Liberalised Remittance Scheme – How Liberal is it?
(An Overview and analysis of Recent Amendments)

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This article looks at recent amendments in the Liberalised Remittance Scheme (LRS) under Foreign Exchange Management Act (FEMA) and in the provisions of Tax Collection at Source (TCS) on remittances under LRS under the Income-tax Act. The changes are significant and people should be aware of these issues. Along with the recent amendments, we have dealt with some important & practical issues also.

A. Foreign Exchange Management Act:

1. Background:

1.1 In February 2004, RBI introduced the LRS with a small limit (vide A.P. Circular No. 64 dated 4.2.2004). Any Indian individual resident could remit up to US$ 25,000 or its equivalent abroad per year from his own funds. It was introduced to provide exposure to individuals to foreign exchange markets. Dr. Y. V. Reddy, ex-Governor of RBI in his book titled "Advice & Dissent" on Page 352 mentions that the funds could be used for almost any purpose. It was supposed to be a "**No questions asked" window** and was **in addition to all existing facilities**. Late Finance Minister Mr. Jaswant Singh in a gathering said "Go conquer the world, we will be your supporters". **That was the underlying theme of the LRS**.

1.2 There was a small negative list of purposes for which remittance could not be made. The negative list included payments prescribed under Schedule I and restricted under Schedule II of Current Account Transaction Rules such as lotteries and sweepstakes; and payments to persons engaged in acts of terrorism. Remittances also could not be made to some countries. Later in 2007 remittance under LRS for margin trading was also prohibited.

1.3 Over the years, the scheme has been modified. The limits have been increased periodically (except for a brief period from 2013 to 2015). Today the limit is US$ 2,50,000 per year per person. Thus, every individual Indian resident can remit US$ 2,50,000 per year for any permitted purpose. At the same time, restrictions have been introduced on current account transactions and investments under LRS and such restrictions have

kept on increasing. **The spirit of the original theme has been diluted to a significant extent**. Let us see the current provisions of LRS including its main issues.

2. **The present LRS:**

2.1 The present LRS is dealt with by the following rules, regulations and circulars. FAQs provide some more clarifications.

i) Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 (FEMA Notification no. 1).
ii) Foreign Exchange Management (Permissible Current Account Transactions) Rules, 2000.
iii) Foreign Exchange Management (Overseas Investment) Rules, 2022 (hereinafter referred to as "OI Rules").
iv) Foreign Exchange Management (Overseas Investment) Directions, 2022 vide AP circular no. 12 dated 22.8.2022 (hereinafter referred to as "OI Directions").
v) Master Direction No. 7 on LRS updated up to 24.8.2022.
vi) FAQs updated up to 21.10.2021 (these have not been updated with the rules and regulations of August 2022. However, these contain some important clarifications.)

The statutory documents are the first three documents – Rules and Regulations. The fourth and fifth documents are essentially directions to Authorised Persons – i.e. Banks for implementation of the rules and regulations. The sixth document - FAQs - doesn't have a binding effect. These are clarifications and wherever helpful, these can be used.

However, if one reads only the statutory documents, one does not get the full picture. One has to read all the documents together to understand the entire scheme with its nuances. At times, A.P. Circulars and Master Directions contain additional provisions which are nowhere covered in the statutory documents. Hence it is necessary to consider all the documents.

Also, as is the case with several rules and regulations under FEMA, one cannot get the entire picture merely by reading the documents. Some things go by practice. Many such issues and practical problems will be dealt with subsequently. Needless to say, it will not be possible to deal with all issues. The focus is on important issues and **issues arising out of amendments to LRS in August 2022 and TCS provisions in Finance Act 2023**.

2.2 **The present LRS in brief:**

2.2.1 Under the present scheme, an Indian resident individual (including a minor) can remit up to US$ 2,50,000 or its equivalent per financial year. This limit has been there

since May 2015. The remittance can be made for any "permitted" Current Account Transaction or a "permitted" Capital Account Transaction. The word "permitted" is a later addition. As per the 2004 circular, the LRS was overriding all restrictions (except those stated in the circular itself).

For remittance under LRS, the simple compliance is the submission of Form A2 with some basic details. [No form is required for making a rupee gift or a loan. However, the person must keep a track to see that aggregate of such rupee payments (discussed later) and foreign exchange remitted during a year are within the LRS limit.]

Remittances during one year have to be made through one bank only.

2.2.2 **Source of funds:** Remittance has to be made out of person's own funds. In a family, one member can gift the funds to another family member and all the relatives can remit the funds under LRS. This has been an accepted position.

Loans: A person cannot borrow funds in India and remit them abroad for capital account transactions. One can refer to these provisions in Paragraphs 8 and 10 in Section B of the present Master Direction on LRS.

A person also cannot borrow funds from a non-resident to invest. Thus, buying a home abroad with a foreign loan is not permitted even if the loan repayment is within the LRS limit. Foreign builders offer schemes where the person can get a completed house, but payment can be made over the next few years after completion. This will clearly be a violation as the payment option over a few years is a loan.

The restriction on taking loans continues right from the beginning. The underlying principle has been that one should use his "own funds" for making remittance under LRS. (Refer para 4.2 of A. P. Circular No. 64 dated 4th February 2004).

However, is loan permitted for a Current Account transaction? Remittance out of borrowed funds was always allowed for current account transactions even before LRS was introduced. LRS was in fact over and above the existing facilities. Para 3.3 of AP circular no. 64 dated 4.2.2004 stated that "*It is further clarified that the facility under the scheme is in addition to those already available for private travel, …. etc as described in Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000.*" Thus, if a person wanted to remit funds for say education, he could always borrow from banks or private parties. There was no existing facility for Capital Account transactions. Thus LRS was over and above the restriction on Capital account transactions.

In FAQs dated 13.8.2018 and subsequent FAQs it has been stated that remittance for current account transaction is permitted based on fund based and non-fund based

facilities from bank, i.e. a person can take a loan from the bank and remit the funds for a Current account transaction. The latest FAQs dated 6th April 2023 also clarify the same.

Here, FAQ is being relied upon. Strictly, FAQs have no legal authority. In practice, it goes on. Thus, a loan can be taken from a bank for a current account transaction like education and funds can be remitted abroad.

However, there is no clarity on loans from third parties. This has created a controversy. It is elaborated below.

LRS states that remittance can be permitted from <u>own funds</u>. Under Current account rules, remittances can be made from <u>loans</u>. FAQs state that current account expenses under LRS can be incurred from <u>bank loans</u>.

This confusion has arisen because – prior to February 2004, Current Account transactions for some purposes such as travel, gift, etc. (items stated in Schedule III of Current Account rules) were allowed earlier within specified limits – but with no restriction on the source of funds – funds could be own or borrowed. For all other Current account transactions, there was no limit and there was no restriction on use of loans for such transactions. Then LRS was introduced in February 2004 as a special scheme allowing individuals to remit upto USD 25,000 for a transaction which was capital account or current account or a combination of both. The LRS was over and above the existing facilities of remittances. As this was a special scheme, only own funds were allowed to be used. But for existing facilities for Current account transactions, there was no restriction on borrowings.

Over the years, LRS has subsumed several other items like travel, education and medical expenses within the overall LRS limit. (See para 2.2.3 for more discussion on this matter.) The LRS which is a special scheme has been clubbed with Current Account Rules – which are general. This has caused the restriction of use of "own funds" applicable also to current account transactions also. With developments over several years this issue has created avoidable controversies.

While prohibition on loan for a Capital Account transaction under LRS is understandable, there is no reason to prohibit loan for a current account transaction.

It would be helpful if RBI comes out with a clarification on loan for Current Account Transactions – whether loan is allowed from a bank or even private parties.

Other prohibited sources: Remittances out of "lottery winnings, racing, riding or any other hobby" are prohibited. These are stated in Schedule I of the Current Account Rules. Hence even if the person has his own funds but earned from these sources, he cannot remit the same under LRS. This is an issue that is missed by many people.

Further, 'hobby' is a broad term. What seems to be prohibited is income from hobbies which involve gambling and chance income.

2.2.3 **Current Account Transactions** – Under clause 1 of Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000, the following purposes are specified for which remittance can be made:

i) Private visits to any country (except Nepal and Bhutan).
ii) Gift or donation.
iii) Going abroad for employment.
iv) Emigration.
v) Maintenance of close relatives abroad.
vi) Travel for business or attending a conference or specialised training or for meeting medical expenses, or check-up abroad, or for accompanying as an attendant to a patient going abroad for medical treatment/check-up.
vii) Expenses in connection with medical treatment abroad.
viii) Studies abroad.
ix) **Any other current account transaction.**

Item (ix) above was introduced in May 2015. Prior to May 2015, there was no limit on remittance for Current Account transaction (except for the specified items). Since May 2015, the limit seems to have been brought in on all current account transactions. Item (ix) above seems to be a misplacement in the Current Account Transaction rules.

In para A.12 of Master Circular dated 1.7.2015 on "Miscellaneous Remittances from India", it was provided as under:

> "**A.12 'Any other current account transaction' as given at item no. (ix) of para 1 of Schedule III to FEM (CAT) Amendment Rules, 2015**
> "Any other current account transaction" as given at item no. (ix) of Rules ibid is to *cover any other current account transactions which were available to individuals in the erstwhile Schedule III to FEM (CAT) Rules, 2000 dated May 3, 2000, and which do not appear in Schedule III to FEM (CAT) Amendment Rules, 2015*."

Thus it was clear that there was no blanket bar on Current Account transactions. However subsequently such an important clarification is missing in Master Directions.

This raises some difficulties. Import of goods is a Current Account transaction. An individual who is doing trading business in his individual name could import goods worth crores of rupees. Now can he import above the LRS limit? The view is that for Import, there is a separate Master Direction laying down procedures and compliances. Under that Master Direction, there is no limit for imports. Hence whatever is covered

under the Master Direction on Imports, can be undertaken freely. All other expenses referred to in Schedule III of Current Account rules prior to Amendment Rules, 2015 are restricted by the LRS limit. Thus, expenses for travel, etc. will be restricted by the LRS limit. It would be helpful if Central Government could come out with a clarification on the lines of Master circular dated 1.7.2015 referred to above.

We would like to state that India has accepted Article VIII of the IMF agreement. Under the agreement, a country cannot impose restrictions on Current Account transactions. However, some reasonable restrictions can be placed. This is the stand adopted by India also (refer Section 5 of FEMA). Under this section, a person is allowed to draw foreign exchange for a Current Account Transaction. However, the Government can impose some "reasonable restrictions". This can mean restrictions on some kinds of transactions or imposition of some conditions. However, a blanket ban above US$ 2,50,000 on all current account transactions may not come within the purview of "reasonable restrictions". A business entity owned by an individual can remit any amount for a Current Account Transaction. But the same individual cannot, if he is doing business in his individual name (except import of goods and services). In our view, this is not logical.

Specified current account transactions allowed without any limit:

i) Expenses for emigration are permitted without limit. However, remittances for making an investment or for earning points for the purpose of an emigration visa are not permitted beyond the LRS limit.

ii) For medical expenses and studies abroad also, one can incur expenses more than the LRS limit subject to an estimate given by the hospital/ doctor or the educational institution.

2.2.4 **Capital Account Transactions** – The permitted Capital Account transactions can be referred to in Clause 6 – Part A of the Master Direction on LRS dated 24th August 2022. Earlier the list was a little more elaborate. Now the list is truncated after the Overseas Investment Rules have been enacted. The permitted transactions are:

i) opening of foreign currency account abroad with a bank.
ii) acquisition of immovable property abroad, Overseas Direct Investment (ODI) and Overseas Portfolio Investment (OPI), in accordance with the provisions contained in OI Rules, 2022; OI Regulations, 2022 and OI Directions, 2022.
iii) extending loans including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined in the Companies Act, 2013.

The LRS is primarily used for opening bank accounts, portfolio investment, acquiring immovable property and giving loans abroad. Prior to 24th August 2022, the circular referred to specific kinds of securities – listed and unlisted shares, debt instruments, etc. Now the reference has been made to Overseas Portfolio Investment (OPI) and Overseas Direct Investment (ODI) under the New Overseas Investment regime. This is discussed more in detail in para 2.2.5 below.

It may be noted that a foreign currency account cannot be opened in a bank in India or an Offshore Banking Unit. The bank account should be outside India.

Resident Individuals can also open a non-interest bearing Foreign Currency Account (FCA) in IFSCs for making the above permissible investments under LRS. Any funds lying idle in the account for a period upto 15 days from the date of its receipt into the account were required to be immediately repatriated to domestic INR account of the investor in India. (As per A. P. Circular No. 11 dated 16th February 2021). This was not in line with the LRS where the individual could open a foreign currency account outside India. There the limit of 15 days did not apply. Recently, RBI issued A. P. Circular No. 3 dated 26th April 2023 in order to align the condition of repatriating idle funds with the provisions under Master Direction on LRS. Where the funds remitted to IFSCs are lying idle till 15 days, the condition to repatriate funds has been removed. It will now be governed by the LRS Master Direction which provides for a limit of 180 days (explained in Para 3 below).

2.2.5 **Overseas Portfolio Investment (OPI)** – OPI has been defined in Rule 2(s) of OI Rules to mean "*investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC*". (It has been clarified that even after the delisting of securities, the investment in such securities shall continue to be treated as OPI until any further investment is made in the entity.)

Basically, OPI means investment in foreign securities. Then, there are exclusions to the same – ODI, unlisted debt instruments and securities issued by a resident [except by a person in the International Financial Services Centre (IFSC)].

ODI includes investment in unlisted equity capital of a foreign entity. Equity Capital includes equity shares and other fully convertible instruments as explained under Rule 2(e) of OI Rules. Thus, now it is clear that investment even in a single unlisted share of a foreign entity falls under ODI and it requires separate compliance.

Listed foreign securities have not been defined. However, "listed foreign entity" has been defined in Rule 2(m) of OI Rules to mean "*a foreign entity whose equity shares or any other fully and compulsorily convertible instrument is listed on a recognised stock exchange outside India.*"

Para 1(ix)(a) of OI Directions provides further prohibitions under OPI which are not covered under the OI Rules. It provides that OPI is not permitted in derivatives and commodities.

This brings out the following:

OPI means Investment in foreign securities. However, investment in the following are not covered under OPI:

i) Investments considered as ODI:
   - a) Investment in <u>unlisted equity capital</u>;
   - b) <u>Subscription to Memorandum</u> of Association;
   - c) Investment in <u>10% or more of listed equity capital;</u>
   - d) Investment of less than 10% of <u>listed equity capital but with control in the foreign entity</u>.

ii) Unlisted debt instruments.
iii) Security issued by a person resident in India (excluding a person in an IFSC).
iv) Derivatives unless specifically permitted by RBI.
v) Commodities including Bullion Depository Receipts.

<u>Debt instruments</u> are defined in clause (A) of Rule 5 of OI Rules. These mean:

i) Government bonds.
ii) Corporate bonds.
iii) All tranches of securitisation structure which are not equity tranches.
iv) Borrowings by firms through loans.
v) Depository receipts whose underlying securities are debt securities.

Other investments:
Apart from listed securities, investment is permitted in units of mutual funds, venture funds and other funds which can be considered as "foreign securities". OI Directions provide additional guidelines for investment in mutual fund units.

Para 1(ix)(e) of OI Directions states that investment (including sponsor contribution) in units of any "investment fund overseas, duly regulated by the regulator" for the financial sector in the host jurisdiction, shall be considered as OPI. Thus, the investment fund should be duly regulated by the financial sector regulator of the host jurisdiction. Hence, investment in funds which are not regulated by a financial sector regulator is not permitted.

Can a person invest in debt mutual fund? In our view, a person can invest in debt mutual fund. The reason for this is as follows. Under OPI definition, investment is permitted in foreign security. Investment is not permitted in unlisted debt instrument.

Mutual fund units are securities. These are not debt instruments. The definition of debt instrument under the OI rules is a specific definition which includes only 5 specific kinds of instruments (see above in this para). None of these includes a mutual fund. Under the Non-debt instrument rules (NDI rules), the meaning of debt instrument is different. Under Rule 2(f) of NDI rules, debt instrument is defined as an instrument "other than a non-debt instrument". Non-debt instrument is defined in rules 2(ai) of NDI rules. It includes "*units of mutual funds or Exchange-Traded Fund (ETFs) which invest more than fifty per cent in equity*". Thus, any mutual fund which invests 50% or more in debt (debt mutual fund), is not a non-debt instrument. It is a debt instrument. But under OI rules, debt mutual fund is not a debt instrument. As it is not a debt instrument, whether it is listed or not, does not matter. It is a security. Hence it is permitted as OPI.

Investment in Gold (or precious metal) bonds is not permitted as it amounts to a corporate bond.

Buying physical gold or other precious metals outside India is also not permitted under LRS. However, importing Gold or other precious metals into India, in accordance with other applicable laws, is permissible under LRS.

One important point to note – Under erstwhile FEMA 120, ODI was allowed in JV/ WOS engaged in bonafide business activity. The term "bonafide business activity" was not defined. Under the new OI Rules, it has been defined under Rule 9 to mean any business activity permissible under any law in force in India and the host country. However, it has been provided that any **overseas investment** (ODI as well as OPI) should be in a foreign entity engaged in bonafide business activity. Effectively, even OPI should be in a foreign entity engaged in bonafide business activity, which was not the case earlier. For example, gambling is illegal in India. Hence one cannot invest abroad in such sectors even as OPI. While this will affect very few activities, one should keep this in mind while making investments in shares or securities of foreign entities.

Also, see para 2.2.12 for more prohibitions under LRS.

2.2.6 **Bank fixed deposits** - Is investment in fixed deposits of banks permitted? Can these be considered as loans? Extending loans is specifically permitted under LRS. What is prohibited is borrowing by firms. Banks are not firms. These are companies.

Bank FDs are also not corporate bonds. Bonds have a specific meaning. It means a security or an instrument which can be transferred. A bank FD cannot be transferred.

However, OPI means investment in foreign securities. A Bank Fixed Deposit is not a "security". Hence in our view, keeping funds in Bank FDs is not considered as OPI.

One view is that bank fixed deposit is like a bank balance. **Hence funds remitted under LRS may be kept in bank fixed deposits.** However, funds remitted abroad have to be used within 180 days. (See para 3 for more discussion). Hence such FDs cannot be held beyond 180 days and should be used for some permitted purpose within 180 days. However, if parking of funds in fixed deposits is considered utilisation of such funds, it would be helpful. A clarification from RBI on this issue will be welcome.

2.2.7 **Unlisted shares of a foreign company – A background:**

From 2004 till 22nd August 2022, the Master Directions were abundantly clear that investment under LRS could be made in unlisted and listed equity shares. However, vide A.P. Circular 57 dated 8th May 2007, the RBI introduced the sentence – "*All other transactions which are otherwise not permissible under FEMA …… are not allowed under the Scheme*." Under this clause, RBI took a view that investment in unlisted shares was not permitted. According to RBI, investment in unlisted shares was permitted only as per ODI rules applicable at that time (Old ODI Regime under FEMA Notification 120 which was in effect before 22nd August 2022). Under those rules, individuals were not permitted to make business investments outside India. Hence, investments made by resident individuals in unlisted foreign companies to undertake business were considered as a violation. With due respect, the stand taken by RBI does not go in line with the language of the Master Directions – right till 22nd August 2022. All penalties imposed for investment in unlisted shares by resident individuals – are not in keeping with the law – FEMA.

The phrase "which are otherwise not permissible" applies to all investments. For example, investment in immovable property abroad is otherwise not permissible. But under LRS it is permissible. Loans abroad are otherwise not permissible. But under LRS they are permissible. The LRS was supposed to apply in addition to all existing facilities. In Master Circular on Miscellaneous Remittances from India – Facilities for Residents dated 1st July 2008, the phrase was amended to "*The facility under the Scheme is* ***in addition to*** *those already included in Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000*". From May 2015, the Current Account Rules were changed and from Master Circular dated 1st July 2015 onwards, the phrase "*in addition to*" has been dropped. However, the fact remains that till 22nd August 2022 investment in unlisted shares was permitted as per Master Direction. From 23rd August 2022, the phrase "unlisted shares" was dropped in the Master Direction.

On representation, RBI formally introduced the scheme of ODI for resident individuals from August 2013 (generally called "LRS-ODI"). It permitted individuals to invest in unlisted shares of a foreign company having bonafide business subject to compliances pertaining to ODI. However, RBI considered investments made prior to August 2013 as a violation which required compounding. This did leave a bad taste for Indian investors.

Thus, now the investment in unlisted securities is covered under the ODI route and has a separate set of rules and compliances. This was the position since August 2013 under the Old ODI regime as well as under the New OI regime notified on 22nd August 2022. It is not dealt with more in this article as that is a subject by itself.

2.2.8 **Listed securities abroad of Indian companies** – Up to Master Circular dated 1st July 2015, the language was that **investment could be made under "assets" outside India**. It did not specifically state that investment could be only in securities of foreign entities. Hence investment made in say GDRs or securities of Indian companies listed abroad was possible. Later, Master Circulars were replaced with Master Directions. From Master Direction dated 1st January 2016, it was provided that **investment could be in "shares of overseas company"**. Hence, it should be noted that under LRS, an individual can invest in listed securities of a foreign entity. One cannot invest in securities of an Indian company which are listed abroad. Some people have invested in bonds of Indian companies listed abroad. Such investments are not permitted under LRS. One should sell such investments and apply for compounding of offence. Under the OI Rules as well, investment in securities issued by a person resident in India is not permitted under OPI. There is only one exclusion to the prohibition – investment in securities issued by an entity in IFSC is allowed.

2.2.9 Investment in permissible security of an entity in IFSC is permitted under LRS. Under the Notification No. 339 dated 2.3.2015, any entity in an IFSC is treated as a non-resident.

OPI as discussed in para 2.2.5 above means *investment …. in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC*". This language creates some confusion. Investment is not permitted in any security issued by an Indian resident which is not in IFSC. Does it mean that investment in any security such as "unlisted debt instrument" issued by an entity in IFSC is permissible? We would not take such a view. One has to equate an IFSC entity with a foreign entity. Whatever security of a foreign entity one can invest in, similar security of an IFSC entity can be invested in. Thus, investment should be in assets discussed in paras 2.2.4 and 2.2.5.

2.2.10 Extending Loans: Under LRS, extending loans to non-residents is allowed. However, this is allowed in the case of outright loans to third parties. For instance, Mr. A (an Indian resident) can give a loan to his friend Mr. B (a US Resident) or to B Inc. (a US company).

However, if Mr. A has made ODI in the USA (whether in his individual capacity or through an Indian Entity), then a loan by Mr. A to the investee entity in the USA is not considered under LRS. Mr. A will have to comply with the ODI Rules in such a case.

This is because what cannot be done directly cannot be done indirectly. Under ODI Rules, only equity investment can be made by individuals. One cannot take a view that investment in equity of a foreign entity will be under ODI and loan to that entity will be under LRS. If there is any equity investment in a foreign entity as ODI, then all conditions of the ODI route shall be fulfilled. Hence, no loan can be given.

2.2.11 Transactions in Indian rupees – Indian residents are allowed to give gifts and loans to NRI/ PIO relatives (as defined under the Companies Act 2013) in rupees in their NRO account.

Para 6(iii) of the Master Direction initially refers to NRIs. Later, it has been clarified that gifts and loans can be given to PIOs also (i.e., foreign citizens but Persons of Indian Origin).

It was represented to RBI that under LRS, foreign exchange can be remitted outside India to anyone. However, if payment has to be made in rupees in India, it is not permitted! RBI has since then permitted gifts and loans in rupees in India but only to NRI/PIO relatives within the overall LRS limit.

2.2.12 Prohibited transactions – Apart from restrictions discussed in para 2.2.5, the following transactions are prohibited:

i) Transactions specified in Schedule I and Schedule II of Current Account Transactions Rules. This includes remittances for lottery tickets, banned magazines, etc.

ii) Remittances to countries identified by FATF as non-co-operative countries.

iii) Remittance for margin trading. Thus, dealing in derivatives and options is not permitted.

iv) Trading in foreign exchange.

2.2.13 New prohibition on gift of overseas investment to non-residents:

Para 22(4) of OI Directions provides a new restriction. It is mentioned that resident individuals are not permitted to transfer any overseas investment to a non-resident as a "gift". Such restriction was not present earlier. Thus now, out of the assets lying abroad which have been acquired under LRS, only bank funds, immovable property and loans can be gifted to a non-resident. One should be careful while giving gifts to non-residents.

3. Retaining funds abroad:

3.1 Background: This is the most important change in the LRS. The individual who has remitted funds under LRS can primarily retain the same abroad, reinvest the funds and retain the income earned from such investments abroad. This has now undergone a change with effect from 24th August 2022. The change has been carried out without any specific announcement.

The Overseas Investment rules and regulations were notified on 22nd August 2022. The Master Direction on LRS was amended on 23rd August 2022 to factor in the changes in capital account transactions as per the OI Rules as explained in paras 2.2.4 and 2.2.5 above. Paragraph 16 of the Master Direction amended on 23rd August 2022 stated that – "*Investor, who has remitted funds under LRS can retain, reinvest the income earned on the investments. At present, the resident individual is not required to repatriate the funds or income generated out of investments made under the Scheme.*" Till 23rd August 2022 funds remitted under LRS and income from the same could be retained and used abroad without any restrictions.

The Master Direction on LRS was amended again on 24th August 2022 (just one day later). This amendment includes an important change in the scheme and has been dealt with in the next para 3.2.

3.2 Main amendment: Under the LRS Master Direction amended on 24th August 2022, Paragraph 16 provides the following:

"*Investor, who has remitted funds under LRS can retain, reinvest the income earned on the investments. The received/realised/unspent/unused foreign exchange, unless reinvested, shall be repatriated and surrendered to an authorised person within a period of 180 days from the date of such receipt/ realisation/ purchase/ acquisition or date of return to India, as the case may be, in accordance with Regulation 7 of Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015 [Notification No. FEMA 9(R)/2015-RB]*".

It is provided that the received or realised or unspent or unused foreign exchange should be repatriated to India, unless it is reinvested. The time limit of 180 days is provided. This condition of repatriating the unused or uninvested funds back to India within 180 days is a major change. No specific announcement was made. It was simply brought in the Master Direction on 24th August 2022.

The language is broad. The terms "received" and "realised" can refer to the amount received on sale of investment, or income on investment. The terms "unspent" and "unused" can refer to amount received on sale of investments, or income on investment, or amount remitted from India under the LRS. The amounts have to be reinvested within 180 days from the date of receipt, realisation, acquisition or purchase of foreign exchange.

While the word "reinvested" is used, it cannot be mandatory that the funds should only be "reinvested". The intention seems to be that funds should not be parked idle. They should be "reinvested" or "used" within 180 days. Let us assume a person makes an investment under LRS, then sells the same and receives the sale proceeds. These proceeds can be used for any permitted Current Account Transaction (expenditure) or Capital Account Transaction (investment) within 180 days. That is the purpose of LRS. Here also it will be helpful if RBI could provide a clarification.

3.3 Retrospective amendment: The requirement to repatriate the idle funds within 180 days applies not only to fresh remittances but also to the existing funds lying abroad which were remitted before 24th August 2022. It is effectively a **retrospective amendment**. Many people are not aware of this.

Let us take a case where funds were remitted under LRS since 2018 and funds were lying idle in the bank account since then. These are unspent funds and the amendment made on 24th August 2022 applies to such funds as well. Hence, the person will have 180 days to invest the funds from 24th August 2022. If it is not done, the funds should be repatriated.

Thus, by 19th Feb 2023 the funds remitted prior to 24th Aug 2022 had to be utilised, if they were lying unspent or unutilised. If the funds are not used by then and are still lying abroad, it is a contravention of FEMA.

3.4 Issues: This will cause difficulties for several people. Let us consider some issues.

3.4.1 Small amounts to be tracked and invested: The income earned on investments abroad should also be invested abroad within 180 days, or these should be remitted back to India. The income on LRS funds could be small. Let us take a case where funds are remitted to a brokerage account in the USA and investment is made in listed shares. A small amount of income is received and lying in the brokerage account. Or some funds are kept in the brokerage account to pay an annual fee. One will have to keep track of all these incomes and reinvest them. Keeping such a track and investing small funds is difficult. Further remittance of funds to India also costs money by way of bank charges, etc.

3.4.2 Time-consuming investments: Let us consider another case. Let us say the person has purchased a flat and after few years, he sells the same. He would like to buy another flat abroad. The sale proceeds of the first flat should be used within 180 days. Either he should buy the flat or invest the funds in permitted investments. At times, to finalise the transaction for a flat takes a lot of time. Therefore, one will have to plan to invest within 180 days from the sale of flat.

3.4.3 Consolidation of funds over multiple years for high-value investments: Some people have sent funds over a few years to buy an immovable property abroad as one year's limit under LRS may not be sufficient. However, with the 180 days' time limit, the accumulation of funds is not possible. In such cases, the funds remitted abroad should be invested in portfolio investment. And when the funds are sufficient to buy the property, the securities can be sold. This however means that the person undertakes risks associated with the securities. A fall in prices of the securities will jeopardise the purchase of property.

3.5 Can the person invest the funds in bank fixed deposits? See para 2.2.6 above where it is stated that Bank FDs do not fall within the definition of OPI. Remitting funds under LRS and keeping them in Bank FDs for up to 180 days is all right. However, bank fixed deposits are not securities and can be considered equivalent to funds in a bank account. Hence, in our view, placing funds in bank fixed deposits will not be considered an "investment" of funds. It will be ideal if RBI comes out with a clarification on the same.

3.6 Some cases where the 180-day limit will not apply: As mentioned in para 2.2.4, Indian residents can give loans and gifts to NRI relatives. Here, there is no question of utilising foreign exchange. Hence there is no limit of 180 days or any other time period. The limit of 180 days applies only for foreign exchange remitted abroad or lying abroad.

Let us take another illustration. A student remits funds under LRS for education purposes to his foreign bank account. Before leaving India, he is an Indian resident. All funds may not be utilised within 180 days. Some funds may be lying for ongoing and future expenses. However, when the student leaves India for education abroad, he becomes a non-resident. In such a case, the 180-day limit will not apply. Once a person is a non-resident, the funds outside India are not liable to FEMA restrictions. Hence, the condition of repatriating the funds within 180 days will not apply.

3.7 Consequences of violation: What are the consequences of a violation of not using the funds within 180 days? The person concerned has to apply for compounding. Compounding is a process under which the person concerned admits to the violation. RBI then levies a penalty for the violation. There is no option to pay Late Submission Fee (LSF) and regularise the matter. LSF is for delays in submitting the documents/forms.

There is however, a hitch. Before applying for compounding, the transactions have to be regularised. How does one regularise?

Regularising means doing something now, which should have been done earlier. In our view, the violation can be regularised in two manners – one is by remitting the funds back to India. The other is to invest/use the funds abroad as permitted – although with

a delay. It is however doubtful whether utilising the funds after the 180-days' period will be considered as regularisation. It will be better for the funds to be repatriated to India. Once the funds are repatriated, a Compounding Application should be filed with RBI.

3.8 Alternate views:

3.8.1 There is a view that the provision of use of funds within 180 days applies to an "investor" only (see para 16 of Master Direction). Thus, if funds are remitted by an investor for investment, one has to use the funds within 180 days. Whereas, if a person has remitted the funds for expenses such as education, one can use the funds beyond 180 days also. However, the language does not suggest such an intention. While the provision starts with the term "investor", the provision goes on further to add that the funds have to be surrendered to the bank "*in accordance with Regulation 7 of Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015 [Notification No. FEMA 9(R)/2015-RB]*". Regulation 7 of Notification 9(R) provides as under:

"*A person being an individual resident in India shall surrender the received/realised/unspent/unused foreign exchange whether in the form of currency notes, coins and travellers cheques, etc. to an authorised person within a period of 180 days from the date of such receipt/realisation/purchase/acquisition or date of his return to India, as the case may be.*"

Regulation 7 applies to all individual Indian residents and for all purposes. Hence even if the funds have been remitted for expenses, they have to be utilised within 180 days. Otherwise, the same should be remitted to India.

3.8.2 There is another view as to when is the amount to be considered as unused/ unspent. The view is that once the amount is remitted abroad, it has to be used on the first day. If it is not used on the first day, then it is unused/unspent. If it unused/unspent, it has to be remitted back to India. The time of 180 days is only to remit the funds back to India.

While literal reading suggests this - in our view, this is neither the correct interpretation, nor the intention. One cannot use the funds on day one. It takes time for the funds to be used. If the funds are not used within 180 days, then they have to be remitted back to India.

4. Some more issues:

4.1 Purpose Codes: At the time of remittance, one has to state the purpose code in the form. For example, one mentions the purpose code as S0023 (remittance for opening a bank account abroad). After remittance, can the funds be used for investment in shares? Or the purpose code stated is investment in real estate (S0005) and one is not

able to invest in real estate within 180 days, and hence invested in shares. Can it be done? Technically it could be considered an incorrect purpose code. However, if one considers the substance of LRS, remittance for any permitted purpose is allowed. One may have the original intention for one purpose, but then the purpose has changed, and it should be all right. After the remittance of funds, change of use has always been permitted. Assume that a person has remitted the funds to open a bank account abroad. Under the present LRS scheme, funds have to be used within 180 days. To comply with this condition, funds are invested. This means the "use of funds" has changed from keeping funds in bank account to investment. Or the funds are sent for investment in shares, and then the shares are sold. Does it mean the sale proceeds have to be reinvested only in shares? No. The funds have to be used or reinvested for any permissible purpose. Section 10(6) states that if foreign exchange acquired or purchased by a person for any declared purpose is not utilised, or utilised for any other impermissible purpose, then such person would be deemed to have committed a contravention of FEMA. If the purpose for which funds have been remitted under LRS has been changed, and the funds have been used for any other permitted purpose, it does not amount to a contravention under section 10(6). Funds are still utilised for another permissible purpose.

It will be better that after remitting the funds for the first time, if there is a change in the use, one should write to the bank and inform the change of use. This is however out of abundant caution. In substance after sending the funds, the same can be used for any permitted purpose. Also see para 3.2 of Part B on TCS provisions.

4.2 Joint holding: There are people who open bank accounts and make investments in joint names. Investment is made by one person (say the first holder). Funds belong to the first holder. That is how it is declared in the income tax returns. However, to take care of situations where the investor dies or becomes incapacitated, the account or the investment is held in the joint name. Otherwise, the funds may be blocked. The process of producing a Will or succession document is a time-consuming process. So, the second name is added for the sake of convenience. Hence in our view, holding an investment or bank account in a joint name is all right. It is a prudent step. There cannot be any objection to this.

5. Co-ownership and Consolidation of funds:

5.1 **Co-ownership** – Assume that funds are sent by two or more relatives in one bank account. From there investment has to be made. It is necessary that the investment should be made in the proportion in which the funds are remitted. Assume that Mr. A remits US$ 1,00,000 and Mrs. A remits US$ 50,000, and together they invest US$ 1,50,000 in shares. The holding ratio in the shares should be 2:1 between Mr. A and Mrs. A. If the investment holding is 50:50, it means Mr. A has given a gift to Mrs. B. Gift outside India

from one resident to another resident is an impermissible transaction. It will become a violation.

5.2 **Consolidation of funds –** Master Direction prior to 23rd August 2022 permitted consolidation of remittances by the family members. It further provided that clubbing is not permitted by family members if they are not the co-owners of bank account/ investment/ immovable property. Here, the condition for co-ownership does not mean being just a co-owner. It means that ownership ratio in the asset should be commensurate with the ratio in which payment is made. This is prima facie in line with the LRS that the owner should remit the funds. If another person becomes the owner without remitting the funds it is as good as a gift from the person who has remitted the funds. This is different from being a joint holder (without remittance or payment) for the sake of convenience discussed in para 4.2 above.

It may be noted that "family members" have not been explained. It should be considered as a family comprising relatives under the Companies Act 2013.

5.3 **Consolidation of funds for acquiring immovable property –** The amended Master Direction on LRS has retained the above-mentioned condition of consolidation of funds and co-ownership. However, the reference to the immovable property has been removed. The Master Direction has stated that remittances for the immovable property should be in accordance with OI rules.

Under the OI rules, an Indian resident can acquire immovable property by remitting funds under LRS. Further, an Indian resident can acquire property as a gift from another resident also, subject to the condition that the donor should have acquired such property in line with FEMA provisions applicable at the time of acquisition.

Further, proviso to Rule 21(2)(ii)(c) of OI Rules states that "*such remittances under the Liberalised Remittance Scheme may be consolidated in respect of relatives if such relatives, being persons resident in India, comply with the terms and conditions of the Scheme*".

Does this mean that relatives can consolidate/ club the remittances, but property can be owned by one person? As discussed above, an Indian resident cannot gift funds to another Indian resident outside India. When consolidated funds are remitted, purchase by one person actually amounts to a gift of funds - which is not permitted. If the property is acquired and then later the share in the property is gifted, it is permissible.

However, if one considers the draft rules on Overseas investment published in 2021 for public consultation, it provided that if funds were consolidated, the immovable property has to be co-owned. In the final OI rules notified by Central Government and the amended Master Direction, the language is different. The condition of co-ownership is not present for the purchase of immovable property abroad. Even in the FAQs dated

6.4.2023 (FAQ 5) does not state that co-ownership of immovable property is required. While it does not come out clearly that funds can be remitted by relatives but property can be purchased by one person, considering the specific changes compared to the old rules, it appears that co-ownership is not required. Property can be purchased in one person's name if family members consolidate the funds and make the remittance.

5.4 In some cases, banks have permitted remittance under LRS from one account of an individual for say 4 different people by obtaining PAN of all 4 people. This is incorrect. Remittance is not based on PAN. It is per person. One individual can remit only up to the LRS limit and that too for himself/ herself. If funds have to be remitted by other Indian resident family members, then the account holder should first gift the funds to others and then others may remit the funds from their account. Of course, if the bank account is a joint account and funds in that account belong to all joint holders, then each joint holder can remit up to the balance available under his ownership. Consolidated funds can be remitted subject to what has been discussed in para 5 above. In such cases, one should keep a proper account of the funds, ownership and remittances.

Summary: LRS was started in the year 2004 as the first step towards capital account convertibility of the rupee. Subsequent amendments have imposed too many conditions and restrictions. This clearly goes back from liberalisation.

B. Income-tax Act - Tax Collection at Source on remittances under LRS:

1. Provisions in force till 30th June 2023:

1.1 Basic provision: Sub-section (1G) was introduced in Section 206C vide Finance Act, 2020 w.e.f. 1st October 2020. It provides for Tax Collection at Source (TCS) at the rate of 5% on remittances out of India under LRS. There is a threshold of INR 7,00,000 for the same, i.e., there is no TCS on remittances up to INR 7,00,000. The rate of 5% is applicable for amount in excess of Rs. 7,00,000. It should be noted that TCS is applicable per person per financial year.

Thus, the bank which sells foreign exchange to the individual for remittance under LRS, will collect tax @ 5% over and above the rupee amount required for sale of foreign exchange. This TCS is like an advance tax. The individual can claim the TCS as tax paid while filing his income-tax return. Many laymen are under the impression that this is a straight loss. However, that is not the case. The issue is that the funds of the person get blocked for some time.

1.2 Non-applicability of TCS:

1.2.1 Remittance not covered under LRS: TCS applies only where remittance is made under the LRS. For instance – if an NRI remits funds from his NRO/ NRE Account, TCS will not apply in such case. It is because this is not a remittance under LRS. Similarly, TCS is not applicable to remittances by persons other than individuals.

1.2.2 Remitter liable to TDS: It has been provided that if the remitter is liable to deduct tax at source under any provisions of the Income-tax Act, and has deducted such tax, then this TCS provision will not apply. The intention seems that TCS is not applicable only if the remitter is liable to deduct tax at source on the "concerned LRS remittance" and has deducted the same.

However, the language is not clear whether the remitter should be liable to deduct tax at source on "the concerned remittance under LRS" or "any transaction". The literal reading suggests that it is not necessary that TDS should be applicable on the concerned LRS remittance. The person may be liable to deduct tax at source on any payment. Consider some examples. Some individuals have to deduct tax at source where the turnover or gross receipts from business/profession exceeds the prescribed thresholds; or on purchase of immovable property u/s. 194-IA; or on payment of rent u/s. 194-IB. These transactions on which TDS is deductible are unrelated to the LRS remittance. The language suggests that TCS is not applicable where the person has deducted tax at source under any provisions. In our view, this is not the intention. It would be better if the Government brings clarity in respect of the provision.

1.3. Concessional rate in case of loan taken for education:

A concessional rate of TCS @ 0.5% is applicable instead of 5% where:

- the remittance is for the purpose of pursuing education; and
- the amount being remitted is from loan funds obtained from a financial institution as defined u/s 80E.

In other words, if the remittance under LRS is made for the purpose of education out of own funds then the concessional rate of TCS will not be applicable and one needs to pay TCS @ 5 per cent.

1.4. Overseas Tour Program Package:

While the threshold of INR 7 Lakhs is prescribed for all purposes, such a threshold is not applicable where the remittance is for the purpose of an overseas tour program package. Hence, in such cases, TCS @ 5% is applicable without any threshold.

This is the position of TCS on remittances under LRS as of now. Let us take a look at the amendments introduced vide Finance Act 2023.

2. Amendment vide Finance Act 2023 as passed by the Lok Sabha on 24.3.2023 - TCS rate to be increased to 20%:

2.1 Vide Finance Act 2023, the rate of TCS has been increased from the existing 5% to 20% for remittances made under LRS w.e.f. 1st July 2023.

One of the reasons explained earlier and in the FAQs issued on 16th May 2023 is that LRS payments by some people are disproportionately high compared to their disclosed incomes.

2.2 Further, the threshold of INR 7,00,000 has been restricted only to cases where remittance is for the purpose of education or medical treatment.

2.3 Consequently, the rate of TCS will now be **20% without any threshold** for all purposes except education and medical treatment.

2.4 One more amendment is that the phrase "out of India" has been removed for the purpose of TCS. Under the original provision, TCS was applicable only where remittance was done "out of India" under LRS. As discussed above in Para 2.2.11, LRS can be used for giving gift or loan in rupees to NRI/ PIO relatives in their NRO account as well. In such case, TCS was not applicable as per existing provision.

From 1st July 2023, TCS will be applicable on such rupee transfers as well. It is not required that there is remittance out of India. It should be noted that for rupee payments discussed in para 2.2.11 of Part A, there is no mechanism to report to the bank. The remitter has to keep track of rupee payments and see that all payments in rupees and foreign exchange should be within the limits of LRS. For remittance abroad, formal reporting must be made to the bank and thus bank will know that the funds are being remitted under LRS. In the case of rupee payments, RBI should work out a mechanism for reporting. Alternatively, the remitter should himself provide the details to the bank and the bank should collect TCS.

2.5 The concessional rate of 0.5% where remittance is out of educational loan (discussed in Para 1.3 above) remains the same after amendment.

3. Payment through International Credit Cards while on a visit outside India: It should also be noted that payments made by International Credit Card (ICCs) while on a visit outside India were not captured within the purview of reporting under LRS. Even the LRS limit was not applicable to the same. This was provided in Rule 7 of Current Account Transaction Rules under FEMA. (Of course the use of ICCs within India was covered under the LRS rules.) . Since such payments were outside LRS, even

TCS provisions did not apply to them. Further, there was also no mechanism to collect tax at source when payment is made by ICC even if it was used in India.

Finance Minister – Smt. Nirmala Sitharaman, while passing the Finance Bill in Lok Sabha on 24th March 2023 made a statement on this. She said that the Central Government had requested the RBI to develop a mechanism to capture payment for foreign tours and TCS by ICC.

On 16th May 2023, the Central Government issued a notification omitting Rule 7 in the Current Account Transaction Rules. Now, payments through ICCs while on a visit abroad are also covered under LRS. Hence, LRS limit as well as TCS provisions will apply to the same. FAQs were also issued by the Finance Ministry providing background and reasoning for the increase in rate of TCS and bringing payment through ICCs under the LRS net.

Another clarification was issued on 19th May in order to remove practical difficulties of collecting tax at source on payments through ICCs and International Debit Cards (IDCs). It has been stated that where payment is through ICC or IDC, payment of up to INR 7 Lakhs will not be considered under LRS. The required amendments have not yet been made in the law at the time of writing this article. We will update the article or write an addendum when the law is amended.

4. Summary: The table below summarises the TCS rate for various transactions before and after the amendments.

Particulars	**Amendment Vide Finance Act 2020**	**As per amendments proposed in Finance Bill 2023**	**Amendment vide Finance Act 2023**
Period involved	**1st October 2020 to 30th June 2023**	**NA**	**1st July 2023 onwards**
Education or Medical treatment including Travel & incidental expense thereto	5% on amount exceeding INR 7,00,000		
Education sourced out of educational loan taken from financial institution defined u/s 80E	0.50% on amount exceeding INR 7,00,000		
Overseas tour program package	5% without any threshold	20% without any threshold	

All other purposes	5% on amount exceeding INR 7,00,000	20% without any threshold	
Transaction which does not lead to remittance out of India	Nil	Nil	As per above provisions
Payment through International Credit Cards on foreign tours	Till 15th May 2023 - Not covered under LRS. No TCS. From 16th May 2023 - Covered under LRS. TCS as per above provisions.		

5. Change in use of funds – As mentioned in para 4.1 of Part A, the purpose can be changed after remitting the funds. This can have some issues.

Normally the TCS rate is 20%. If the purpose of remittance is changed to education, the TCS should have been lower at 5%. As excess tax is collected, there is no difficulty. In any case, TCS is like advance tax. It will be claimed as such in the income tax return.

However, let us assume that funds are remitted for education and TCS is 5%. Later the use is changed to investment, then there is a shortfall in the TCS. Banks would of course have collected the tax based on declaration and documents provided by the remitter. The change in use would not cause any liability on the bank. Will it cause any liability on the remitter? There should be no implication for a bonafide case. For example, The original remittance was for education purpose but some funds could not be used within 180 days. In order to comply with the condition of investing the funds within 180 days, the funds were invested. Subsequently the investments were sold and funds were used for education. This should not be an issue. Even otherwise there is no specific provision for change of use. Please note that we are discussing bonafide change in use and not false declarations. Out of abundant caution, the remitter may inform the bank on change of use and if necessary, ask the bank to collect additional tax from him and pay the same to the Government. It may even collect interest. The remitter will in any case claim the additional TCS in his tax return.

Summary:

20% is a very high rate for TCS. There are no thresholds. The threshold of INR 7 Lakhs has also been removed. Sometimes, remittances are made for pure expenses or gift to relatives which do not lead to any potential incomes. With the steep hike in TCS rate, it appears that the government does not wish to encourage remittances under LRS. Hence it is making remittances costlier.

Conclusion:

There are significant changes in the LRS in terms of inserting some restrictions and disincentives. Before making remittances under the LRS, one should carefully understand the implications and then go ahead with the remittance.

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