to its restrictions or requirements. As a result, it is permitted and can be carried out without any regulatory concerns or limitations imposed by FEMA.

f. Gifting through bank/ cash transfers

i. Under FEMA, NRI can freely gift money from their NRO bank account to the NRO bank account of another NRI, as transfers between NRO accounts are considered permissible debits and credits. Similarly, gifting money from one NRE account to another NRE account belonging to another NRI is also allowed without restrictions.

ii. However, the question comes up regarding whether it is allowed to gift money from an NRO account to the NRE account of another NRI or from an NRE account to the NRO account of another NRI. In our view, this may not be permissible, as the regulations regarding permissible debits and credits for NRE and NRO accounts do not explicitly cover this type of gifting transaction and restrict it to the same category of accounts.

iii. Furthermore, concerning the gifting of cash to any person resident outside India, as discussed in paragraph A.1.f.iv, gifting cash by NRI to NRI is not permitted.

g. Gifting of movable assets such as jewelry, paintings, cars, etc

i. Given that the FEMA regulations do not clearly outline provisions for gifting such movable assets

situated in India, it is advisable to seek prior approval from the Reserve Bank of India (RBI) before proceeding with such transactions.

A.4 Applicability of the Foreign Contribution (Regulation) Act, 2010

The Foreign Contribution (Regulation) Act, 2010 ('FCRA') governs the acceptance and utilization of foreign contributions by individuals and organizations in India. As per the Foreign Contribution (Regulation) Act, 2010, foreign contribution means the donation, delivery, or transfer made by any foreign source of any article, currency (whether Indian or foreign), or any security as defined in Securities Contracts (Regulations) Act, 1956 as well as foreign security as defined in FEMA. Thus, receipt of the above assets by PRI from foreign sources will trigger the applicability of FCRA. Hence, it is pertinent to analyze the definition of the term 'foreign source' as specified in FCRA.

It is important to highlight here that NRIs are not classified as a 'foreign source' under the provisions of FCRA. This distinction is crucial because it implies that gifts received from NRIs are not subjected to the stringent regulations that govern foreign contributions. Consequently, PRIs can freely acquire such gifts without falling under the scrutiny of FCRA.

INCOME TAX ASPECTS OF GIFTING

A.5 Applicability of Section 56 of the Income Tax Act, 1961

The framework of Section 56:

Section 56 of the Income-tax Act, of 1961, is primarily concerned with income that does not fall under other heads of income, such as salaries, house property, or business income. This section covers "Income from Other Sources" and serves as a residual category for various types of income that cannot be specifically classified under other heads.

This section deals, inter alia, with the taxability of gifts and the transfer of property under specific "conditions.This section was introduced to prevent tax avoidance by transferring assets or property without proper consideration (gifting) as a method to evade taxes.

Applicability:

As per this section, **any person** who receives income from any individual or individuals on or after 1st April, 2017, will have that income chargeable to tax. The 'income' types are outlined in the table below:

Sub- Section	Type of Income/ Property	Condition	Threshold	Taxable Amount
(a)	Money Received	Without consideration	₹ 50,000 aggregate per financial year	The entire amount received is taxable
(b)*	Immovable property received	Without consideration: If stamp duty value exceeds ₹ 50,000	₹ 50,000 stamp duty value	Stamp duty value of the property
(b)*	Immovable property received	With consideration: If the consideration paid is less than the stamp duty value and the excess is more than the greater of ₹ 50,000 or 10 per cent of the consideration.	Greater than ₹ 50,000 or 10 per cent** of consideration	Excess of stamp duty value over the consideration paid
(c)	Movable Property Received	Without consideration:Fair market value exceeds ₹ 50,000	₹ 50,000 aggregate fair market value	Entire fair market value
(c)	Movable Property Received	With consideration: If the consideration paid is less than the fair market value and the difference exceeds ₹ 50,000.	₹ 50,000 difference	Excess of fair market value over consideration paid

*Proviso to section 56(2)(x)(b)

** The Finance Act 2018 introduced a safe harbor limit set at 5 per cent of the actual consideration. However, the Finance Act 2020 increased this limit to 10 per cent of the actual consideration.

Proviso	Details	Taxable Amount
1	If the date of agreement and registration are not the same, the stamp duty value on the date of the agreement can be taken, provided payment was made by account payee cheque, draft, electronic clearing system, or other prescribed electronic modes.	Stamp duty value on the agreement date is used if conditions are met.
2	If the stamp duty value is disputed, the Assessing Officer may refer it to a Valuation Officer. The provisions of Sections 50C and 155(15) will apply.	The value is determined by the Valuation Officer, if applicable.
3	In cases covered under Section 43CA(1) (for certain types of properties), the 10 per cent threshold is increased to 20 per cent.	The difference between the stamp duty value and consideration if it exceeds ₹ 50,000 or 20 per cent of the consideration.

Exemption:

Though the list of exemptions is exhaustive, we have included key exemptions that are specifically pertinent concerning the gifting aspects only.

1. Any sum of money or any property received from any relative

The term "relative" shall be construed in the same manner as defined in the explanation to clause (vii) of Section 56(2), which delineates the definition of "relative" as follows:

Relative means:

i. In the case of an individual—

(A) spouse of the individual;

(B) brother or sister of the individual;

(C) brother or sister of the spouse of the individual;

(D) brother or sister of either of the parents of the individual;

(E) any lineal ascendant or descendant of the individual;

(F) any lineal ascendant or descendant of the spouse of the individual;

(G) spouse of the person referred to in items (B) to (F); and

ii. in the case of a Hindu undivided family, any member thereof,

2. Any sum of money or any property received on the occasion of the marriage of the individual

a. **Scope of Exemption:** Money or property received by the individual on their marriage is exempt under Section 56(2)(x), excluding gifts to parents. Further, the gifting of money or property, etc. will eventually be subjected to FEMA applicability as well in cross-border transaction cases.

b. **No Monetary Limit:** No limits on the value of gifts.

c. **Sources of Gifts:** Gifts can come from anyone, not just relatives.

d. **Timing of Gifts:** Gifts received before or after the wedding are exempt if related to the marriage.

A.6 Applicability of Clubbing Provisions under the Income Tax Act, 1961

Section 64 of the Income Tax Act, 1961, (ITA) addresses the taxation of income that arises from the transfer of assets to certain relatives, specifically focusing on preventing tax avoidance strategies that involve shifting income-generating assets. It aims to ensure that income from such assets is ultimately taxed in the hands of the original owner, thereby maintaining fairness in the taxation system.

The provisions of Section 64 concerning the clubbing of income is summarised in the table below:

Particulars	Provisions
Income of Spouse	**Transfer of Assets:** If a non-resident individual (let's say Mr. A) transfers an asset such as an immovable property located outside India or equity shares of Apple Inc. to his Indian resident spouse (Mrs. A) without adequate compensation, any income generated from that asset — such as rental income from the house or dividends from shares — will be treated as Mr. A's income. **Whether capital gains pre-exemption or post-exemption to be clubbed:** The High Court of Kerala, in the case of Vasavan[2], while interpreting Section 64 of ITA, held that the assessing authority was bound to treat the 'capital gains' which, but for Section 64 should have been assessed in the hands of the wife, as the capital gains of the assessee was liable to be assessed in his hands in the same way in which the same would have been assessed in the hands of the wife". Therefore, based on the above judicial pronouncements, one may claim that the capital gain income first needs to be computed in the hands of the spouse, and thereafter, capital gain income remaining net of allowable exemptions under Section 54/ Section 54F needs to be clubbed in the hands of husband for computing his total income in India.
Income of Minor Child	**Clubbing of Income:** Any income earned by a minor child, including income from gifts received, will be clubbed with the income of the parent whose total income is higher. This applies to all minor children of the individual. **Exemption:** There is a specific exemption of up to ₹ 1,500 per child for income derived from the assets of the minor. If the income exceeds this limit, the excess amount is clubbed with the income of the parent.
Income of Disabled Child	**Separate Assessment:** If a minor child is physically or mentally disabled, their income is not subject to clubbing provisions, allowing the child's income to be assessed separately. This recognition acknowledges the unique circumstances and financial burdens that may arise from disability.
Income from Assets Transferred to Daughter-in-Law	If an individual transfers assets to his daughter-in-law, any income generated from those assets will also be clubbed with the income of the transferor.
Transfer of Assets and Adequate Consideration	The clubbing provisions apply specifically to transfers made without adequate consideration. If the transferor receives fair value in exchange for the asset (like selling an asset), the income generated from that asset will not be subject to clubbing.

2 [1992] 197 ITR 163 (Kerala)

A.7 Applicability of Section 9(i)(viii) of the Income Tax Act, 1961

1. Introduction:

Till AY 20–21, no provision in the Act covered income of the type mentioned in section 56(2)(x) if it did not accrue or arise in India (e.g. gifts given to a non-resident outside India). Such gifts, therefore, escaped tax in India. To plug this gap, the Finance (No. 2) Act, 2019 inserted section 9(1)(viii) with effect from the assessment year 2020–21 to provide that income of the nature referred to in section 2(24)(xviia) arising outside India from any sum of money paid, on or after 5th July, 2019, by a person resident in India to a non-resident or foreign company shall be deemed to accrue or arise in India.

2. Key Provisions:

a. Conditions for Deeming Income:

i. There is a sum of money.

ii. The sum of money is paid on or after 5th July, 2019.

iii. The money is paid by a person resident in India.

iv. The money is paid to a non-resident[3], not a company or to a foreign company.

b. Exclusions from Coverage:

i. Gifts of property situated in India are expressly excluded from the purview of this section: Section 56(2) refers to the sum of money as well as property. However, section 9(1)(viii) reads as 'income … being any sum of money referred to in sub-clause (xviia) of clause (24) of section 2'. Thus, it refers only to the sum of money. Hence, a gift of property is not covered by section 9(1)(viii).

ii. The provision does not apply to gifts received by relatives or those made on the occasion of marriage, as specified in the proviso to section 56(2)(x) of the Income Tax Act.

iii. Gift of the sum of money by NRI to another NRI.

c. Threshold Limit:

i. Any monetary gift not exceeding ₹50,000 in a financial

3 We have not mentioned applicability to resident and not ordinarily resident since we are dealing with provisions concerning NRIs in this article.

year remains exempt from classification as income under section 9(1)(viii).

A.8 Applicability of Section 68 of the Income Tax Act, 1961

Section 68 of the Income Tax Act imposes a tax on any credit appearing in an assessee's books when the assessee fails to satisfactorily explain the nature and source of that credit. This provision operates as a deeming fiction, treating unexplained credits as income if the explanation provided is inadequate.

Under Section 68, the initial burden is on the assessee to demonstrate the nature and source of the credit. Judicial precedents have established that to satisfactorily explain a credited amount, the assessee must prove three key elements:

- Identity of the payer: The assessee must provide clear identification of the person or entity that made the payment. This includes details such as the payer's name, address, and any relevant identification numbers.

- Payer's capacity to advance the money: The assessee must show that the payer had the financial capacity to provide the funds. This could involve demonstrating that the payer had sufficient income, savings, or assets that would allow them to make such a payment.

- Genuineness of the transaction: Finally, the assessee needs to prove that the transaction was genuine and not a façade to disguise income. This could include providing documentation such as bank statements, agreements, or other relevant evidence supporting the legitimacy of the transaction.

It is also critical to understand that just because a transaction is taxable under Section 56(2)(x), it does not exempt it from consideration under Section 68. For example, consider Mr. A, who receives a gift of Rs. 1 crore from his non-resident son. This amount will not be taxable under Section 56(2)(x) because it falls within the definition of a relative, exempting it from tax. However, Mr. A will still have an obligation to prove the identity, capacity, and genuineness of this gifting transaction under Section 68 to ensure compliance with tax regulations.

When it comes to taxation, there are significant differences between these sections. If an addition is made under Section 56(2)(x), the income will be taxed at the individual's applicable slab rate, allowing the taxpayer to claim deductions for any losses incurred as well as set-off of losses. In contrast, if the addition is made under Section 68, Section 115BBE applies, imposing a much higher tax rate of 60 per cent on the added income, with no allowance for any deductions or set-offs for losses.

A.9 Applicability of TCS Provision under the Income Tax Act, 1961

In order to widen and deepen the tax net, the Finance Act 2020 amended Section 206C and inserted Section 206(1G) to provide that an authorized dealer who is receiving an amount for remittance out of India from the buyer of foreign exchange, who is a person remitting such amount under LRS is required to collect tax at source ('TCS') as per the rates and threshold prescribed therein. Gifting to a person resident outside India either in foreign exchange or in Indian rupees is very well covered within the purview of LRS remittances.

As per the TCS provision as applicable currently, at the time of gift by PRI to NRI either in foreign exchange or in Indian rupees, the authorized dealer bank of PRI will collect the tax at source @ 20 per cent in case the gift amount is in excess of ₹7 lakh. The second part of this Article will deal with important aspects of "Loans by and to NRIs". ■

"Time is really the only capital that any human being has, and the only thing that he can't afford to lose."

— Thomas Edison

GIFTS AND LOANS — BY AND TO NON-RESIDENT INDIANS - II

HARSHAL BHUTA | NAISAR SHAH
Chartered Accountant

Editor's Note:

This is the second part of the Article on Gifts And Loans — By and to Non-Resident Indians. The first part of this Article dealt with Gifts by and to NRIs, and this part deals with Loans by and to NRIs. Along with the FEMA aspects of "Loans by and to NRIs", the authors have also discussed Income-tax implications including Transfer Pricing Provisions. The article deals with loans in Indian Rupees as well as Foreign Currency, thereby making for interesting reading.

B. LOANS BY AND TO NRIs

FEMA Aspects of Loans by and to NRIs

Currently, the regulatory framework governing borrowing and lending transactions between a Person Resident in India ('PRI') and a Person Resident Outside India ('PROI') is legislated through the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 ('ECB Regulations') as notified under FEMA 3(R)/2018-RB on 17th December, 2018.

PRIs are generally prohibited from engaging in borrowing or lending in foreign exchange with other PROIs unless specifically permitted by RBI. Similarly, borrowing or lending in Indian rupees to PROIs is also prohibited unless specifically permitted. Notwithstanding the above, the Reserve Bank of India has permitted PRIs to borrow or lend in foreign exchange from or to PROIs, as well as permitted PRIs to borrow or lend in Indian rupees to PROIs.

With this background, let us delve into the key provisions regarding borrowing / lending in foreign exchange / Indian rupees:

B.1 Borrowing in Foreign Exchange by PRI from NRIs

❖ **Borrowing by Indian Companies from NRIs**

- According to paragraph 4(B)(i) of the ECB Regulation, eligible resident entities in India can raise External Commercial Borrowings (ECB) from foreign sources. This borrowing must comply with the provisions in Schedule I of the regulations and is required to be in accordance with the FED Master Direction No. 5/2018–19 — Master Direction-External Commercial Borrowings, Trade Credits, and Structured Obligations ('ECB Directions').

- Schedule I details various ECB parameters, including eligible borrowers, recognised lenders, minimum average maturity, end-use restrictions, and all-in-cost ceilings.

- The key end-use restrictions in this regard are real estate activities, investment in capital markets, equity investment, etc.

- Real estate activities have been defined to mean any real estate activity involving owned or leased property for buying, selling, and renting of commercial and residential properties or land and also includes activities either on a fee or contract basis assigning real estate agents for intermediating in buying, selling, letting or managing real estate. However, this would not include (i) construction/ development of industrial parks/integrated townships/ SEZ, (ii) purchase / long-term leasing of industrial land as part of new project / modernisation of expansion of existing units and (iii) any activity under 'infrastructure sector' definition.

• It is important to note that, according to the above definition, the construction and development of residential premises (unless included under the integrated township category) will be classified as real estate activities. Therefore, ECB cannot be availed for this purpose.

• To assess whether NRIs can lend to Indian companies, we must consider the ECB parameters related to recognised lenders. Recognised lenders are defined as residents of countries compliant with FATF or IOSCO. The regulations specify that individuals can qualify as lenders only if they are foreign equity holders. The ECB Directions in paragraph 1.11 define a foreign equity holder as a recognized lender meeting certain criteria: (i) a direct foreign equity holder with at least 25 per cent direct equity ownership in the borrowing entity, (ii) an indirect equity holder with at least 51 per cent indirect equity ownership, or (iii) a group company with a common overseas parent.

• In summary, lenders who meet these criteria qualify to become recognized lenders. Consequently, NRIs who are foreign equity holders can lend to Indian corporates in foreign exchange, provided they comply with other specified ECB parameters.

❖ **Borrowing by Resident Individual from NRIs**

• An individual resident in India is permitted to borrow from his / her ***relatives*** outside India a sum not exceeding USD 2,50,000 or its equivalent, subject to ***terms and conditions*** as may be specified by RBI in consultation with the Government of India ('GOI').

• For these regulations, the term 'relative' is defined in accordance with Section 2(77) of the Companies Act, 2013. This definition ensures clarity regarding who qualifies as a relative, which typically includes family members such as parents, siblings, spouses, and children, among others. This clarification is crucial for determining eligibility for borrowing from relatives abroad.

• Additionally, Individual residents in India studying abroad are also permitted to raise loans outside India for payment of education fees abroad and maintenance, not exceeding USD 250,000 or its equivalent, subject to **terms and conditions** as may be specified by RBI in consultation with GOI.

• It is also noteworthy that although the External Commercial Borrowings (ECB) regulations were officially introduced in 2018, no specific terms and conditions necessary for implementing these borrowing provisions have been prescribed by the RBI. The absence of detailed guidelines indicates that, although a framework is in place for individuals to borrow from relatives or obtain loans for educational purposes, potential borrowers may experience uncertainty about the specific requirements they need to adhere to.

B.2 Borrowing in Indian Rupees by PRI from NRIs

❖ **Borrowing by Indian Companies from NRIs**

• Similar to borrowings in foreign exchange, Indian companies are also permitted to borrow in Indian rupees (INR-denominated ECB) from NRIs who are foreign equity holders subject to the satisfaction of other ECB parameters.

• Unlike the FDI regulations, RBI has not specified any mode of payment regulations for the ECB. The definition of ECB, as provided in ECB regulations, states that **ECB means borrowing by an eligible resident entity from outside India** in accordance with the framework decided by the Reserve Bank in consultation with the Government of India. Further, even Schedule I of the ECB Regulation states that **eligible entities may raise ECB from outside India** in accordance with the provisions contained in this Schedule. Hence, based on these provisions, it is to be noted that the source of funds for the INR-denominated ECB should be outside of India.

• **Hence, the source of funds should be outside of India, irrespective of whether it is a foreign currency-denominated ECB or INR-denominated ECB.**

❖ **Borrowing by Resident Individuals from NRIs**

• PRI (other than Indian company) are permitted to borrow in Indian Rupees from NRI / OCI relatives subject to **terms and conditions** as may be specified by RBI in consultation with GOI. For these regulations, the term 'relative' is defined in accordance with Section 2(77) of the Companies Act, 2013. It is also noteworthy that although the External Commercial Borrowings (ECB) regulations were officially introduced in 2018, the specific **terms and conditions** necessary for implementing these borrowing provisions have yet to be prescribed by the RBI.

• Additionally, it is to be noted that the borrowers are not

permitted to and utilise the borrowed funds for restricted ***end-uses***.

• According to regulation 2(xiv) of the ECB Regulations, "Restricted End Uses" shall mean end uses where borrowed funds cannot be deployed and shall include the following:

1. In the business of chit fund or Nidhi Company;

2. Investment in the capital market, including margin trading and derivatives;

3. Agricultural or plantation activities;

4. Real estate activity or construction of farm-houses; and

5. Trading in Transferrable Development Rights (TDR), where TDR shall have the meaning as assigned to it in the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2015.

B.3 Lending in Foreign Exchange by PRI to NRIs

❖ Branches outside India of AD banks are permitted to extend foreign exchange loans against the security of funds held in NRE / FCNR deposit accounts or any other account as specified by RBI from time to time and maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016, notified vide Notification No. FEMA 5(R)/2016-RB dated 1st April, 2016, as amended from time to time.

❖ Additionally, Indian companies are permitted to grant loans in foreign exchange to the employees of their branches outside India for personal purposes provided that the loan shall be granted for personal purposes in accordance with the lender's Staff Welfare Scheme / Loan Rules and other terms and conditions as applicable to its staff resident in India and abroad.

❖ Apart from the above, the current External Commercial Borrowing (ECB) regulations do not include specific provisions that allow Non-Resident Indians (NRIs) to obtain foreign exchange loans for non-trade purposes, either from individuals or entities residing in India. For example, lending in foreign exchange by PRI to their close relatives living abroad is not permitted under FEMA.

B.4 Lending in Indian Rupees by PRI to NRIs

❖ **Lending by Authorised Dealers (AD)**

• AD in India is permitted to grant a loan to an NRI/ OCI Cardholder for meeting the borrower's personal requirements / own business purposes / acquisition of a residential accommodation in India / acquisition of a motor vehicle in India/ or for any purpose as per the loan policy laid down by the Board of Directors of the AD and in compliance with prudential guidelines of Reserve Bank of India.

• However, it is to be noted that the borrowers are not permitted to utilise the borrowed funds for restricted end-uses. The list of restricted end-use has already been provided in paragraph B.4 of this article.

❖ **Other Lending Transactions**

• A registered non-banking financial company in India,a registered housing finance institution in India, or any other financial institution, as may be specified by the RBI permitted to provide housing loans or vehicle loans, as the case may be, to an NRI / OCI Cardholder subject to such terms and conditions as prescribed by the Reserve Bank from time to time. The borrower should ensure that the borrowed funds are not used for restricted end uses. The list of restricted end-use has already been provided in paragraph B.4 of this article.

• Further, an Indian entity may grant a loan in Indian Rupees to its employee who is an NRI / OCI Cardholder in accordance with the Staff Welfare Scheme subject to such terms and conditions as prescribed by the Reserve Bank from time to time. The borrower should ensure that the borrowed funds are not used for restricted end uses.

• Additionally, a resident individual is permitted to grant a rupee loan to an NRI / OCI Cardholder relative within the overall limit under the Liberalised Remittance Scheme subject to such terms and conditions as prescribed by the Reserve Bank from time to time. The borrower should ensure that the borrowed funds are not used for restricted end uses.

• Furthermore, it's important to note that even the revised Master Direction on the Liberalized Remittance Scheme (LRS) still outlines the terms and conditions for NRIs to obtain rupee loans from PRI. The decision to retain these terms and conditions in the LRS Master Direction may indicate a deliberate stance by the RBI, especially since the RBI has

not yet specified the terms and conditions mentioned in various parts of the ECB regulations.

• Specifically, Master Direction LRS states that a resident individual is permitted to lend in rupees to an NRI/Person of Indian Origin (PIO) relative ['relative' as defined in Section 2(77) of the Companies Act, 2013] by way of crossed cheque / electronic transfer subject to the following conditions:

i. The loan is free of interest, and the minimum maturity of the loan is one year;

ii. The loan amount should be within the overall limit under the Liberalised Remittance Scheme of USD 2,50,000 per financial year available for a resident individual. It would be the responsibility of the resident individual to ensure that the amount of loan granted by him is within the LRS limit and that all the remittances made by the resident individual during a given financial year, including the loan together, have not exceeded the limit prescribed under LRS;

iii. the loan shall be utilised for meeting the borrower's personal requirements or for his own business purposes in India;

iv. the loan shall not be utilised, either singly or in association with other people, for any of the activities in which investment by persons resident outside India is prohibited, namely:

a. The business of chit fund, or

b. Nidhi Company, or

c. Agricultural or plantation activities or in the real estate business, or construction of farm-houses, or

d. Trading in Transferable Development Rights (TDRs).

Explanation: For item (c) above, real estate business shall not include the development of townships, construction of residential/ commercial premises, roads, or bridges;

v. the loan amount should be credited to the NRO a/c of the NRI / PIO. The credit of such loan amount may be treated as an eligible credit to NRO a/c;

vi. the loan amount shall not be remitted outside India; and

vii. repayment of loan shall be made by way of inward remittances through normal banking channels or by debit to the Non-resident Ordinary (NRO) / Non-resident External (NRE) / Foreign Currency Non-resident (FCNR) account of the borrower or out of the sale proceeds of the shares or securities or immovable property against which such loan was granted.

B.5 Borrowing and Lending Transactions between NRIs

❖ ECB Regulations do not cover any situation of borrowing and lending in India between two NRIs.

❖ However, in line with our view discussed in paragraph A.3.f, NRI may grant a sum of money as a loan to another NRI from their NRO bank account to the NRO bank account of another NRI, as transfers between NRO accounts are considered permissible debits and credits. The expression transfer, as defined under section 2(ze) of FEMA, includes in its purview even a loan transaction. Similarly, granting a sum of money as a loan from an NRE account to another NRE account belonging to another NRI is also allowed without restrictions.

❖ However, a loan from an NRO account to the NRE account of another NRI, or vice versa, may not be allowed in our view, as the regulations concerning permissible debits and credits for NRE and NRO accounts do not specifically address such loan transactions.

B.6 Effect of Change of Residential Status on Repayment of Loan

❖ As per Schedule I of ECB Regulations, repayment of loans is permitted as long as the borrower complies with ECB parameters of maintaining the minimum average maturity period. Additionally, borrowers can convert their ECB loans into equity under specific circumstances, provided they adhere to both ECB guidelines and regulations governing such conversions, such as compliance with NDI Rules, pricing guidelines, and reporting compliances under ECB regulations as well as NDI Rules.

❖ Additionally, there may be situations where, after a loan has been granted, the residential status of either the lender or the borrower changes. Such situations are envisaged in the Regulation 8 of ECB Regulations. The following table outlines how the loan can be serviced in those situations of changes in residential status:

Residential Status of Lender at the time of Loan	Residential Status of Borrower at the time of Loan	Whose Residential Status Changed?	Impact
AD Bank - Resident	Resident	Borrower became non-resident	Permitted subject to such terms and conditions as specified by the Reserve Bank from time to time. The RBI has not yet specified the terms and conditions.
Resident	Resident	Lender became non-resident	Repayment of the loan by the resident borrower should be made by credit to the NRO account or any other account of the lender maintained with a bank in India as specified by the Reserve Bank from time to time, at the option of the lender.
Non-resident	Resident	Lender became resident	Repayment of the loan permitted.
Non-resident	Non-resident	Borrower became resident	Permitted to service loans subject to terms and conditions and limits as specified by the Reserve Bank from time to time. The RBI has not yet specified the terms and conditions.

❖ Furthermore, it is to be noted here that not all cases of residential status have been envisaged under ECB Regulations such as those given below and, therefore, may require prior RBI permission in the absence of clarity.

Residential Status of Lender at the time of Loan	Residential Status of Borrower at the time of Loan	Whose Residential Status Changed?
Resident	Resident	Borrower became non-resident
Non-resident	Non-resident	Lender became resident

INCOME TAX ASPECT OF LOAN

B.7 Applicability of Transfer Pricing Provisions under the Income Tax Act, 1961

Section 92B(1), which deals with the meaning of international transactions includes lending or borrowing of money. Further, explanation (i)(c) of Section 92B states as follows: capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business.

As per Section 92A of the Income Tax Act, NRI can become associated enterprises in cases such as (i) NRI holds, directly or indirectly, shares carrying not less than 26 per cent of the voting power in the other enterprise; (ii) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by NRI; (iii) a loan advanced by NRI to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise, etc.

Hence, the borrowing or lending transaction between associated enterprises is construed as an international transaction and is required to comply with the transfer pricing provisions. Section 92(1) states that any income arising from an international transaction shall be computed having regard to the arm's length principle. Consequently, financing transactions will be subjected to the arm's length principle and are required to be benchmarked based on certain factors such as the nature and purpose of the loan, contractual terms, credit rating, geographical location, default risk, payment terms, availability of finance, currency, tenure of loan, need benefit test of loan, etc.

For benchmarking Income-tax Act does not prescribe any particular method to determine the arm's length price with respect to borrowing/ lending transactions. However, the Comparable Uncontrolled Price ('CUP') method is often applied to test the arm's length nature of borrowing/ lending transactions. The CUP method compares the price charged or paid in related party transactions to the price charged or paid in unrelated party transactions. Further, it has been held by various judicial precedents[1] that the rate of interest prevailing in the jurisdiction of the borrower has to be adopted and currency would be that in which transaction has taken place. In this case, it would be the international benchmark rate.

To simplify certain aspects, Safe Harbour Rules ('SHR') are also in place, which now cover the advancement of loans denominated in INR as well as foreign currency. The

1 Tata Autocomp Systems Limited [2015] 56 taxmann.com 206 (Bombay); Aurionpro Solutions Limited [2018] 95 taxmann.com 657 (Bombay)

SHR specifies certain profit margins and transfer pricing methodologies that taxpayers can adopt for various types of transactions. The SHR is updated and periodically extended for application to the international transactions of advancing of loans.

B.8 Applicability of Section 94B of the Income Tax Act, 1961

Further, to address the aspect of base erosion, India has also introduced section 94B to limit the interest expense deduction based on EBITDA. Section 94B applies to Indian companies and permanent establishments of foreign companies that have raised debt from a foreign-associated enterprise. The section imposes a limit on the deduction of interest expenses. The deduction is restricted to 30 per cent of the earnings before interest, tax, depreciation, and amortization (EBITDA). This provision may apply when NRI, being an AE, advances a loan to an Indian entity over and above the application of transfer pricing.

B.9 Applicability of Section 40A(2) of the Income Tax Act, 1961

Section 40A(2) of the Income Tax Act deals with the disallowance of certain expenses that are deemed excessive or unreasonable when incurred in transactions with related parties. When transfer pricing regulations are applicable for transactions with associated enterprises, the provisions of Section 40A(2) are not applicable.

As a result, in scenarios where transfer pricing provisions apply (for instance, when shareholding exceeds 26 per cent), both transfer pricing regulations and Section 94B will come into effect. In such cases, Section 40A(2) will not apply. Conversely, in situations where transfer pricing provisions do not apply (for example, when shareholding is 25 per cent, which is the minimum percentage required under ECB Regulations to be considered a foreign equity holder eligible for granting a loan), Section 40A(2) will be applicable, and the provisions of transfer pricing and Section 94B will not become applicable.

B.10 Applicability of Section 68 of the Income Tax Act, 1961

Same as discussed in the gift portion in paragraph A.8 of this article. Additionally, the resident borrower also needs to explain the source of source for loan availed by NRIs.

B.11 Applicability of Section 2(22)(e) of the Income Tax Act, 1961

In a case where the loan is granted by the Indian company in foreign exchange to the employees of their branches outside India (who are also the shareholders of the company) for personal purposes as permitted under ECB Regulations, implications of Section 2(22)(e) need to be examined.

C. Deposits from NRIs — FEMA Aspects

Acceptance of deposits from NRIs has been dealt with in Notification No. FEMA 5(R)/2016-RB - Foreign Exchange Management (Deposit) Regulations, 2016, as amended from time to time.

According to this, a company registered under the Companies Act, 2013 or a body corporate, proprietary concern, or a firm in India may accept deposits from a non-resident Indian or a person of Indian origin on a **non-repatriation basis**, subject to the terms and conditions as tabled below:

Particulars	Deposit on non-repatriation basis
Who can accept the deposit?	Proprietorship concern, firm, Indian company (including NBFC)
Mode	A private arrangement or public deposit scheme
Credit rating	If NBFC, then it should be registered with RBI, and credit rating is required
Maturity	< 3 years
Interest	As prescribed under RBI guidelines for NBFC / Companies (Acceptance of Deposits) Rules, 2014. In both cases, it is 12.5% p.a. presently.
Investment	Debit to NRO Account only. Inward remittance and transfer from NRE/FCNR(B) Account prohibited.
End-use restriction	The amount cannot be used for re-lending (not applicable to NBFC), carrying on agricultural/ plantation activities or, investment in real estate, or investment in any other entity engaged in the above.
Repatriability of loan o/s India	Not allowed

It may be noted that the firm may not include LLP for the above purpose.

CONCLUSION

FEMA, being a dynamic subject, one needs to verify the regulations at the time of entering into various transactions. An attempt has been made to cover

various issues concerning gifts and loan transactions between NRIs and Residents as well as amongst NRIs. However, they may not be comprehensive, and every situation cannot be envisaged and covered in an article. Moreover, there are some issues where provisions are not clear and/or are open to more than one interpretation, and hence, one may take appropriate advice from experts/authorized dealers or write to RBI. It is always better to take a conservative view and fall on the right side of the law in case of doubt. ■

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

PRASHANT PALEJA | PARAS DOSHI | KARTIK BADIANI
Chartered Accountants

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

#Acknowledging contribution of CA Mohan Chandwani and CA Vimal Bhayal for supporting in the research.

#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 s 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/permissibility 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 ransfer 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).

5.6Capital 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 31st March, 2003	No restriction	Exempt	Exempt
From 1st April 2003 to 31st March, 2012	20% or less	Exempt	Exempt
	More than 20%	Taxable	Exempt
On or After 1st April, 2012	10% or less	Exempt	Exempt
	More than 10%	Taxable	Exempt
On or after 1st April, 2023, having a premium of more than ₹ 5 lakh	NA	Taxable	Exempt
ULIP issued on or after 1st 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. ■

NON-REPATRIABLE INVESTMENT BY NRIs AND OCIs UNDER FEMA: AN ANALYSIS – PART - 1

BHAUMIK GODA | SAUMYA SHETH | DEVANG VADHIYA
Chartered Accountants

This is the 11th Article in the ongoing NRI series dealing with "Non-repatriable Investment by NRIs and OCIs under FEMA — An Analysis."

Summary

"What cannot be done directly, cannot be done indirectly - Or can it be?"

FEMA's golden rule has always been that what you cannot do directly, you cannot do indirectly—but then comes Schedule IV, sneaking in like that one friend who always finds a way out. It's the ultimate legislative exception, allowing NRIs and OCIs to invest in India as if they never left, minus the luxury of an easy exit. Curious? Dive into the fascinating world of non-repatriable investments — you won't be disappointed (unless, of course, you were hoping to take the money back out quickly!)

INTRODUCTION AND REGULATORY FRAMEWORK

Non-resident investors — including Non-Resident Indians (NRIs), Overseas Citizens of India (OCIs), and even foreign entities — can invest in India under the Foreign Exchange Management Act, 1999 (FEMA). FEMA provides a broad statutory framework, which is supplemented by detailed rules and regulations issued by the government and the Reserve Bank of India (RBI). In particular, the **Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules)** (issued by the Central Government) and the **Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 (Reporting Regulations)** (issued by RBI) lay down the regime for foreign investments in "non-debt instruments." These are further elaborated in the **RBI Master Direction on Foreign Investment in India,** which consolidates the rules and is frequently consulted by practitioners.

Under this framework, foreign investment routes are categorised by schedules to the NDI Rules. Of particular interest are **Schedule I (Foreign Direct Investment on a repatriation basis), Schedule III (NRI investments under the Portfolio Investment Scheme on a repatriation basis), Schedule IV (NRI / OCI investments on non-repatriation basis), and Schedule VI (Investment in Limited Liability Partnerships).** This article focuses on the nuances of non-repatriable investments by NRIs / OCIs under Schedule IV, contrasting them with repatriable investments and other routes. We will examine the legal definitions, eligible instruments, sectoral restrictions, compliance obligations, and the practical implications of choosing the non-repatriation route, with a structured analysis suitable for legal professionals.

DEFINITION OF NRI AND OCI UNDER FEMA; ELIGIBILITY TO INVEST

Non-Resident Indian (NRI) – An NRI is defined in FEMA and the NDI Rules as an individual who is a **person resident outside India and is a citizen of India.** In essence, Indian citizens who reside abroad (for work, education, or otherwise) become NRIs under FEMA once they cease to be "person resident in India" as per Section 2(w) of FEMA. Notably, this definition **excludes foreign citizens,** even if they were formerly Indian citizens – such persons are not NRIs for FEMA purposes once they have given up Indian citizenship.

Overseas Citizen of India (OCI) – An OCI for FEMA purposes means an individual resident outside India who is registered as an OCI cardholder under Section

7A of the Citizenship Act, 1955. In practical terms, these are foreign citizens of Indian origin (or their spouses) who have obtained the OCI card. OCIs are a separate category of foreign investors recognized by FEMA, often extending the same investment facilities as NRIs. In summary, NRIs (Indian citizens abroad) and OCIs (foreign citizens of Indian origin) are both eligible to invest in India, subject to the FEMA rules.

Eligible Investors under the Non-Repatriation Route – Schedule IV specifically permits the following persons to invest on a non-repatriation basis):

• NRIs (individuals resident outside India who are Indian citizens);

• OCIs (individuals resident outside India holding OCI cards);

• Any overseas entity (company, trust, partnership firm) incorporated outside India which is owned and controlled by NRIs or OCIs.

This extension to entities owned / controlled by NRIs / OCIs means that even a foreign-incorporated company or trust, if predominantly NRI / OCI-owned, can use the NRI non-repatriation route. However, as discussed later, such entities do not enjoy certain repatriation facilities (like the USD 1 million asset remittance) that individual NRIs do. Moreover, it is important to note that while these NRI / OCI-owned foreign entities are eligible for Schedule IV investments, they cannot invest in an Indian partnership firm or sole proprietorship under this route — only individual NRIs / OCIs can do so in that case.

NRIs and OCIs have broadly two modes to invest in India: (a) on a **repatriation basis** (where eventual returns can be taken abroad freely), or (b) on a **non-repatriation basis** (where the investment is treated as a domestic investment and cannot be freely taken out of India). Both modes are legal, but they carry different conditions and implications, as explained below.

WHAT ARE NON-DEBT INSTRUMENTS? – PERMISSIBLE INVESTMENT INSTRUMENTS

Under FEMA, all permissible foreign investments are classified as either **debt instruments or non-debt instruments.** Our focus is on non-debt instruments, which essentially cover equity and equity-like investments. The NDI Rules define "non-debt instruments" expansively to include:

• **Equity instruments** of Indian companies – e.g. equity shares, fully and mandatorily convertible debentures, fully and mandatorily convertible preference shares, and share warrants. (These are often referred to simply as “FDI” instruments.)

• **Capital participation in LLPs** (contributions to the capital of Limited Liability Partnerships).

• **All instruments of investment recognized in the FDI policy,** as notified by the Government from time to time (a catch-all for any other equity-like instruments).

• **Units of Alternative Investment Funds (AIFs), Real Estate Investment Trusts (REITs),** and Infrastructure Investment Trusts (InvITs).

• **Units of mutual funds or Exchange-Traded Funds (ETFs)** that invest more than 50 per cent in equity (i.e. equity-oriented funds).

• The **junior-most (equity) tranche of a securitization structure.**

• Immovable property in India (acquisition, sale, dealing directly in land and real estate, subject to other regulations).

• **Contributions to trusts** (depending on the nature of the trust, e.g. venture capital trusts, etc.).

• **Depository receipts** issued against Indian equity instruments (like ADRs / GDRs).

All the above are considered non-debt instruments. Thus, when an NRI or OCI invests on a non-repatriation basis, it can be in any of these forms. In practice, the most common instruments for NRI / OCI non-repatriable investment are equity shares of companies, capital contributions in LLPs, units of equity-oriented mutual funds, and investment vehicles like AIFs / REITs.

It is important to note that **debt instruments** (such as NCDs, bonds, and government securities) are governed by a separate set of rules (the Foreign Exchange Management (Debt Instruments) Regulations) and generally fall outside the

scope of Schedule IV. NRIs / OCIs can also invest in some debt instruments (for example, NRI investments in certain government securities on a non-repatriation basis are permitted up to a limit, but those are subject to different rules and are not the focus of this article.

REPATRIABLE VS. NON-REPATRIABLE INVESTMENTS: MEANING AND LEGAL DISTINCTION

Repatriable Investment means an investment in India made by a person resident outside India which is eligible to be repatriated out of India, i.e. the investor can **bring back the sale proceeds or returns to their home country** freely (net of applicable taxes) in foreign currency. In other words, both the dividends/ interest (current income) and the capital gains or sale proceeds (capital account) are transferable abroad in a repatriable investment without any ceiling (subject to taxes). Most foreign direct investments (FDI) in India are on a repatriation basis, which is why repatriable NRI investments are treated as foreign investments and counted towards foreign investment caps. For instance, if an NRI invests in an Indian company under Schedule I (FDI route) or Schedule III (portfolio route) on a repatriable basis, it is **counted as foreign investment (FDI / FPI),** with all attendant rules.

Non-Repatriable Investment means the investment is made by a non-resident, but **the sale or maturity proceeds cannot be taken out of India** (except to the limited extent allowed). The NDI Rules define it implicitly by saying, "investment on a non-repatriation basis has to be construed accordingly" from the repatriation definition. In simple terms, this means the principal amount invested **and** any capital gains or sale proceeds **must remain in India.** The investor cannot freely convert those rupee proceeds into foreign currency and remit abroad. Such investments are essentially treated as **domestic investments ––** the NDI Rules explicitly deem any investment by an NRI / OCI on a non-repatriation basis to be **domestic investment, on par with investments made by residents.** This distinction has crucial legal effects: **NRI/OCI non-repatriable investments are not counted as foreign investments for regulatory purposes.** They do not come under FDI caps or sectoral limits (since they are treated like resident equity). This was confirmed by India's DPIIT (Department for Promotion of Industry and Internal Trade) in a clarification that downstream investments by a company owned and controlled by NRIs on a non-repatriation basis will not be considered indirect FDI. Effectively, **non-repatriable NRI / OCI investments enjoy the flexibility of domestic capital but with the sacrifice of free repatriation rights.**

Advantages of Non-Repatriation Route: The non-repatriable route (Schedule IV) offers NRIs and OCIs significant advantages in terms of flexibility and compliance:

• **No Foreign Investment Caps:** Since it is treated as domestic investment, an NRI/OCI can invest **without the usual foreign ownership limits.** For example, under the portfolio investment route, NRIs cannot exceed 5 per cent in a listed company (10 per cent collectively), but under non-repatriation, there is **no such limit —** an NRI could potentially acquire a much larger stake in a listed company under Schedule IV (outside the exchange) without breaching FEMA limits. Similarly, total NRI / OCI investment can go beyond 10/24 per cent aggregate because Schedule IV holdings are not counted as foreign at all.

• **Simplified Compliance:** Many of the onerous requirements applicable to FDI – e.g. adherence to pricing guidelines, filing of RBI reports, sectoral conditionalities, mandatory approvals — are relaxed or not applicable for non-repatriable investments (since regulators treat it like a resident's investment). We detail these compliance relaxations below.

• **Current income can be freely repatriable:** Current income arising from such investments like interest, rent, dividend, etc., is freely repatriable without any limits and is not counted in the $1mn threshold.

• **Deemed Domestic for Downstream:** As noted, if an NRI/OCI-owned Indian entity invests further in India, those downstream investments are not treated as FDI. This can allow greater expansion without triggering indirect foreign investment rules.

Drawbacks of the Non-Repatriation Route: The obvious trade-off is **illiquidity from an exchange control perspective.** The investor's capital is locked in India. Specifically:

• Inability to Repatriate Capital Freely: The principal amount and any capital gains cannot be freely converted and sent abroad. The investor must either reinvest or keep the funds in India (in an NRO account)

after exit, subject to a limited annual remittance (discussed later).

• Perpetual Rupee Exposure: Since eventual proceeds remain in INR, the investor bears currency risk on the investment indefinitely, which foreign investors might be unwilling to take for large amounts.

• **Exit Requires Domestic Buyer or Special Approval:** To actually get money out, the NRI / OCI may need to convert the investment to repatriable by selling it to an eligible foreign investor or seek RBI permission beyond the allowed limit. This adds a layer of uncertainty for the exit strategy.

• **Not Suitable for Short-Term Investors:** This route is generally suitable for long-term investments (often family investments in family-run businesses, real estate purchases, etc.) where the NRI is not looking to repatriate in the near term. It is less suitable for foreign venture capital or private equity, which typically demand an assured exit path.

INVESTMENT UNDER SCHEDULE IV: PERMITTED INSTRUMENTS AND SECTORAL CONDITIONS

What Schedule IV Allows: Schedule IV of the NDI Rules (titled "Investment by NRI or OCI on the non-repatriation basis") lays out the scope of investments NRIs / OCIs can make on a non-repatriable basis. In summary, **NRIs/OCIs (including their overseas entities) can, without any limit, invest in or purchase the following on a non-repatriation basis:**

• **Equity instruments of Indian companies –** listed or unlisted shares, convertible debentures, convertible preference shares, share warrants – **without any limit,** whether on a stock exchange or off-market.

• **Units of investment vehicles –** units of AIFs, REITs, InvITs or other investment funds — **without limit,** listed or unlisted.

• **Contributions to the capital of LLPs –** again, **without limit**, in any LLP (subject to sectoral restrictions discussed below).

• **Convertible notes of startups –** NRIs / OCIs can also subscribe to **convertible notes** issued by Indian startups, as allowed under the rules, on a non-repatriation basis.

Additionally, Schedule IV explicitly provides that **any investment made under this route is deemed to be a domestic investment** (i.e. treated at par with resident investments). This means the general FDI conditions of Schedule I do not apply to Schedule IV investments unless specifically mentioned.

Sectoral Restrictions – Prohibited Sectors: Despite the broad freedom, **Schedule IV carves out certain prohibited sectors where even NRI / OCI non-repatriable investments are NOT permitted.** According to Para 3 of Schedule, an NRI or OCI (including their companies or trusts) shall not invest under non-repatriation in:

• **Nidhi Company** (a type of NBFC doing mutual benefit funds among members);

• **Companies engaged in agricultural or plantation activities** (this covers farming, plantations of tea, coffee, etc., and related agricultural operations);

• **Real estate business** or **construction of farmhouses;**

• **Dealing in Transfer of Development Rights (TDRs).**

These mirror some of the standard FDI prohibitions, with a key addition: agricultural / plantation is completely off-limits under Schedule IV (whereas under FDI policy, certain agricultural and plantation activities are permitted up to 100 per cent with conditions). The term **"real estate business"** is defined (by reference to Schedule I) to mean dealing in land and immovable property **with a view to earning profit from them** (buying and selling land/buildings). Notably, the **development of townships, construction of residential or commercial premises, roads or infrastructure, etc., is specifically excluded from the definition of "real estate business"**, as is **earning rent from property without transfer.** So, an NRI / OCI can invest in a construction or development project or purchase property for earning rent on a non-repatriation basis (since that is not considered a "real estate business" for FEMA purposes) but cannot invest in a pure real estate trading company.

Implication – Some Sectors Allowed on Non-Repatriation that are Prohibited for FDI, and vice

versa: Because Schedule IV's prohibited list is somewhat different from Schedule I (FDI) prohibited list, there are interesting differences:

• **Additional Sectors Open under Schedule IV:** Certain sectors like **lottery, gambling, casinos, tobacco manufacturing, etc.,** which are prohibited for any FDI under Schedule I, are **not mentioned in Schedule IV's prohibition list.** This may imply that an NRI / OCI could invest in such businesses on a non-repatriation basis. For example, a casino business in India cannot receive any FDI (foreign investor money on a repatriable basis), but it **could receive NRI/ OCI investment as a domestic investment under Schedule IV. However, such investments may be subject to provisions or prohibitions in various other laws and Statewise restrictions in India, and therefore, one must be careful in making such investments.**

• From a policy perspective, this leverages the idea that an Indian citizen abroad is still treated akin to a resident for these purposes. Thus, apart from the specific exclusions in Schedule IV, **all other sectors (even those barred to foreign investors) are permissible for NRIs / OCIs on non-repatriation.** This provides NRIs/OCIs a unique opportunity to invest in sensitive sectors of the economy, which foreigners cannot, theoretically increasing the investment funnel for those sectors via the Indian diaspora.

• **Conversely, Some Investments Allowed via FDI Are Barred in Non-Repatriation:** There are cases where FDI rules are more liberal than the NRI non-repatriable route. A prime example is **plantation and agriculture.** Under FDI (Schedule I), certain plantation sectors (like tea, coffee, rubber, cardamom, etc.) are allowed 100 per cent foreign investment under the automatic route (with conditions such as mandatory divestment of a certain percentage within time for tea). However, **Schedule IV flatly prohibits NRIs from investing in agriculture or plantation** without exception. Thus, a foreign company could invest in a tea plantation company on a repatriable basis (counting as FDI), but an NRI cannot invest in the same on a non-repatriable basis, ironically. Another example: **Print media** — FDI in print media (newspapers / periodicals) is restricted to 26 per cent with Government approval under FDI policy. If an Indian company is in the print media business, an NRI / OCI could still invest on a non-repatriable basis (since Schedule IV's company restrictions don't list print media) — meaning potentially up to 100% as domestic investment. However, **if the print media business is structured as a partnership firm or proprietorship, Schedule IV (Part B) prohibits NRI investment** in it. We see a regulatory quirk: an NRI can invest in a print media company on non-repatriation (domestic equity, no specific cap) but not in a print media partnership firm. These inconsistencies require careful attention when structuring investments.

In summary, **NRIs / OCIs have a broader canvas in some respects under Schedule IV, but must be mindful of the specifically forbidden areas.** As a rule of thumb, apart from Nidhi, plantation / agriculture, real estate trading, and farmhouses / TDRs, most other activities are allowed. NRIs have leveraged this to invest in real estate development projects, infrastructure, and even sectors like multi-brand retail by ensuring their investments are non-repatriable (thus not triggering the foreign investment prohibitions or caps). On the other hand, they cannot use this route for farming or plantation businesses even if foreign investors could via FDI.

Special Case – Investment by NRIs / OCIs in Border-Sharing Countries: In April 2020, India introduced a rule (now embodied in NDI Rules) that any investment from an entity or citizen of a country that shares a land border with India (e.g. China, Pakistan, Bangladesh, etc.) requires prior Government approval, regardless of sector. This was to curb opportunistic takeovers. This rule **applies to NRIs / OCIs as well if they are residents of those countries.** However, notably, that restriction is relevant **only for investments on a repatriation basis.** If an NRI / OCI residing in, say, China or Bangladesh wants to invest under the non-repatriation route, **Schedule IV does not impose the same approval requirement.** In effect, an NRI/OCI in a neighbouring country can still invest in India as a de facto domestic investor under Schedule IV without going through government approval, whereas the same person investing under a repatriable route would face a clearance hurdle. This exception again underscores the policy view of NRI non-repatriable funds as akin to Indian funds. Whilst permissible, in view of authors, considering the geo-political climate, care and caution need to be exercised. Loophole or policy openness may not be the final answer, as national interest always comes first.

PRICING GUIDELINES AND VALUATION — ARE THEY APPLICABLE?

One significant compliance relief for non-repatriable

investments is in **pricing regulations.** Under FEMA, when foreign investors invest in or exit from Indian companies on a repatriation basis, there are strict pricing guidelines to ensure shares are not issued at an unduly low price or purchased at an unduly high price (to prevent outflow/inflow of value unfairly). For instance, the issue of shares to a foreign investor must typically be at or above fair market value (as per internationally accepted pricing methodology), and transfer from resident to foreign investor cannot be at less than fair value, etc. **These pricing restrictions do not apply to investments under Schedule IV. Since Schedule IV** investments are treated as domestic, the law does not mandate adherence to the pricing formulae of Schedule I.

Practical effect: Indian companies can issue shares to NRIs / OCIs on a non-repatriation basis at *face value or book value or any concessional price* they choose, even if that is below the fair market value, without contravening FEMA. Similarly, NRIs/OCIs could potentially buy shares from resident holders at a negotiated price without being bound by the ceiling that would apply if the NRI were a foreign investor on a repatriation basis. This flexibility is often useful in family arrangements or preferential allotments where prices may be deliberately kept low for the NRI (which would otherwise trigger questions under FDI norms). For example, an Indian family-owned company can allot shares to an NRI family member at par value under Schedule IV, even if the fair value is much higher — a practice not allowed if the NRI were taking them on a repatriable basis. **The only caution** is that the Income Tax Act's fair value rules (for deemed income on undervalued transactions) might still apply, but from a FEMA standpoint, it's permissible.

To illustrate, the RBI Master Directions explicitly note that **pricing guidelines are not applicable for investments by persons resident outside India on a non-repatriation basis,** as those are treated as domestic investments. Thus, **NRIs / OCIs have an advantage in valuation flexibility under Schedule IV.**

REPORTING AND COMPLIANCE REQUIREMENTS

Another area of divergence is in **regulatory reporting.** Normally, any foreign investment coming into an Indian company must be reported to RBI (through its authorised bank) via forms on the FIRMS portal (previously Form FC-GPR for new issues, Form FC-TRS for transfers, etc.). However, **investments by NRIs / OCIs on a non-repatriation basis do not require filing the typical foreign investment reports** like FC-GPR. The rationale is that since these are not counted as foreign investments, the RBI does not need to capture them in its foreign investment data.

Indeed, **no RBI reporting is prescribed for a fresh issue / allotment of shares under Schedule IV.** An NRI/OCI investing on a non-repatriable basis can be allotted shares without the company filing any form to RBI (By contrast, if the same shares were issued under FDI, a Form SMF/FC-GPR would be required within 30 days.) That said, it is a **best practice** for the investee company or the NRI to **intimate the AD bank** in a letter about the receipt of funds and the fact that the shares are issued on a non-repatriation basis. This helps create a record, so that if in future any question arises, the bank/RBI is aware those shares were categorized as non-repatriable from the start.

One exception to the no-reporting rule is when **there is a transfer of such shares to a person on a repatriation basis.** If an NRI/OCI holding shares on a non-repatriable basis sells or gifts them to a foreign investor or NRI on a repatriable basis, that transaction **does trigger reporting (Form FC-TRS)** because now those shares are becoming foreign investments. The responsibility for filing the FC-TRS lies on the resident transferor or transferee, as applicable. We will discuss transfers shortly, but in summary: no reporting when NRIs invest non-repatriable initially, but **reporting is required when the character of investment changes to repatriable via a transfer.**

It's important to maintain **proper records in the company's books** classifying NRI / OCI holdings as non-repatriable. Practitioners note that if a company mistakenly records an NRI's holding as repatriable FDI and files forms or treats it as a foreign holding in compliance reports, it could lead to regulatory confusion or even penalties. For instance, it might appear the company exceeded an FDI cap when, in reality, the NRI portion should have been excluded. Therefore, both the investor and investee company should internally document the nature of the investment (e.g. through a board resolution noting the shares are issued under Schedule IV, non-repatriation).

In summary, **compliance for Schedule IV investments is lighter:** no entry-level RBI approvals (it's an automatic route in all cases), no pricing certification, and no routine filing for allotments. Contrast that with Schedule I investments, where one must comply with valuation norms and file forms within the prescribed time. This ease of doing business is a key attraction of the non-repatriable route for many NRIs.

Mode of Payment and Repatriation of Proceeds

Funding the Investment: An NRI/OCI investing on a non-repatriation basis can fund the investment through any of the standard channels for NRI investments. Permissible modes include:

• **Inward remittance** from abroad through normal banking channels (i.e. sending foreign currency, which is converted to INR for investment).

• **Payment out of an NRE or FCNR account** maintained in India (these are rupee or foreign currency accounts which are repatriable).

• **Payment out of an NRO account** in India (Non-Resident Ordinary account, which holds the NRI's funds from local sources in INR).

Use of an NRO account is notable — since NRO balances are non-repatriable (beyond the USD 1 million a year), routing payment from NRO naturally aligns with the non-repatriable nature of the investment. But even if funds came from an NRE/FCNR (which are repatriable accounts), once invested under Schedule IV, the money **loses its repatriable character** for the principal and becomes subject to Schedule IV restrictions.

Credit of Sale / Disinvestment Proceeds: When an NRI / OCI eventually sells the investment or the Indian company liquidates, the **sale proceeds must be credited only to the NRO account of the investor.** This rule is crucial — it ensures the money remains in the non-resident's ordinary rupee account (NRO), which is not freely repatriable. Even if the original investment was paid from an NRE account, the exit money cannot go back to NRE; it has to go to an NRO (or a fresh NRO if the investor doesn't have one). Once in NRO, those funds are under Indian jurisdiction with limited outflow rights.

Repatriation of Proceeds — The USD 1 Million Facility: FEMA does provide a limited facility for NRIs / OCIs to remit out funds from their NRO accounts/ sale proceeds under the **Remittance of Assets Regulations, 2016. A Non-Resident Indian or PIO is allowed to remit up to USD 1,000,000 (One Million USD) per financial year** abroad from an NRO account or from the sale proceeds of assets in India, including capital gain. This is a general limit for all assets combined per person per year. This means an NRI who sold shares that were on a non-repatriable basis can utilise this route to gradually repatriate the money, up to $ 1M (USD One Million) annually. Notably, this facility is **only available to individuals (NRIs / PIOs)** and not to companies or other entities. So, if an NRI made a large investment and eventually exited, they could take out $1M each year (approximately ₹8.75 crore at current rates) from India. Any amount beyond that in a year would require **special RBI approval.**

In practice, RBI approval for exceeding the USD 1M cap is rarely granted except in exceptional hardship cases. RBI typically expects the NRI to stagger the remittances within the allowed limit across years. Therefore, investors should plan accordingly if the sums are large – it could take multiple years to fully repatriate the corpus unless they find some other mechanism (like transferring the shares to a repatriable route investor before sale, etc.). It has been observed that **RBI is generally not inclined to allow one-time large remittances** beyond the automatic limit, emphasizing that the non-repatriable route is meant for money that essentially stays in India with only a slow trickle out.

No $1M facility for foreign entities: As mentioned, if the investor was not an individual but an overseas company or trust owned by NRIs / OCIs, that entity does **not qualify as an NRI or PIO under the Remittance of Assets rules.** Thus, it cannot directly avail of the $1M automatic repatriation. Such entities would have to apply to RBI for any repatriation, which is uncertain. This is why advisors often recommend that if repatriation might eventually be desired, the investment should be structured in the individual NRI's name (or at least eventually transferred to the individual NRI before exit). By keeping the investor as a natural person, the exit flexibility using the $1M per year route remains available.

Repatriation of Current Income: Importantly, **current income (yield) from the investment is freely repatriable even if the investment itself is non-repatriable.** FEMA distinguishes between repatriation

of capital versus repatriation of current income such as dividends, interest, or rent. As a general rule, any dividend or interest earned in India by an NRI can be remitted abroad after paying due taxes, irrespective of whether the underlying investment was on a non-repatriation basis. RBI Master Circular confirms that authorised dealers may allow remittance of current income (like dividends, pension, interest, rent) from NRO accounts, subject to CA certification of taxes paid. This means an NRI who invested in shares under Schedule IV can still have the company declare dividends, and the NRI can **get those dividends out of India** without dipping into the $1M capital remittance limit. Likewise, interest on any NRO deposits of the sale proceeds is repatriable as current income. This provision is a relief because it allows NRIs/OCIs to enjoy returns on their investment globally, even though the principal stays locked.

To summarize, the **inflow of funds** for non-repatriable investments is flexible (NRE/FCNR/NRO all allowed), but the **outflow of funds** is tightly controlled. NRIs should channel the exit money into NRO and then plan systematic remittances of up to $1M a year unless they intend to reuse the funds in India. Many simply reinvest in India, treating it as part of their India portfolio.

"And That's a Wrap... for Now!"

Congratulations! If you've made it this far, you're officially a FEMA warrior—armed with the wisdom of **Schedule IV** and the art of non-repatriable investments. We've explored how NRIs and OCIs can invest in India like residents and enjoy the flexibility that even FDI can't offer. But wait—what happens **when it's time to exit?** Can you **sell, transfer, or gift** these investments? Will FEMA let you walk away freely, or will it make you fill out just one more RBI form?

All this (and more!) is in **Part 2,** where we unlock the secrets of **transfers, repatriation limits, downstream investments, and compliance puzzles.** Stay tuned—because just like FEMA regulations, **this story isn't over yet!** ■

NON-REPATRIABLE INVESTMENT BY NRIs/OCIs UNDER FEMA: AN ANALYSIS – PART 2

BHAUMIK GODA | SAUMYA SHETH | DEVANG VADHIYA
Chartered Accountants

NON-REPATRIABLE INVESTMENTS: EASY ENTRY, TRICKY EXIT!

In Part I, we explored how NRIs and OCIs can invest in India under Schedule IV, enjoying the perks of domestic investment while sidestepping FDI restrictions. We saw how this route offers flexibility in entry—with no foreign investment caps, no strict pricing rules, and freedom to invest in LLPs, AIFs, and even real estate (as long as it's not a farmhouse!). But, much like a long-term relationship, once you commit, FEMA expects you to stay for the long haul.

Now, in Part II, we address the big question: Can you transfer, sell, or gift these investments? Will FEMA allow you a graceful exit? We'll dive into the rules governing transfers, repatriation limits, downstream investments, and more—so buckle up, because while the non-repatriable entry was smooth, the exit is where the real thrill begins!

TRANSFER OF SHARES/INVESTMENTS HELD ON NON-REPATRIATION BASIS

Just as important as the entry is the ability to **transfer or exit** the investment. FEMA provides certain pathways for transferring shares or other securities that were held on a non-repatriation basis:

• **Transfer to a Resident:** An NRI/OCI can **sell or gift the securities to an Indian resident** freely. Since the resident will hold them as domestic holdings, this is straightforward. **No RBI permission, pricing guideline, or reporting form is required.** For instance, if an NRI uncle wants to gift his shares (held on a non-repat basis) in an Indian company to his resident Indian nephew, it's permitted and no specific FEMA filing is triggered (aside from perhaps a local gift deed for records). Similarly, suppose an NRI non-repat investor wants to sell his stake to an Indian co-promoter. In that case, he can transact at any price mutually agreed upon (pricing restrictions don't apply as this is essentially a resident-to-resident transfer in FEMA's eyes), and no FC-TRS form is required.

• **Transfer to another NRI / OCI on Non-Repat basis:** NRIs / OCIs can also **transfer such investments amongst themselves,** *provided the investment remains on non-repatriation.* For example, one OCI can gift shares held under Schedule IV to another OCI or NRI (maybe a relative) who will also hold them under Schedule IV. This is allowed without RBI approval, and again, no pricing or reporting requirements apply. The only caveat is that the transferee must be eligible to hold on a non-repat basis (which generally means they are NRI / OCI or their entity). Gifting among NRIs / OCIs on the non-repat route is quite common within families. **Note:** If it's a gift, one should ensure it meets any conditions under the Companies Act or other laws (for instance, if the donor and donee are "relatives" under Section 2(77) Companies Act, as required by FEMA for certain cross-border gifts – more on that below).

• **Transfer to an NRI / OCI on a repatriation basis (i.e., converting it to FDI):** This scenario is effectively an **exit from the non-repatriable pool into the repatriable pool.** For instance, an NRI with non-repat shares might find a foreign investor or another NRI who wants those shares but *with repatriation rights.* FEMA permits the sale, but since the buyer will hold on a repatriation basis (Schedule I or III), it must conform to **FDI rules.** That means **sectoral caps and entry routes must be respected, and pricing guidelines apply** to the transaction. If it's a **gift** (without consideration) from an NRI (non-repat holder) to an NRI / OCI (who will hold as repatriable), **prior RBI approval is required** and certain conditions must be met. These conditions (laid out in NDI Rules and earlier in TISPRO) include: (a) the donee must be eligible to hold the investment under the relevant repatriable schedule (meaning the sector is open for FDI for that person); (b) the gift amount is within 5% of the company's paid-up capital (or each series of debentures / MF scheme) cumulatively; (c) sectoral cap is not breached by the donee's holdings; (d) donor and donee are relatives as defined in Companies Act, 2013; and (e) the value of securities gifted by the donor in a year does not exceed USD 50,000. These

are designed to prevent the abuse of gifting as a loophole to transfer large foreign investments without consideration. If all conditions are met, RBI may approve the gift. If it's a **sale (for consideration)** by NRI non-repat to NRI/OCI repatriable, no prior approval is needed (sale is under automatic route) but pricing must be at or higher than fair value (since NR to NR transfer with one side repatriable is treated like an FDI entry for the buyer). **Form FC-TRS must be filed** to report this transfer, and in such a case, since the **seller was holding non-repat,** the onus is on the seller (who is the one changing their holding status) to file the FC-TRS within 60 days. Our earlier table from the draft summarizes: Seller NRI-non-repat -> Buyer NRI-repat: pricing applicable, FC-TRS by seller, auto route subject to caps.

• **Transfer from a foreign investor (repatriable) to an NRI/OCI (non-repatriable):** This is the reverse scenario – a person who holds shares as foreign investment sells or gifts to an NRI / OCI who will hold as domestic. For example, a foreign venture fund wants to exit and an OCI investor is willing to buy but keep the investment in India. FEMA allows this as well. Since the new holder is non-repatriable, the sectoral caps don't matter post-transfer (the investment leaves the FDI ambit). However, up to the point of transfer, compliance should be there. In a **sale** by a foreign investor to an NRI on a non-repat basis, **pricing guidelines again apply** (the NRI shouldn't pay more than fair value, because a foreigner is exiting and taking money out – RBI ensures they don't take out more than fair value). **FC-TRS reporting** is required, and typically, the **buyer (NRI / OCI)** would report it because the buyer is the one now holding the securities (the authorized dealer often guides who should file; it has to be a person resident in India and as non-repat investment is treated as domestic investment, it has to be filed by NRI / OCI acquiring it on non-repat basis). If it's a **gift** from a foreign investor to an NRI / OCI relative, RBI approval would similarly be needed with analogous conditions (the NDI Rules conditions on gift apply to any resident outside to resident outside transfer, repatriable to non-repat likely treated similarly requiring approval unless specified otherwise). The draft table indicated: Buyer NRI-non-repat from Seller foreign (repat) – gift allowed with approval, pricing applicable, FC-TRS by buyer, and subject to FDI sectoral limits at the time of transfer.

In all the above cases of **change of mode (repatriable vs non-repatriable),** one can see FEMA tries to ensure that whenever money is leaving India (repatriable side), fair value is respected and RBI is informed. But when the money remains in India (purely domestic or non-repat transfers), the regulations are hands-off.

Downstream Investment Impact: A critical implication of holding investments on non-repatriation basis is how the investing company is classified. FEMA and India's FDI policy have the concept of **indirect foreign investment –** if Company A is foreign-owned or controlled, and it invests in Company B, then Company B is considered to have foreign investment to that extent. However, **Schedule IV investments are excluded from this calculation.** The rules (as clarified in DPIIT's policy) state that if an Indian company is owned and controlled by NRIs / OCIs on a non-repatriation basis, **any downstream investment by that company will not be considered foreign investment.** In other words, an Indian company that has only NRI / OCI non-repat capital is treated as an **Indian-owned company.** So if it later invests in another Indian company, that target company doesn't need to worry about foreign equity caps because the investment is coming from an Indian source (deemed). This is a major benefit – it effectively **ring-fences NRI domestic investment from contaminating downstream entities with foreign status.** This clarification was issued to remove ambiguity, especially in cases where OCIs set up investment vehicles. Now, an NRI / OCI-owned investment fund (registered as an Indian company or LLP) can invest freely in downstream companies without subjecting them to FDI compliance, provided the fund's own capital is non-repatriable.

From a practical standpoint, when structuring private equity deals, if one of the investors is an NRI / OCI willing to designate their contribution as non-repatriable, the company can be treated as fully Indian-owned, allowing it to invest into subsidiaries or other companies in restricted sectors without ceilings. This has to be balanced with the investor's interest (since that NRI loses repatriation right). Often, OCIs with a long-term commitment to India might be agreeable to this to enable, say, a group structure that avoids FDI limits.

Summary of Transfer Scenarios: For quick reference:

• *NRI / OCI (Non-repat) -> Resident:* Allowed, **gift allowed,** no pricing rule, no reporting.

• *Resident -> NRI / OCI (Non-repat):* Allowed, gift allowed, no pricing rule, no reporting (essentially the mirror of above, turning domestic holding into NRI non-repat).

• *NRI / OCI (Non-repat) -> NRI / OCI (Non-repat):* Allowed, gift allowed, no pricing, no reporting.

• *NRI / OCI (Non-repat) -> Foreigner / NRI (Repat):* Allowed, the **gift needs RBI approval (with conditions)**, if sale then pricing applies; report FC-TRS.

• *Foreigner / NRI (Repat) -> NRI / OCI (Non-repat):* Allowed, gift possibly with approval; sale at pricing; report FC-TRS.

The key is whether the **status of the investment (domestic vs foreign) changes** as a result of transfer, and ensuring the appropriate regulatory steps in those cases.

Comparative Interplay Between Schedules I, III, IV, and VI

To fully understand Schedule IV in context, one must compare it with other relevant schedules under FEMA NDI Rules:

Schedule I (FDI route) vs Schedule IV (NRI non-repat route)

• **Nature of Investment:** Schedule I covers FDI by any person resident outside India (including NRIs) on a repatriation basis. Schedule IV covers investments by NRIs / OCIs (and their entities) on a non-repatriation basis. Schedule I investments count as foreign investment; Schedule IV do not.

• **Sectoral Caps and Conditions:** Schedule I investments are subject to sectoral caps (% limits in various sectors) and sector-specific conditions (like minimum capitalization, lock-ins, etc., in sectors like retail, construction, etc.). By contrast, Schedule IV investments are generally not subject to those caps/ conditions because they are treated as domestic. For example, multi-brand retail trading has a 51% cap under FDI with many conditions – an OCI could invest 100% in a retail company under Schedule IV with none of those conditions, as long as it's on a non-repatriation basis. Similarly, real estate development has minimum area and lock-in requirements under FDI, but an NRI could invest non-repat without those (provided it's not pure trading of real estate).

• **Prohibited Sectors:** Schedule I explicitly prohibits foreign investment in sectors like lottery, gambling, chit funds, Nidhi, real estate business, and also limits in print media, etc. Schedule IV has its own (smaller) prohibited list (Nidhi, agriculture, plantation, real estate business, farmhouses, TDR) but notably does not mention lottery, gambling, etc. **Thus, some sectors closed in Schedule I are open in Schedule IV,** and vice versa (as discussed earlier).

• **Valuation / Optionality:** Under Schedule I, any equity instruments issued to foreign investors can have an optionality clause only with a minimum lock-in of 1 year and no assured return; effectively, foreign investors cannot be guaranteed an exit price. Under Schedule IV, these restrictions **do not apply** – one can issue shares or other instruments to NRIs/OCIs with an assured buyback or fixed return arrangement since it's like a domestic deal. Likewise, provisions like deferred consideration (permitted for FDI up to 25% for 18 months) need not be adhered to strictly for non-repat investments – an NRI investor and company can agree on different terms as it's a private domestic contract in FEMA's eyes.

• **Reporting:** FDI (Sch. I) transactions must be reported (FC-GPR, FC-TRS, etc.), whereas Sch. IV initial investments are not reported to RBI as noted.

• **Exit / Repatriation:** Schedule I investors can repatriate everything freely (that's the point of FDI), whereas Schedule IV investors are bound by the NRO / $1M rule for exits.

Bottom line: Schedule IV is far more liberal on entry (no caps, any price) but restrictive on exit, whereas Schedule I is vice versa. A legal advisor will often weigh these options for an NRI client: if the priority is to eventually take money abroad or bring in a foreign partner, Schedule I might be preferable; if the priority is flexibility in investing and less regulatory hassle, Schedule IV is attractive.

Schedule III (NRI Portfolio Investment) vs Schedule IV (NRI Non-Repatriation)

Schedule III deals with the **Portfolio Investment**

Scheme (PIS) for NRIs / OCIs on a repatriation basis, primarily buying/selling shares of listed companies through stock exchanges.

• **Listed Shares via Stock Exchange:** Under Schedule III (PIS), an NRI / OCI can purchase shares of listed Indian companies **only through a recognized stock broker on the stock exchange** and is subject to the rule that **no individual NRI / OCI can hold more than 5% of the paid-up capital** of the company. All NRIs / OCIs taken together cannot exceed 10% of the capital unless the company passes a resolution to increase this aggregate limit to 24%. These limits are to ensure NRI portfolio investments remain "portfolio" in nature and do not take over the company. In contrast, under Schedule IV, **NRIs / OCIs can acquire shares of listed companies without regard to the 5% or 10% limits** because those limits apply only to repatriable holdings. An NRI could, for instance, accumulate a larger stake by buying shares off-market or via private placements under Schedule IV.

• **Other Securities:** Schedule III also allows NRIs to purchase on a repatriation basis certain government securities, treasury bills, PSU bonds, etc., up to specified limits, and units of equity mutual funds (no limit). On this front, **both Schedule III and Schedule IV allow NRIs to invest in domestic mutual fund units freely** if the fund is equity-oriented. So whether repatriable or not, an NRI can buy any number of units of, say, an index fund or equity ETF.

• **Nature of Investor:** Schedule III is meant for NRIs investing as **portfolio investors** (often through NRE PIS bank accounts), whereas Schedule IV is not limited to portfolio activity – it can be FDI-like strategic investments too.

• **Trading vs Investment:** Under PIS (Sch. III), NRIs are typically not allowed to make the stock trading their full-time business (they cannot do intraday trading or short-selling under PIS; it's for investment, not speculation). Schedule IV has no such restriction explicitly; however, if an NRI were actively trading frequently under non-repatriation, it might raise questions – usually, serious traders stick to the PIS route for liquidity.

In summary, **Schedule III is a subset route** for market investments with tight limits, whereas **Schedule IV offers NRIs a way to invest in listed companies beyond those limits** (albeit off-market and non-repatriable). As a strategy, an NRI who sees a long-term value in a listed company and wants significant ownership may choose to buy some under PIS (repatriable) but anything beyond the threshold under the non-repat route, combining both to achieve a larger stake.

SCHEDULE VI (FDI IN LLPs) Vs SCHEDULE IV (NRI INVESTMENT IN LLPs)

Schedule VI allows **foreign investment in Limited Liability Partnerships (LLPs)** on a repatriation basis. It stipulates that FDI in LLP is allowed only in sectors where 100% FDI is permitted under automatic route and there are no FDI-linked performance conditions (like minimum capital, etc.). This effectively bars FDI in LLPs in sectors like real estate, retail trading, etc., because those sectors either have caps or conditions. For example, multi-brand retail is 51% with conditions – so a foreign investor cannot invest in an LLP doing retail. Real estate business is prohibited entirely for FDI – so no LLP can be structured. Even an LLP in construction development is problematic under FDI if conditions (like a lock-in) are considered performance conditions.

However, **Schedule IV imposes no such sectoral conditionality for LLPs (apart from the same prohibited list).** Therefore, **NRIs / OCIs can invest in the capital of an LLP on a non-repatriation basis even if that LLP is engaged in a sector where FDI in LLP is not allowed.** For instance, an LLP engaged in the business of building residential housing (construction development) — FDI in such an LLP would not be allowed repatriably because construction development, while 100% automatic, had certain conditions under the FDI policy. Under Schedule IV, an NRI could contribute capital to this LLP freely as domestic investment. Another concrete example: LLP engaged in **single-brand or multi-brand retail** – FDI in LLP is not permitted because retail has conditions, but NRI non-repat funds could still be infused into an LLP doing retail trade. **The only caveat** is if the LLP's activity falls under the explicit prohibitions of Schedule IV (agriculture, plantation, real estate trading, farmhouses, etc., which we already know). As long as the LLP's business is not in that small prohibited list, NRI / OCI money can be invested on non-repatriable basis.

Thus, **Schedule IV significantly expands NRIs' ability to invest in LLPs** vis-à-vis Schedule VI. It

allows the Indian-origin diaspora to use LLP structures (which are popular for smaller businesses and real estate projects), which are otherwise off-limits to foreign investors. The outcome is that an LLP which cannot get FDI can still get funds from NRI partners, treated as local funds, potentially giving it a competitive edge or needed capital infusion. As noted earlier, **an LLP receiving NRI non-repat investment remains an "Indian" entity for downstream investment purposes** as well, so it could even invest in other companies without being tagged as foreign-owned.

SCHEDULE IV Vs SCHEDULE IV (FIRM/ PROPRIETARY CONCERNS)

There is also a provision (in Part B of Schedule IV) for **investment in partnership firms or sole proprietorship concerns** on a non-repatriation basis. There is **no equivalent provision under repatriation routes** – meaning NRIs cannot invest in a partnership or proprietorship on a repatriable basis at all under NDI rules. Under Schedule IV, an NRI/OCI can contribute capital to any proprietorship or partnership firm in India provided the firm is not engaged in **agriculture, plantation, real estate business, or print media.** These mirror the older provisions from prior regulations. The exclusion of print media here is interesting, as discussed: an NRI cannot invest in a newspaper partnership but could invest in a newspaper company. This is likely a policy decision to keep sensitive sectors like news media more closely regulated (partnerships are unregulated entities compared to companies which have shareholding disclosures, etc.).

For completeness, **Schedule V** under NDI Rules is for investment by other specific non-resident entities like Sovereign Wealth Funds in certain circumstances, and Schedule VII, VIII, IX cover foreign venture capital, investment vehicles, and depository receipts respectively.

PRACTICAL CHALLENGES AND LEGAL IMPLICATIONS

While the non-repatriation route offers flexibility, it also presents some **practical challenges and considerations for legal practitioners** advising clients:

1. Exit Strategy and Liquidity: Perhaps the biggest issue is planning how the NRI/OCI will **exit or monetize the investment** if needed. Since direct repatriation of capital is capped at USD 1 million per year, clients who invest large sums must understand that they can't easily pull out their entire investment quickly. Case in point: if an OCI invests $5 million in a startup via Schedule IV and after a few years the startup is sold for $20 million, the OCI cannot take $20 million out in one go. They would either have to flip the investment to a repatriable mode before exit (e.g. sell their stake to a foreign investor prior to the main sale, thereby converting to FDI at fair value and then repatriating through that foreign investor's sale) or *accept a long repatriation timeline* using the $1M per year route, or approach RBI (which historically is reluctant to approve a big one-shot remittance). This illiquidity needs to be clearly explained to clients

2. Mixing Repatriable and Non-Repatriable Funds: Often, companies have a mix of foreign investment – say, a venture capital fund (FDI) and an NRI relative (non-repat). In such cases, **accounting properly for the two classes is key.** From a corporate law perspective, both hold equity, but from an exchange control perspective, one part of equity is foreign, and one part is domestic. The **company's compliance team must carefully track these** when reporting foreign investment percentages to any authority or while calculating downstream foreign investment. Misclassification can lead to errors – e.g., a company might erroneously count the NRI's holding as part of FDI and think it breached a cap, or conversely ignore a foreign holding, thinking it was NRI domestic. It's advisable in company records and even on share certificates to mark non-repatriable holdings distinctly. Some companies create separate folios in their register for clarity..

3. Corporate Governance and Control: Because Schedule IV allows NRIs to invest beyond usual foreign limits, we see scenarios of **foreign control via NRI routes.** For example, foreign parents could nominate OCI individuals to hold a majority in an Indian company so that it is "Indian owned" but effectively under foreign control through OCI proxies. Regulators are aware of this risk. The law currently hinges on **"owned and controlled by NRIs / OCIs"** as the test for deeming it domestic. If an OCI is truly acting at the behest of a non-OCI foreigner, that could be viewed as a circumvention. In diligence, one should ensure OCI investors are bona fide and making decisions independently, or at least within what law permits. If an Indian company with large NRI non-repat investment is making downstream investments in a sensitive sector, one must document

that control remains with OCI and not via any agreement handing powers to someone else, lest the structure be challenged as a sham.

4. Changing Residential Status: An interesting practical point – if an NRI who made a non-repat investment later moves back to India and becomes a resident, their holding simply becomes a resident holding (no issue there). But if they then move abroad again and become NRI once more, by default, that holding would become an NRI holding on a non-repat basis (since it was never designated repatriable). That person might now wish it were repatriable. There isn't a straightforward mechanism to "retroactively designate" an investment as repatriable; typically, the person would have to do a transfer (e.g., transfer to self through a structure, which is not really possible) or approach RBI. It's a corner case, but it shows that once an investment is made under a particular schedule, toggling its status is not simple unless a third-party transfer is involved.

7. Evidence of Investment Route: Down the line, when an NRI / OCI wants to remit out the sale proceeds under the $1M facility, banks often ask for proof that the investment was made on a non-repatriation basis (because if it was repatriable, the sale proceeds would be in an NRE account and could go out without using the $1M quota). Thus, maintaining paperwork – such as the board resolution or offer letter mentioning the shares are under Schedule IV, or a copy of the share certificate with a "non-repatriable" stamp, or the letter to AD bank at the time of issue – becomes useful to avoid confusion. If records are lost or unclear, the bank might fear to allow remittance or might treat it as some foreign investment needing RBI permission. So, documentation is a practical must.

8. Taxation Aspect: Though not directly a FEMA issue, note that **dividends repatriated to NRIs** will be after TDS, and any gift of shares etc. might have tax implications (gift to a relative is not taxable in India, but to a non-relative, it could trigger tax for the recipient if over ₹50,000). Also, the favourable FEMA treatment doesn't automatically confer any tax residency benefit – e.g., just because OCI investment is deemed domestic doesn't make the OCI an Indian resident for tax

BEFORE WE ALL NEED A REPATRIATION ROUTE, LET'S WRAP THIS UP!

Before we exhaust ourselves—or our dear readers start considering their own non-repatriable exit strategies—let's conclude. The non-repatriation route under FEMA is like a VIP pass for NRIs and OCIs to invest in India while enjoying the perks of domestic investors. It's a fine balancing act by policymakers: welcoming diaspora investments with open arms but keeping foreign exchange reserves snugly in place.

For legal practitioners, Schedule IV is both a playground and a puzzle—offering creative structuring opportunities while demanding meticulous planning for exits and compliance. Done right, it's a win-win for investors and Indian businesses alike, seamlessly blending "foreign" and "domestic" investment. So, whether you're an NRI looking for investment options or a lawyer navigating these rules—remember, patience, planning, and a strong cup of chai go a long way! ■

"We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten."
- Bill Gates

"Happiness comes from solving problems, not avoiding them."
- Mark Manson