Understanding of FEMA with emphasis on Regulations related to NRIs, LRS & Immovable property

Virtual Workshop on FEMA
Karnataka State Chartered Accountant Association and
The Society of Auditors' Chennai
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Presentation Layout

Sr. No.	Particulars
1	FEMA – An Introduction
2.	NRI – Facilities and Obligations
3	Immovable Properties Regulations
4	Liberalised Remittance Scheme

FEMA – A Policy Law

- FEMA is a policy law
- Drafted loosely
- Compounded by change in position later in time
  - Principles keep changing as individuals keep changing
  - No Institutional Memory
- Multiple notifications and rules can apply to a particular transaction
- Inconsistencies between Govt and RBI
- Recourse to appellate options limited

FEMA – Back to the Past?

- From FERA to FEMA
  - Earlier, foreign exchange related restrictions were stated under FERA
  - Under FERA, everything was prohibited unless permitted
  - FEMA was introduced in 2002 to change from 'regulation' to 'management'
  - Largely lip service

- Law is small. Prohibits almost everything. Then notifications & circulars provide what is permitted.
  - Many provisions have been liberalized and are continuously being liberalized
  - However, on ground regulation has not kept pace – more on next slide

- Criminal prosecution under FEMA was not possible
  - However, situation has changed post FA 2015
  - Introduction of Sections 37A and amendments in Section 13

Compliance with FEMA a must

- FEMA is now more draconian than erstwhile FERA
- Seizure of assets in India
  - Section 37A newly introduced vide Finance Act, 2015 in FEMA
  - Provides that if any person holds any foreign exchange, foreign security or any immovable property outside India in contravention of Section 4 of FEMA, the equivalent value of property in India can be seized
    - No opportunity is to be given to prove that the accused is actually innocent before seizure, only later
    - Exemption for assets under value of Rs. 1 crore
- Can lead to penalty and prosecution
- Matters in violation under FEMA can generally be compounded failing which Enforcement Directorate has rights to adjudicate the case

Compliance with FEMA is a must, not an option

FEMA Law – features causing difficulties

- Administered through banks. Banks are like sub-regulators !

- RBI refuses to provide clarification. Views on some matters have changed without a change in law.

- 2015 amendment – Foreign assets acquired in violation of FEMA are liable for :
- Confiscation of equivalent Indian assets; &
- Prosecution.

FEMA – What it really is!

- Government Policy drafted in a legal language
  - Not the best drafting
    - Precis writing gone bad
    - One cannot just interpret and take action.
  - Written in non-legal language
    - Compounded by change in position later in time
      - Principles keep changing as individuals keep changing
    - Aggravated when interpreted by legal experts
      - Technical interpretation will not work
  - Multiple notifications and rules can apply to a particular transaction
    - Inconsistencies between Govt and RBI

- Intent matters over and above everything else
  - No hesitation by RBI in amending notifications with retrospective effect
  - Views change as you move down the corridor!
  - Hardly any institutional memory

FEMA – What it really is!

- All encompassing reach
  - But far away from business realities
  - No threshold – impacts each and everyone dealing in forex
  - Recourse to appellate options limited
  - Regulatory mentality has still not changed
  - Hardly any publicity
  - FEMA learnt more through violation than compliance

What cannot be done directly, cannot be done indirectly

Several Players

Finance Ministry	RBI	DPIIT	CCEA	Ministries	ED
Issue Notifications	Administration, reporting, receipt & payment, compounding	Industrial Policy and Approval	Approvals over specified limits	For specific approvals	Violation, Penalty, Investigation

AD Banks have own set of requirements and monitoring responsibilities

Too many players with each having a different understanding of the law

FEMA – How it operates

- Regulated by Government and RBI: Enforced by ED

- Section 3: Prohibits dealings in foreign exchange except through any person authorized to deal in foreign exchange or foreign securities (an authorised dealer, money changer, off-shore banking unit, etc.)

- Section 4: No person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India - Section 4 of FEMA

- Section 6 of FEMA:
  - Section 6(1) - Any person may sell or draw forex for a capital account transaction subject to:
  - Sections 6(2) and 6(3) gave powers to RBI to prescribe, regulate, prohibit or restrict transactions
    - Powers taken away by Govt. from RBI. Regulations now being issued by Government
      - “Non-Debt Instruments Rules” issued at present covering FDI and Immovable Property
      - Draft Overseas Non-debt Instrument Rules issued

- Section 7 of FEMA: Export of Goods and Services
- Section 8: Realisation & Repatriation of Foreign Exchange

Statutory Documents

- Foreign Exchange Management Act.
- Authorised Persons Circulars (AP-DIR Circulars)
- FEMA Notifications
- Master Directions
- Government Regulations – a new system in place

- Press Releases
- Frequently Asked Questions

- First 5 are statutory documents. The remaining 2 are informative & sometimes practical

Regulation Principles

- Regulation is based on:
- Person:
  - Whether the person is a Resident or Non-resident
- Transaction:
  - Whether it is a Current or Capital Account transaction

- FEMA does not apply:
  - Between 2 Residents – unless it's an overseas transaction
  - Between 2 non-residents – unless its for an Indian transaction
- But:
  - Foreign branches and overseas JV/WOS are still under FEMA net though fully operating outside India
  - Residents outside India – FEMA still applies
  - Citizens of certain countries – FEMA still applies even if they are Resident

NRI Regulations

Various terms for status of non-resident

- **Resident / Non-resident**
  - For Income-tax and FEMA
- **Deemed Resident**
  - New category for Indian citizens from non-taxed countries
- **Not Ordinarily Resident (NOR)**
  - This is relevant under Income-tax for exemption of foreign income
- **NRI and NR**
  - For Income-tax and FEMA
- **OCI (Overseas Citizen of India)**
  - This is different from "citizenship". It is relevant for FEMA (apart from visa etc.)
- **PIO (Person of Indian Origin)**
  - For Income-tax and FEMA
  - No fresh PIO cards are issued. Advisable to obtain OCI card. No specific relief for PIO card holders.

OCI cardholders can be PIOs.
But PIOs are not automatically OCIs.

Various terms for status of non-resident

- **Returning Indian**
  - This is relevant under FEMA and means a person who was a non-resident and has now returned to India and become an Indian resident
  - It is relevant for exemption under FEMA for foreign assets – Section 6(4)
- **Not permanently resident**
  - Relevant under FEMA for exemption from FEMA for Indian residents
- **Citizenship**
  - Relevant for some issues under FEMA and Income-tax. (Sometimes "Nationality" is used in place of citizenship.)
- **Domicile**
  - Criteria to determine liability to tax in certain countries
  - Relevant for estate duty in foreign countries.

Resident & ordinarily resident of India (R&OR) for tax

- As per Sec. 6(1)
- Number of Days test
  - Simple unlike other countries
  - Also prone to abuse with many NRIs gaming the system by staying close to 181 days

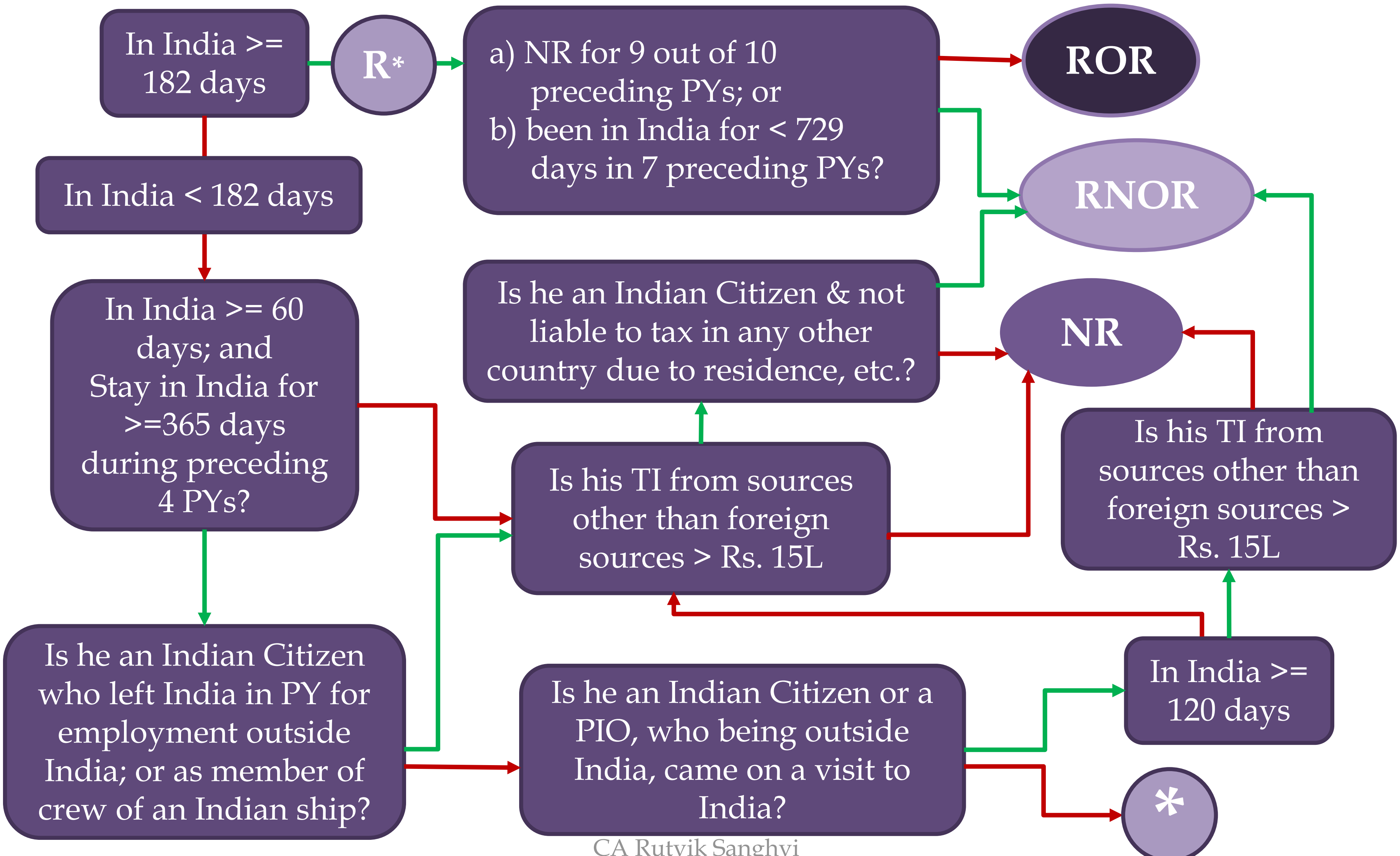
- **Erstwhile conditions:**
- Resident if:
  - In India for more than 181 days during PY - 6(1)(a)
  - In India for more than 60 days during PY **and** 365 days during preceding 4 PYs - 6(1)(c)
  - Relief provided by increasing threshold of 60 days to 181 days for:
  - Resident leaving India for the purposes of employment outside India
  - Resident Indian Citizen who has left India as member of crew on Indian ship
    - Issues for expats and sailors who continue for more than 181 days in year of departure

- **New condition applicable from 1st April 2020:**
  - 181 days relaxation now reduced to **120 days** for Indian citizens and PIOs who have total income from sources other than foreign sources of more than Rs. 15 lakhs

Deemed Resident u/s. 6(1A)

- **New sub-section introduced from 1.4.2020**
- Notwithstanding anything contained in clause (1) an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.
- Paired with introduction of new category of NOR status
- Result is deemed residents will perpetually be NORs
- Applicable only if individual remains NR even under Sec. 6(1)
  - Explanation inserted by the Taxation And Other Laws (Relaxation And Amendment Of Certain Provisions) Act, 2020

Residential Status for Individuals under Income Tax - Flow Chart



Threshold limit

- New criteria for residential status are applicable only if:
- Total income, other than the income from foreign sources, exceeds fifteen lakh rupees during PY
- "income from foreign sources" means income which accrues or arises outside India
  - And is not "deemed" to accrue or arise in India
  - Except income derived from a business controlled in or a profession set up in India

- **Circular reference:**
- Amended Explanation refers to 'total income'
- Total income as per section 2(45) takes you to section 5
- To determine scope of total income under section 5, you need to know the residential status
  - For determining inclusion of certain exempt incomes like FCNR interest, etc.
  - For determining computation of certain taxable incomes like capital gains, etc.
  - For determining incomes as per tax treaty, if applicable

RNOR Status

- Unique residential status – a gift of British Raj
- Erstwhile categories, which continue:
- RNOR means a person resident in India but who has been:
  - NR for 9 out of preceding 10 PYs; or
  - Who has spent less than 729 days in the preceding 7 PYs
- RNOR status can thus be enjoyed for a max period of 3 PYs
- These RNOR statuses available to both Indian & Foreign citizens

- **New categories, with effect from 1st April 2020:**
- RNOR also includes an Indian citizen covered u/s. 6(1) who spends more than 120 days in India and fulfils the specified conditions; and
- RNOR also includes an Indian citizen covered u/s. 6(1A) who is not liable to tax in any other country reason due to his domicile, residence, etc.

Benefit:

- Only incomes received or accrued in India taxable for RNORs
  - Incomes earned, accrued or received outside India not taxable in hands of RNOR
  - Scope of income taxable almost similar to that of NR
- However, incomes derived from a business controlled in, or a profession set up in India becomes taxable in India for RNOR

Scope of Income for RNOR under Section 5

*Income derived from Business Controlled in India or Profession Setup in India

Additional Income taxable for RNOR

- Scope of income as per Section 5(1) r.w. Proviso includes:
- Income accruing or deemed to accrue in India
- Income received or deemed to be received in India
- **Income which does accrues or arises outside India, but is "derived" from:**
  - **a business controlled in India**
  - **a profession set up in India**
- Limited increase in scope of taxable income for RNORs as compared to NRs
  - Intentional and targeted approach of Government
  - In line with the Press Release issued by Government on 2nd February 2020

Comparative table for NRs turning RNORs

Adverse Points	Beneficial Points
1. Limited increase in scope of income – income from business controlled or profession set-up in India	1. Slab rates available for senior citizens, etc., would be available to NORs.
2. Concessional tax rates under Chapter XIIA and certain other exemptions available only to and NR not to NOR	2. TDS deduction not as per Section 195 lowering rates in most cases
3. Concessional tax rates under DTAA would not be available where India is a source country and individual tie-breaks in favour of India	3. Eligible to claim Foreign Tax Credit for doubly taxed incomes
4. Presumption that control of firm, HUF, company, etc., is in India - Erin Estate v CIT 34 ITR 1 - SC	4. Availing concessional tax rates under DTAA where India is a source country and individual tie-breaks in favour of foreign jurisdiction
5. Overall reduction in years of NOR relief to Returning NRIs	5. Relaxation on reporting requirements (may not be required to file detailed ITR 2 as per extant provisions)
6. Clearly within tax compliance framework including TDS obligations, tax return filing, etc.	6. Access to India DTAA network in respect of foreign sourced incomes

Neutral Points
1. No obligation to report Foreign Assets
2. NOR to be treated as NR for determining AE relationship, and for the purposes of Section 93
3. No major changes under FEMA residential status due to change in tax residential status

Residence under treaty

- A person resident outside India and resident under the Act due to the new clauses would end up being dual resident in most cases
- In such a case, if a treaty is available between the two countries, residence for the purposes of tax treaty would be determined as per the "tie-breaker" test
- Tie-breaker test is a series of tests to determine treaty residence
- Determines residence as per treaty
  - Resident of another country as per treaty would lead that person to be a non-resident of India leading to taxation only of Indian sourced incomes
  - Scope of taxability narrower than Income-tax Act for even RNORs
  - However, compliance requirements for Residents still stand
    - Need to file tax return to claim this treaty relief
    - Need TRCs of both countries to claim dual resident status
- Documentation very important for tie-breaker test

Tie-Breaker Test

Home
- Resident of the Country where he has a **permanent home** available to him

Centre
- If he has a permanent home available to him in both countries, then
- Resident of the country with which his personal and economic relations are closer – his **centre of vital interest**

Abode
- If the country in which he has centre of vital interests cannot be determined, or he has a permanent home in both countries, then
- Resident of the country in which he has a **habitual abode**

National
- If he has habitual abode in both or neither countries, then
- Resident of the country of which he is a **national**

MAP
- If he is a national of both countries (not possible in India), then Competent Authorities will determine by **Mutual Agreement Procedure**

Tie-Breaker Test

- Permanent Home
  - Can by any type of home, even rented. Should be in his possession
  - Focus is on permanence, i.e., available for continuous stay as opposed to available only for a short or fixed duration or occasionally for example for study, holiday, business travel, etc.
- Centre of Vital Interest
  - Factual exercise to be examined as a whole
  - Important factors are family and social relations, occupations, political, cultural or other activities, place of business, etc.
- Habitual Abode
  - Means the stay of that individual in each country without referring to the reasons for such stay
  - Comparison should be over a sufficient period of time to ascertain in which country does the individual have his habitual abode
  - Intervals at which the stays take place are also relevant
- National
  - Determined based on the country of which the individual is a citizen
  - Green Card or Residency Visa is not equivalent to nationality
  - OCI Card holder is not a citizen of India

Meaning of NRI under FEMA

Meaning of NRI under FEMA

- Before Feb. 2016, NRI generally meant Indian citizen + PIO. NRI included following persons:
  - Indian citizen
  - Ex-Indian citizen
  - Person whose parent was an Indian citizen
  - Person whose grand parent was an Indian citizen
  - 3 generations
  - There were some exceptions

Meaning of NRI under FEMA

- From Feb. 2016, NRI has different meanings for different purposes.
- Non-resident **Indian citizens** are always considered as NRIs for all purposes.
- For Non-resident **Foreign citizens** to be considered as NRI, there are different criteria for different assets.
  - Criteria for Foreign citizens can be divided in following groups:
  - **Group 1:** Business & portfolio investment;
  - **Group 2:** Bank accounts, Deposits, Rupee loans to residents, rupee loans from residents under LRS, remittance under US$ 1 mn. scheme, Insurance, etc.;
  - **Group 3:** Immovable property
  - Tabulated in next slide

Meaning of NRI – Comparative Analysis

Particulars	Business and Portfolio Investment	Bank Accounts, etc.	Immovable Property
Eligible Foreign Citizens	• OCI Cardholder (up to 4th gen.) • Spouse of Indian citizen/OCI cardholder (if marriage subsisted for 2 years)	• OCI Cardholder • PIOs (upto 4th gen.) • Spouse of NRI	• PIOs (up to 3rd gen.)
Excluded Citizens	• Bangladesh • Pakistan	• Bangladesh • Pakistan	• Spouse of NRI • Bangladesh • Pakistan • Sri Lanka • Afghanistan • China • Iran • Nepal • Bhutan
Remarks	PIOs should obtain OCI card to invest in India	This is the broadest definition of NRI	

Not Permanently Resident (NPR)

- NPR 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.**

- Indian employers can remit PF etc. abroad to those who are expatriate staff, i.e. whose PF, etc., is maintained outside India by the principal employer

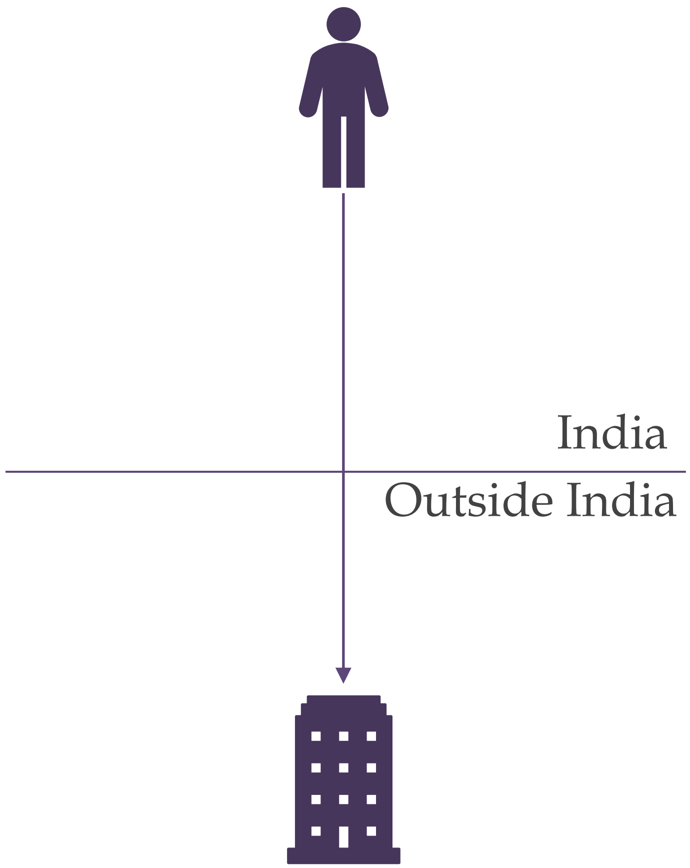
- NPR Foreign citizen can remit net salary abroad
- NPR Indian citizen on "deputation" to Indian branch, Indian subsidiary or Indian JV company of foreign company can remit net salary abroad
  - Net salary means net of Tax, PF, etc.

- Life insurance policy can be issued in foreign currency or rupees
  - Premiums to be paid from abroad or from repatriable incomes

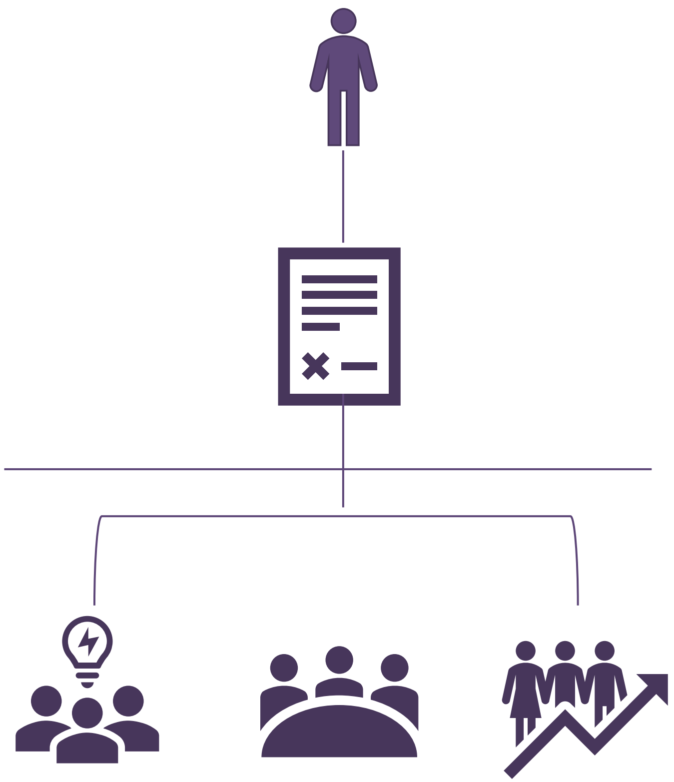
Case Study 1 - When does a person turn NRI?

- Mr. Resident wants to know his residential status for FY 2020-21.

- Issues:
  - Due to what reasons can he be considered NRI?
  - What are the safeguards he must employ before change of residence?
  - What are the implications?



Case Study 2: NRI's non-repatriable investment in India



Mr. Nirav, an NRI, wants to invest in India:

- Equity shares of a startup company engaged in retail trading
- Capital of an Indian Firm engaged in Print Media
- In an AIF

Issues:

- He fears authorities will catch him in case of defaults and hence wants to invest through his foreign company.
- Can he do so?
- How can he exit in future?

Case Study 2 – Analysis of NRI's Non-repatriable investment

- **Schedule IV of Foreign Exchange Management Non-Debt Instruments (NDI) Rules (earlier FEMA Notification no. 20(R)):**
- Brings NRI investment on par with domestic investment

- NRI can invest directly, or through his foreign SPV - company, trust or firm
  - Firm should include LLP, LP

- The SPV should be <u>owned and controlled</u> by NRIs.
  - Owned and controlled defined in Regn. 14 of FEMA 20 for Companies & LLPs

  - **No definition for firm and trust**

- OCB concept has been re-introduced - in a more liberal manner
  - Possibility of misuse

Case Study 2 – Analysis of NRI's Non-repatriable investment

- Investment can be in equity instruments, equity-oriented MF units, capital of LLP without any limit
- Investment can be in units of Investment vehicle (old VCF, AIF, REITs, InvIts)
- Investment can be in convertible notes issued by startups
- Investment in the company and Investment Vehicle can be direct or through stock market
  - Portfolio investment scheme **on non-repatriable basis** abolished

- Investment can also be in capital of Firm or Proprietory concern

Case Study 2 – Analysis of NRI's Non-repatriable investment

- Investment considered at part with domestic investment – hence investee entity can do any business in India allowed to residents

- Only restrictions are no investment in
  - Nidhi
  - Agricultural / plantation
  - Real estate business
  - Construction of farm houses
  - Trading in TDRs
  - For Firms and Proprietory concerns - **print media**

- Real estate leasing, retail trading is permitted.

Case Study 2 – Analysis of NRI's Non-repatriable investment

- No lock-in period
- No filing of any documents
  - However details to be given to bank
- No valuation norms
  - However take care of S. 56 of Income-tax Act
- No limit for portfolio investment

Investment on non-repatriable basis by NRIs - Transfers

- Is transfer by way of sale from NRI/OCI/SPV to Non-resident permitted?
  - Yes, subject to sectoral caps, pricing guidelines and other conditions
    - If sale made to NRI/OCI/SPV under Schedule 4 then no conditions applicable
    - Reg. 13(2) permits transfer from NR to NR.

- Is transfer by way of gift from NRI/OCI/SPV to Non-resident permitted?
  - Yes, to another NR relative with prior approval of RBI and subject to conditions as per Reg. 13(3)
  - Yes, to another NRI/OCI/SPV without any conditions if investment made on non-repatriation basis as per Reg. 10(6)

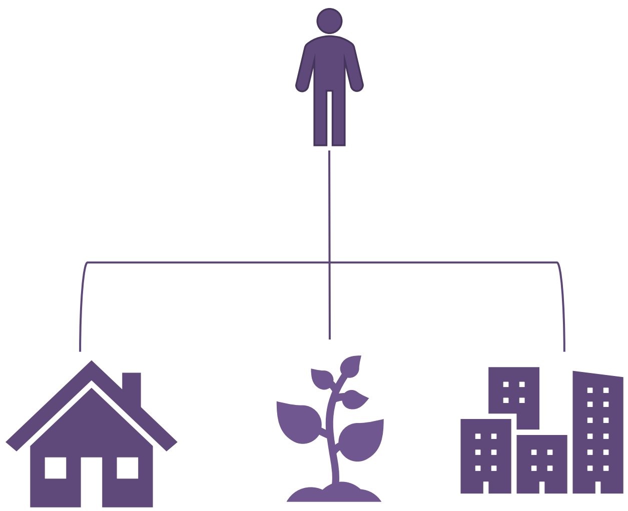
Investment on non-repatriable basis by NRIs – Sale proceeds

- Sale proceeds should be credited to NRO account

- US$ 1 mn. scheme for repatriation available?
  - NRI can transfer sale proceeds of his investment outside India under the US$ 1 Million Scheme freely
  - Incomes freely repatriable within the limit
  - However, SPV not entitled to US$ 1 mn. Scheme as **scheme is only for Individuals**
    - SPV can transfer funds to NRI as distribution
    - NRI can then remit under US$ 1 mn. scheme.
    - Consider tax implications on distribution

Case Study 3: NRI's incomes from immovable properties and repatriation on transfer

- Mr. NRI wants to do the following:
  1. Sell 3 house properties and remit capital gains abroad.
  2. Sell 3 plots of lands and invest in a new agricultural plot of land.
  3. Lease out 10 flats and earn rental income.



- Issues:
  - Leasing of multiple properties possible?
  - Tax on rental incomes for NRIs
  - Sale of properties and earning of capital gains

Analysis of Case Study 3

- **On sale of house properties**
- Income-tax:
  - Income taxable in India as property situated in India:
  - If held for more than 24 months: 20% with indexation
  - Computation of Capital Gains similar to that for residents
  - Credit of tax paid in India should be available in Foreign Countries
    - If not available, avail deductions to reduce tax outgo
  - TDS on sale of property only on amount of gains, not full sale consideration. Details in next slide

- FEMA:
  - Repatriation allowed NOT only of cost BUT ALSO gain.
    - Earlier only cost was allowed
  - Repatriation of only 2 residential properties allowed
    - Controversy whether limit is annual or life-time
  - Tax needs to be paid before repatriation

Analysis of Case Study 3

TDS on sale of property

- Deduction on gross amount or capital gain?
  - Section 195(1) says "**income**"
  - Deduction on Capital Gains
    - Shri Bhagwandas Nagla ITA No. 143/Hyd/2017
- Documents required to correctly compute gain
  - Purchase & Sale Deeds
  - Valuation Report
  - Detailed Application & Representation
  - If deduction to be claimed
    - Indemnity for investment in bonds
    - Purchase Agreement / Capital Gain Account Scheme if deduction to be claimed against purchase of new property
  - PAN Card and Passport
  - Tax Returns

- Can CA give certificate?

Analysis of Case Study 3

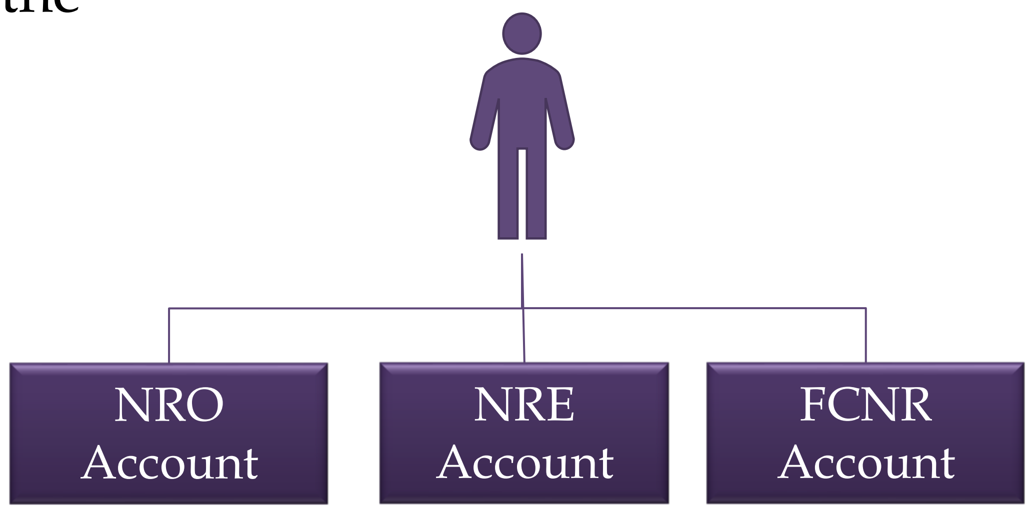
- **On sale and purchase of plots of lands**
- FEMA:
  - Investment in agricultural land not allowed – Master Direction 12 – Acquisition and Transfer of IP under FEMA – Part II – Reg. 3.1
    - Person turning non-resident can continue holding agricultural land but needs to stop agricultural activities.
    - Investment in non-agricultural land allowed
  - Sale of multiple plots of lands:
    - Business in real estate is prohibited. Trading in land would be considered Real Estate Business – Master Direction 11 – Foreign Investment in India – Reg. 2.20
- Income-tax implications on sale of NA land similar to that on sale of house properties
  - Capital gains on sale of Agricultural land exempt if conditions met – thorough checking now

Analysis of Case Study 3

- **On lease of house properties**
- Income-tax:
- Rent earned taxable as Income from House Property
  - Flat deduction of 30% and interest on loans available
  - Tax paid in India should be available as tax credit in country of residence
    - Full tax credit available even though effectively on 70% income taxed in India
  - TDS needs to be deducted @ 30% on gross amount by payer unless ITO/CA Certificate available.
- FEMA:
  - Renting of property would not amount to Real Estate Business – Explanation (b) to definition in Schedule 1 to NDI Rules
  - Any number of properties now allowed to be leased
    - However, care should be taken that it is not considered as business in real estate

Case Study 4: NRI's interest incomes

- Mr. NRI has funds lying in the following:
  1. NRO Account
  2. NRE Account deposits
  3. FCNR Fixed Deposits



- Issues:
  - What are the tax implications of interest income earned on these deposits
  - What happens if residential status changes during term of deposit?
  - Can he gift a large balance to his resident father in India and his NRI brother in USA?

Analysis of Case Study 4

- Tax in India on interest income earned from:

Type of Account	Taxability of Interest	Currency Denomination	Exemption allowed for
NRO Account	Taxable as per normal provisions	INR	NA
NRE Account	Exempt u/s. 10(4)(ii)	INR	NR as per FEMA
FCNR Deposit	Exempt u/s. 10(15)(iv)(fa)	Foreign Currency	NR or NOR as per ITA

- TDS on taxable interest income can be capped to DTAA Rate
  - TRC of Country of Residence required
- Need to be careful in case of change of residential status
  - NRO and NRE accounts need to be changed to Resident Ordinary accounts on date of change of status
  - FCNR deposits can continue till maturity but will be treated as resident accounts

Comparative chart for NRO, NRE and FCNR Accounts

Point of Difference	NRO Account	NRE Account	FCNR Deposits
Full Form	Non-resident (Ordinary) Account	Non-resident (External) Account	Foreign Currency Non-Repatriable account Deposits
Repatriability	Not freely repatriable except incomes	Freely repatriable	Freely repatriable
Type of Account	It can be – i. Savings Account; ii. Current Account; iii. Recurring Deposit; iv. Fixed Deposit	It can be – i. Savings Account; ii. Current Account; iii. Recurring Deposit; iv. Fixed Deposit	It is a Fixed Deposit account
Currency of Account	INR	INR	£ / $ / € / ¥ / AUD / CAD
Taxability of Interest earned in such account	Taxable	Exempt u/s 10(4)(ii) of for NRs under **FEMA**	Exempt u/s. 10(15)(iv)(fa) for NRs and NOR under **Tax**

Comparative chart for NRO, NRE and FCNR Accounts

<table>
<tr><th>Point of Difference</th><th>NRO Account</th><th>NRE Account</th><th>FCNR Deposits</th></tr>
<tr><td>Major Permissible Credits</td><td>• Remittance from Outside India (through bank)
• Permitted currency tendered during temporary visit
• Transfer from Rupee a/c. of NR banks
• Legitimate dues in India
• Transfer from other NRO Accounts
• Any amount recd. in accordance with FEMA</td><td colspan="2">• Remittance in permitted Foreign Currency
• Proceeds of personal cheques, bank drafts, travellers' cheques, foreign currency or bank notes tendered during his temporary visit in India
• Transfer from other NRE/FCNR accounts
• Interest on the funds held in the account
• Current income subject to taxes
• Maturity, sale proceeds of eligible inv., refund of application money in securities or IPs of investment made out of the NRE/FCNR a/c or funds were remitted from outside India
• Any amount recd. in accordance with general or special permission of the RBI</td></tr>
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Comparative chart for NRO, NRE and FCNR Accounts

Point of Difference	NRO Account	NRE Account	FCNR Deposits
Major Permissible Debits	• Local payments • Eligible investments • Current Incomes net of taxes • Transfer to other NROs • Settlement of charges on Intl. Credit Cards subject to limit provided in Remittance of Assets regulations	• Local disbursements • Remittances outside India • Transfer to NRE/FCNR of self or other person eligible to hold such account • For making eligible investments including investment in IPs • Any other transaction permitted generally or specially by the RBI	

Specific Issues with respect to NRO, NRE and FCNR Deposits

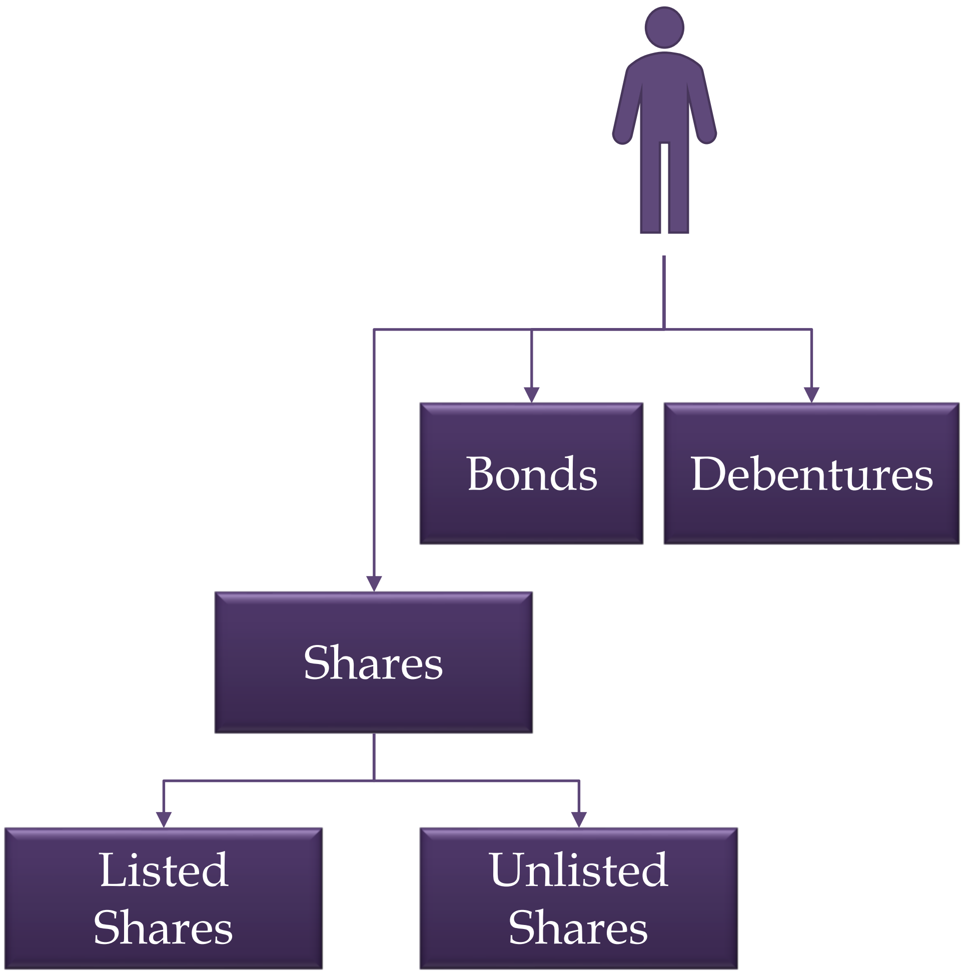
- **Gift of funds to residents**
  - Practically no limits
  - However, has to be reasonable
  - Tax investigations where amounts are large and frequent
  - Proper documentation required regarding:
    - Source
    - KYC
    - Bank records

- **Can funds be gifted by one NRI to another NRI?**
- Gifts from NRE to NRE account is allowed
  - Regn. 4(c) of Schedule 1 to Notfn. No. 5(R) – Deposit Regn. 2016

- Gifts from NRO to NRO account now allowed
  - However, **such amount cannot be remitted under $1M Scheme**
- Gifts from NRO to NRE account not allowed
  - Not a permissible debit under NRO account scheme
- Gifts from NRE to NRO account not permitted
  - Not a permissible debit under NRE account scheme

Case Study 5: NRI's incomes from securities

- Mr. NRI has invested in the following:
  1. Listed Shares
  2. IRFCL Bonds
  3. Unlisted Shares
  4. Debentures



- Issues:
  - What are the tax implications of capital gains earned on sale of these securities?
  - What are the implications for dividends earned on shares?

Analysis of Case Study 5

Type of Security	Listed Shares	Unlisted Shares	Bonds	Debentures
Period of holding for Long-term	12 months	24 months	**Listed –** 12 m **Unlisted –** 36 m	**Listed –** 12 m **Unlisted –** 36 m

- Tax rates on Long-term Capital Gains:

Listed Shares	Unlisted Shares	Listed Bonds	Unlisted Bonds	Listed Debentures	Unlisted Debentures
Till 31.03.18– Exempt From 01.04.18 @10% without Forex Fluctuation Adjustment (FFA) or Indexation	Taxable @10% without FFA or Indexation	Effective rate @ 10% without indexation	Taxable @10% without indexation or FFA	Taxable @10% **with** FFA	Taxable @10% without FFA or indexation
TDS - nil till 31.03.18; @10% from 01.04.18	**TDS @20%**	**TDS @20%**	TDS @10%	**TDS @20%**	TDS @10%

- STCG on listed shares @15% - S. 111A
- STCG on others at normal slab rates

Analysis of Case Study 5

- Capital Gains as part of total income
  - Relief for basic amount not chargeable to tax not available
  - No deductions allowed
  - No rebates allowed

- Taxability of dividends
  - Exempt from tax under Section 10(34) up to 31st March 2020
    - Tax of 10% over Rs. 10 lakhs u/s. 115BBDA only for residents
  - Tax directly in hands of NRI shareholder from 1st April 2020
    - 20% tax rate
    - Non-resident can claim lower tax rate under applicable DTAA
      - TRC will be required to claim tax relief

- Repatriation under FEMA
  - Sale proceeds of securities allowed to be remitted under 1 Million Dollar Scheme
  - Dividends are current account transactions and freely repatriable without any limit
  - Tax on gains and dividends have to be paid before remittance is allowed

Investment in Debt Instruments under FEMA

- Regulated by Foreign Exchange Management (Debt Instruments) Regulations, 2019
- Administered by RBI

- NRI / OCI can purchase/subscribe to the following on Repatriation basis:
- a. Government dated securities (other than bearer securities) or treasury bills or units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity;
- b. Bonds issued by a Public Sector Undertaking (PSU) in India;
- c. Bonds issued by Infrastructure Debt Funds;
- d. Listed non-convertible/ redeemable preference shares or debentures issued in terms of Regulation 6 of these Regulations;
- e. Debt instruments issued by banks, eligible for inclusion in regulatory capital.
- f. National Pension System governed and administered by Pension Fund Regulatory and Development Authority (PFRDA), provided such person is eligible to invest as per the provisions of the PFRDA Act. The annuity/ accumulated saving will be repatriable:

- No limit to investment
- Shall be paid out of inward remittances from abroad through banking channels or out of funds held in NRE/ FCNR(B) account except for subscriptions to National Pension System which can be out of funds held in NRO account too

Investment in Debt Instruments under FEMA

- NRI/OCI may sell/ redeem the instruments subject to such terms and conditions as may be specified by the RBI and the SEBI
- The net sale/ maturity proceeds (net of taxes) of instruments held by NRIs or OCIs, may be:
  - Remitted abroad or at the NRI/ OCI investor's option, credited to his NRE/ FCNR(B)/ NRO account, where the instruments were purchased on repatriation basis;
  - Credited to the NRO account person concerned where the payment for the purchase of the instruments sold was made out of funds held in NRO account; or
  - Credited to the NRO account person concerned where the instruments were held on non-repatriation basis

Computation of Capital Gains for non-residents

- Full value of consideration received on transfer is to be reduced by the expenditure on transfer and the cost of acquisition or improvement – Section 48
- Forex Fluctuation Adjustment (FFA) – 1st proviso, Sec. 48
  - Capital gains for shares or debentures shall be computed by converting the amount of sale consideration into the same foreign currency as was used at the time of purchase

Sr. No.	Particulars	In Rupees	Forex Rate @	In USD
a.	Cost	45,000	Rs. 45/$	1,000
b.	Sale consideration	60,000	Rs. 60/$	1,000
c.	Gain in respective currency (b – a)	15,000		Nil
d.	Taxable gain on account of application of FFA	Nil		

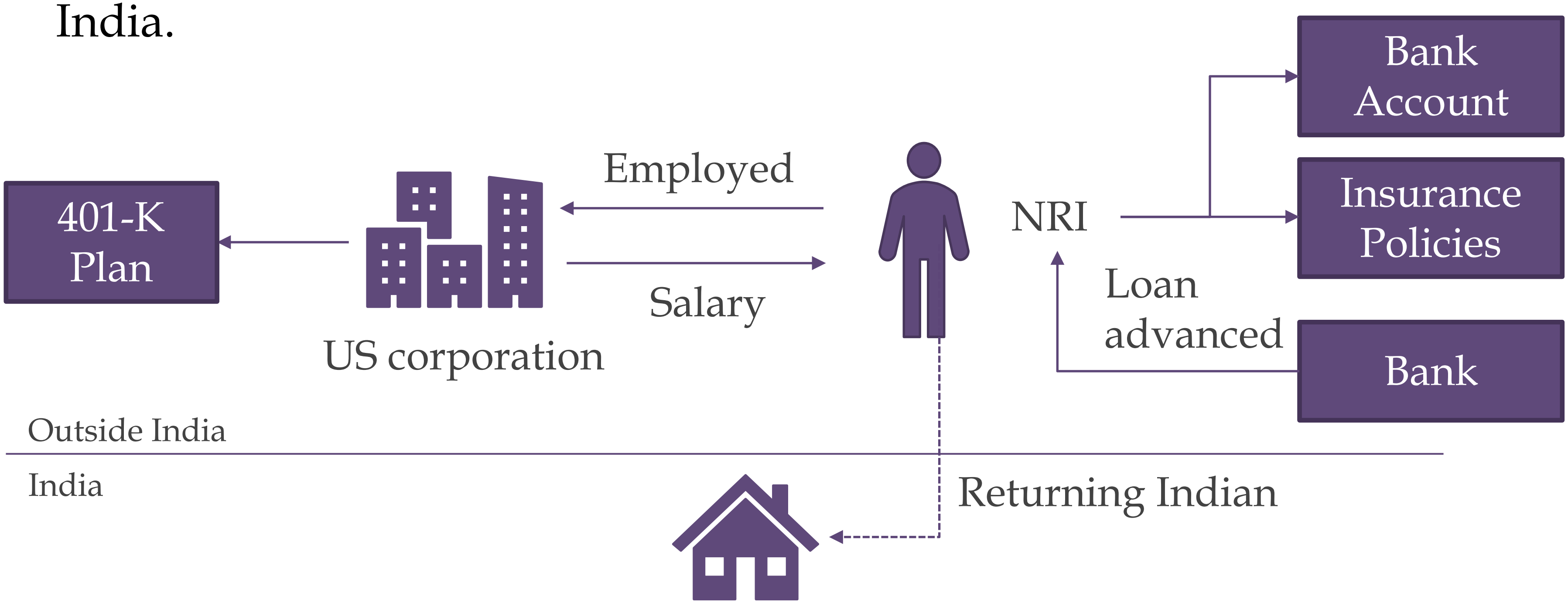
Chapter XIIA – Special provisions for NRIs

- Most provisions of Chapter XIIA are now not beneficial
- Only benefit is for long-term gains earned on listed securities
  - Other than units
  - Which are not exempt under Sec10(38) till 31.03.18 or covered under Section 112A from 1.04.18
  - As per Section 112(1)(c)(ii) such gains are taxable at 20%
  - But under Section 115E of Chapter XIIA gains are taxable @ 10%
- Dividends earned from 1.4.2020 which are liable to tax @20% - no benefit under this Chapter

Assets covered	Incomes covered	Tax rate
'Specified assets' if purchased, acquired or subscribed to in convertible foreign exchange: a. Shares in an Indian company; b. Debentures in or deposits with an Indian company which is not a private company; and c. Specified Government securities.	a. Investment income which is defined as income derived from the specified assets, but excluding dividends referred to in Section 115-O	20%
	b. Long-term capital gains	10%

Case Study 6: Returning Indian

- An NRI wants to return to India. He is having employment outside India and receives salary. Certain amount is being contributed to Pension Plan also. He has taken life insurance policies. He has also taken some loan from the bank.
- **Issue:** FEMA and Income-tax implications on returning back to India.



Analysis of Case Study 6 – Returning Indian

Income-tax Issues

- Incomes earned abroad need to be offered for tax in India after he turns R&OR
  - Check residential status as per relevant DTAA
    - Tie-breaker test to be checked
- Salary income generally taxable in country where services rendered under DTAA
- PF Accounts (401-K)
  - Income credited to PF Account – Taxable in India in same year
  - On withdrawal of Capital on seniority – Capital not taxable
  - Issue of Foreign Tax Credit for taxes paid in USA on withdrawal while incomes offered to tax every year
  - Disclosures required in Schedule FA of investments made under 401-K plan
- Joint Returns filed
  - Proper division of income
  - Issue of Foreign Tax Credit

Analysis of Case Study 6 – Returning Indian

FEMA Issues

- FEMA permits Returning Indian to retain foreign assets abroad and continue foreign businesses subject to conditions
- Indian assets will become "Non-repatriable"
- NRE Account to be converted to resident account
  - Transfer can be made to RFC Account
- Life Insurance policies taken from abroad
  - Can be continued
  - Premiums to be paid from foreign account, RFC account or LRS
- Repayment of foreign loans
  - Law not clear
  - No objection from RBI if payment from foreign or other remittable funds

Way Forward

- Several relaxations under FEMA for NRIs
- However, not many tax reliefs for NRIs now
- Residential status now a challenge
- More and more scrutiny of NRIs
  - Documents need to be maintained for source on return to India
- Care needs to be taken in relation to change of residence
- NRI status cannot be misused
  - GAAR – AO has power to ignore change of residence

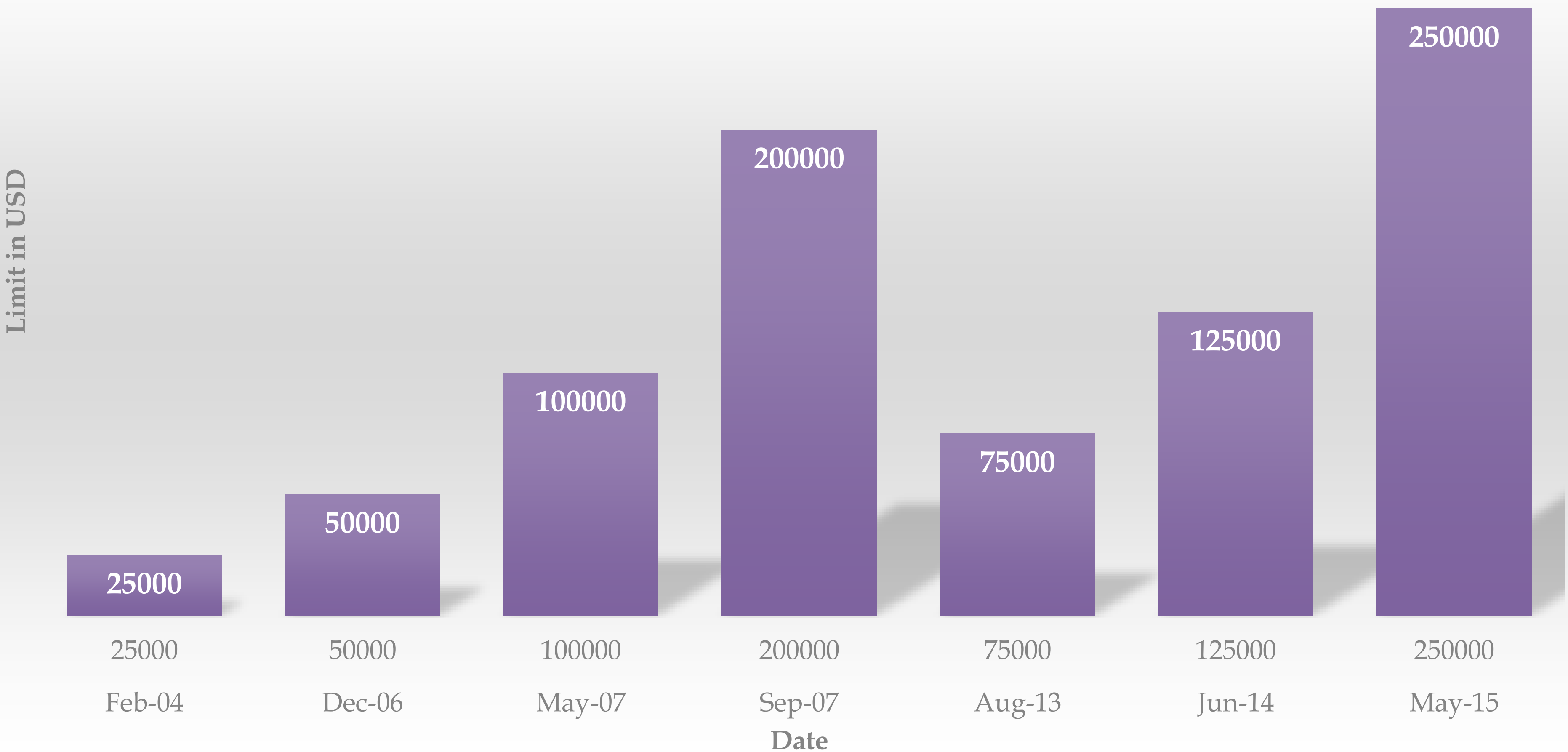
Liberalised Remittance Scheme

Liberalised Remittance Scheme

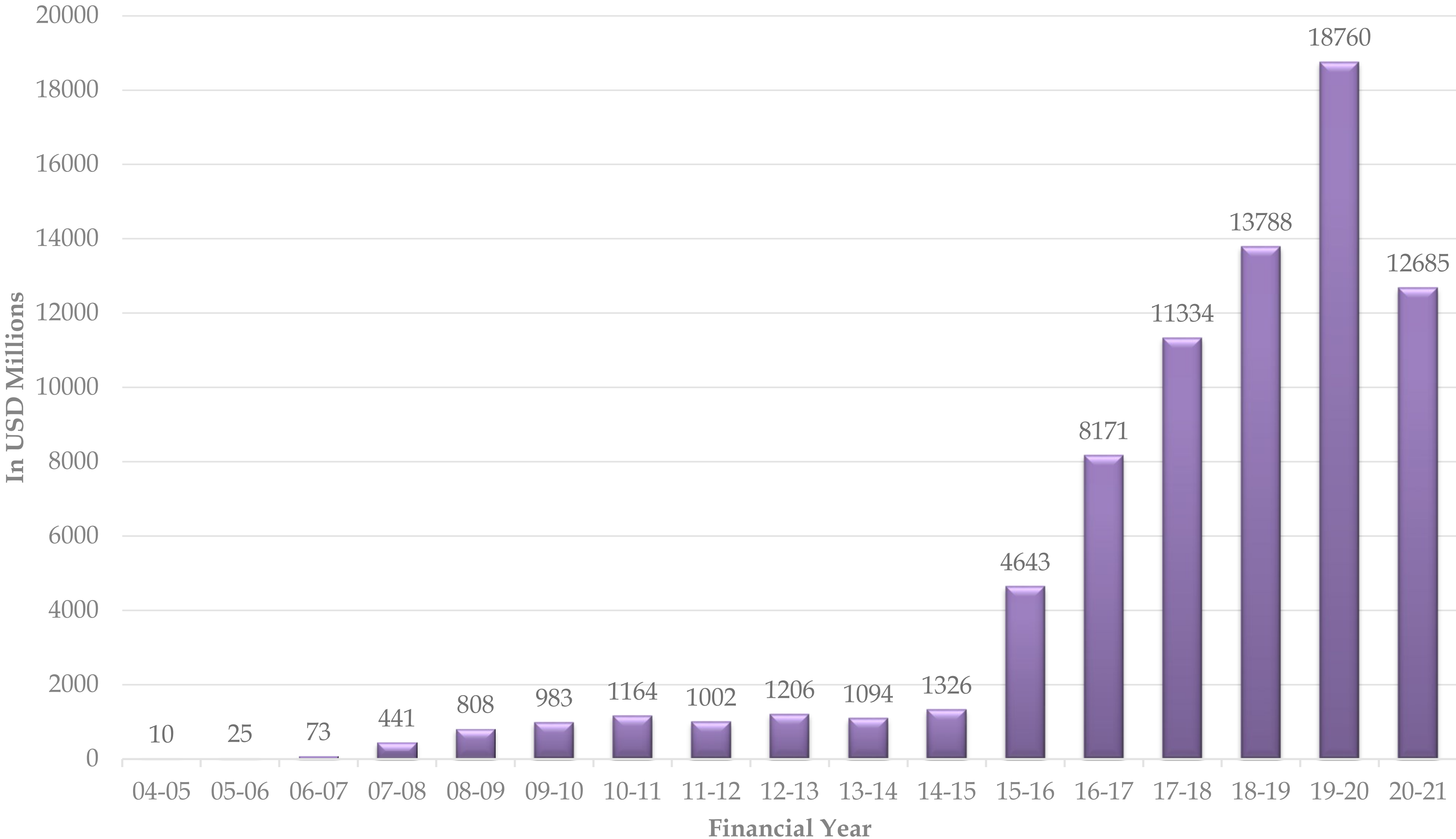
- LRS limit brought in as a relief to all Indian Residents to remit money outside India
- Available to all Resident Individuals including minors
  - Not available to corporates, partnership firms, HUF, Trusts etc.??
- All earlier facilities for release of exchange or for remittances for current account transactions under Para 1 of Schedule III are subsumed under the overall limit of USD 250,000 – no separate limits for gifts, donations, etc.,

- Up to USD 250,000 per financial year can be remitted
  - Introduced on February 4, 2004, with a limit of USD 25,000
  - Limit has increased over the years but is subject to forex position with RBI

LRS Limit over the years



Remittances under LRS over the years



LRS - Prohibitions

- LRS prohibited:
  - For remittance to FATF identified countries as "non co-operative"
    - Presently only Iran and North Korea
    - Prohibition for remittance to Mauritius, Pakistan, Nepal, Bhutan removed though FAQs silent about capital account transactions
  - For any purpose specifically prohibited under Schedule-I (like purchase of lottery tickets/sweep stakes, proscribed magazines, etc.) or any restricted items
  - For remittance from India for margins or margin calls to overseas exchanges / overseas counterparty
  - For remittance for trading in foreign exchange abroad.
  - For remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism
  - For purchase of FCCBs issued by Indian companies in the overseas secondary market

LRS Prohibitions contd…

- **Remittance must be out of funds belonging to remitter**
  - Gifts received can be remitted
    - Once money clearly under title of remitter no prohibition in sending funds

  - Cannot be out of loaned funds for capital account transactions
    - Master Direction - Banks prohibited from providing credit facilities to facilitate *capital account* remittances under LRS Scheme
    - FAQ 16 – Credit facilities allowed for Current Account transactions

Difference between Current and Capital Account Transactions

- Capital Account transaction means a transaction which alters
  - Assets or liabilities including contingent liabilities outside India for persons resident in India
  - Assets of liabilities in India of persons resident outside India
- Transactions other than Capital Account transactions are Current Account Transactions

- Current Account transactions freely allowed unless restricted
- Capital Account transactions prohibited unless specifically allowed

- Distinction to be viewed from the perspective of India's Current Account position
  - Accounting terminology not to be used
    - Not exactly classified as revenue and capital in nature
  - Will the transaction have a lasting impact on India's foreign assets and liabilities position internationally or get squared off?

Difference between Current and Capital Account Transactions

- Illustrations:

Current Account	Capital Account
Machinery imported on normal credit terms	Machinery imported on instalment basis or EMI
Payment of Guarantee Fee to non-resident	Guarantee provided by a Resident outside India
Foreign house rental payments	Purchase of foreign Immovable property
Gold imported into India	Gold purchased and kept in locker abroad
Interest payments	Loans taken abroad

Pre-LRS position

- Current Account Transactions (CAT) Rules under Schedule I prohibited and Schedule II allowed only with prior approval of Government
- Current Account Transactions under Schedule III allowed only with Government Permission
- Other than above transactions, **no restriction or limit** on any Current Account Transaction
- **CAT Rules sought to provide restrictions on only certain transactions**

- All Capital Account transactions restricted
- Allowed only as specified under Notifications issued by RBI under Section 6 of FEMA, now by Government directly
- **LRS sought to provide relief from these restrictions up to LRS Limit**

- Now both restrictions on Current Account Transactions and relief for Capital Account Transactions covered under LRS
  - Leads to confusion and incorrect application of Indian's clear position on Full Current Account Convertibility

LRS - "Current" Account Transactions

- LRS specifies **"permissible"** current account transactions
  - (i) Private visits to any country (except Nepal and Bhutan).
  - (ii) Gift or donation.
  - (iii) Going abroad for employment.
  - (v) Maintenance of close relatives abroad.
  - (vi) Travel for business or attending a conference or specialised training; or for meeting expenses for meeting medical expenses, or check-up abroad; or for accompanying as 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**

LRS - "Current" Account Transactions

- Prior Approval needed from RBI for remittance beyond LRS limit for specified current account transactions
  - Possible if circumstances warrant need for enhanced remittance
  - Approval not required for Emigration, Medical Treatment and Studies abroad
    - Can be supported by self-declaration
    - Banks might ask for more documentation
- Limits for Gifts and Donations subsumed under LRS limit
  - Gift of funds by one resident to another resident outside India not allowed
  - Gift of shares limited to USD 50,000
- **Any gift made to a resident outside India needs to be brought back to India**
  - Shares allowed to be retained abroad
    - Prone to abuse - intention is to cover portfolio shares –

LRS - "Capital" Account Transactions

- Opening of **foreign currency account** abroad with a bank;
- Purchase of **property** abroad
- Making **investments abroad-** acquisition and holding shares of both listed and unlisted overseas company or debt instruments;
- Acquisition of **qualification shares** of an overseas company for holding the post of Director;
- Acquisition of **shares of a foreign company** towards professional services rendered or in lieu of Director's remuneration;
- Investment in **units** of Mutual Funds, Venture Capital Funds, unrated debt securities, promissory notes;
- **Extending loans** including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined in Companies Act, 2013.

LRS - "Capital" Account Transactions

- Capital Account transactions other than those specifically permitted are not allowed:
  - Asset purchase outside India is not allowed unless imported into India
    - Gold
    - Art
  - Long-term lease tantamount to purchase of asset also covered
  - Guarantees
  - "Property" mentioned in CAT Rules does not mean all assets
    - Intention is to cover only immovable property

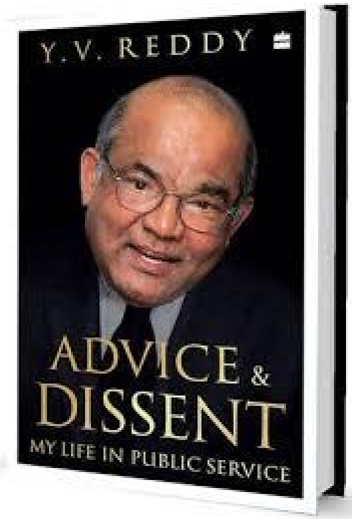
Liberalised Remittance Scheme – Flip Flop Policy

- LRS when introduced was with clear objective to allow Resident Individuals to remit funds within LRS limit for "**<u>any purpose</u>**":
- For any Current Account Transaction; or
- For any Capital Account Transaction; or
- For a combination of both!

- Funds up to the limit would be partial capital account convertibility
  - Can be used to purchase **<u>any asset</u>** outside India without approval of RBI
- Limit of LRS was in addition to limit under Schedule III

Liberalised Remittance Scheme – Flip Flop Policy

- Famous Quotes:
- RBI Deputy Governor: "We are flush with funds. Use LRS for any purpose – you can as well throw the remitted funds from the Alps."
  - In 2004 forex reserves were around USD 100 Billion
- RBI Governor Dr. Y V Reddy in his book "Advice & Dissent" quotes Mr. Jaswant Singh, then FM:
- "Go and conquer the world, we will be your supporters."
- **"This is a no-questions asked window and was in addition to all the existing facilities."**
- "The oppressive forex regime that had haunted individuals in India since 1957 was put to an end on 19 February 2004"



Liberalised Remittance Scheme – Flip Flop Policy

- Drastic change in position brought in from May 2007
- LRS can be used to remit for any 'permissible' current or capital account transaction or a combination of both
  - **No guidance on what is 'permissible' transaction in 2007**
  - Paradoxical situation as LRS was introduced to allow transactions which required prior approval!

- Permissible capital account transactions under LRS specified only in 2015 as:
  - Opening of foreign currency account abroad with a bank;
  - Purchase of property abroad;
  - Making investments abroad;
  - Setting up Wholly owned subsidiaries and Joint Ventures abroad;
  - Extending loans including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined in Companies Act, 2013.

Liberalised Remittance Scheme - Issues

- Are all Current account transactions covered under LRS limit?
- Clause (ix) of Para 1 Schedule III covers "any other current account transactions"
  - Limitation placed unfairly on all CATs.

- Problem is compounded by fourth proviso which states "person other than individual may also avail forex facility within LRS limit" for CATs!!
  - Worded as if providing a relief, when in fact it becomes a restriction
  - Problems created by mixing up CAT rules with relief from Capital Account transactions

- For example, Co. ABC makes remittance towards royalties of USD 5,00,000.
  - Will such remittance made towards current account transactions be covered under LRS limit?
- **Current Account Transactions have no limits unless prescribed – Section 5 of FEMA**

Liberalised Remittance Scheme - Issues

- Can assets be kept outside India?
  - What about inheritance?
  - What about change of residence?

- Does income have to be remitted back to India?
  - Income and sum remitted need not be brought back into India and can be reinvested overseas
  - However, position different for LRS-ODI

- Purpose code for remittance has now become important
  - Can purpose of remittance be changed later on?

Investment through IFSC

- RBI allows resident individuals to make remittances under LRS to IFSCs in India from 16th February 2021

- Remittance to be made only for making investments in securities other than those issued by entities/companies resident in India.

- Resident Individuals may 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 shall be immediately repatriated to domestic INR account of the investor in India.

- Resident Individuals shall not settle any domestic transactions with other residents through these FCAs held in IFSC.

TCS on LRS

- New provision introduced for TCS on LRS from 1st October 2020
- 5% TCS from remittance above 7 lakhs in a FY
  - Roughly 9,000 USD at current rates
  - Limit applicable from 1st April 2020, collection only for amount sent after 1st October 2020
  - All remittances included except those to Foreign Tour Operator
- Grossing up needed for making exact payments towards invoices, fees, etc.
- Reduced rate of 0.5% for remittance from borrowed funds towards education
- Separate TCS of 5% on remittance to Foreign Tour Operator
  - No threshold limit
- TCS provisions are for obtaining information and not tax collection as remittances are towards expenses
  - LRS remittances can happen only through banks with PAN
  - Daily information is provided by Bank to RBI

Overseas Direct Investment by Resident Individuals under LRS

Investment by Resident Individuals – LRS-ODI

- Resident Individuals - allowed to form JV/WOS outside India under LRS-ODI from 5th August 2013
  - Resolution of arbitrary change in LRS Scheme – incomplete and only prospective
  - Notification No. FEMA. 263/RB-2013
- Investment limited to LRS limit - USD 2,50,000 per Financial Year
  - Includes investment from balances in EEFC and RFC Accounts
- Investment can be made singly or in association with other Resident Individuals or with Indian Party
- Only for bonafide business outside India

Investment by Resident Individuals – Restrictions

- Investment only in equity or compulsorily convertible preference **shares**
  - **No other instruments allowed**
- **No guarantees allowed**
- Investment only in operating entity
- No step-down subsidiary is allowed
  - Effectively no SPV can be created
- No pledge of shares allowed
- No non-cash remittances allowed
- Charge on domestic or foreign assets not allowed
- Write-offs not allowed

- Above restrictions make LRS-ODI useless for many businesses

LRS-ODI by Resident Individuals – Restrictions

- Prohibited to invest in a JV / WOS which is engaged in
  - Real estate business; or
  - Banking business; or
  - Financial services activity
    - Business of holding portfolio shares covered as 'financial services activity'?
- Cannot invest in countries identified as "non-cooperative countries and territories" by FATF
- Resident individual should not be on Reserve Bank's Exporters Caution List or List of defaulters to the banking system or under investigation by any investigation/enforcement agency or regulatory body

Mode of investment and Valuation

- Investment needs to be through banking route
  - Use of credit cards or cash withdrawals to open companies outside a violation of FEMA
  - Gifting of shares by relatives or non-relatives may not strictly fall within RBI intent – better to go through LRS-ODI Route
    - What cannot be done directly, cannot be done indirectly

- Valuation to be done by Category I Merchant Banker registered with SEBI or a registered Investment Banker / Merchant Banker in host country if investment is more than USD 5 cr.
  - In all other cases by a CA or CPA

Investment by Resident Individuals – Reporting & Disinvestment

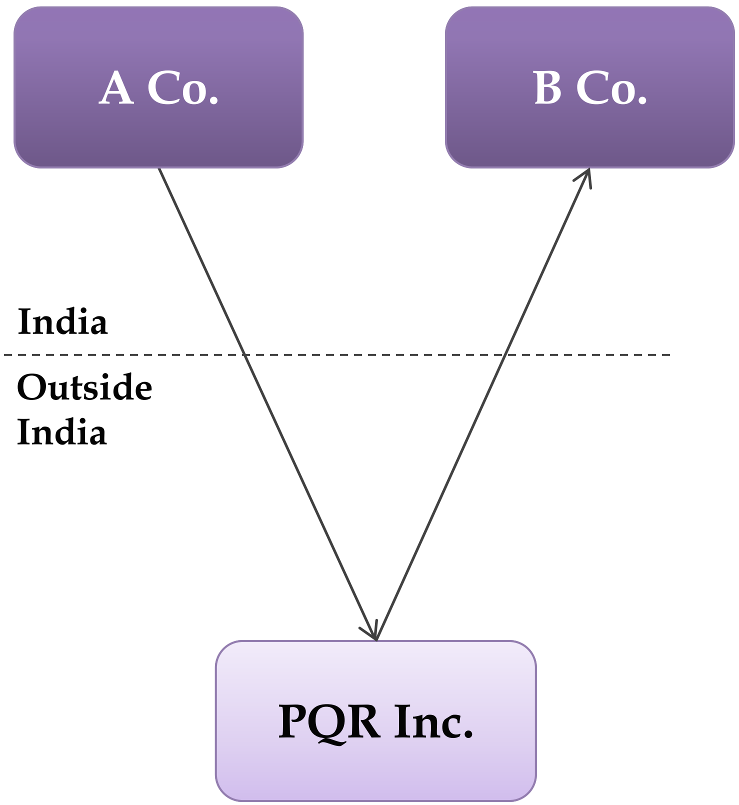
- Duly completed Part I of the Form ODI to be filed within 30 days of remittance
- APR Form to be filed annually
  - FLA not required
- Alteration in shareholding pattern to be reported within 30 days

- Disinvestment allowed only after one year from the date of first remittance
- Disinvestment proceeds to be repatriated to India immediately and in any case not later than 60 days
- No write off shall be allowed
- Disinvestment may be reported by the designated AD to the Reserve Bank in Part IV of Form ODI within 30 days of receipt of proceeds

- What happens in case of change of residence?
  - No clarity in law
  - Technically investment covered under FEMA, thought investor is not

Round Tripping

Round Tripping

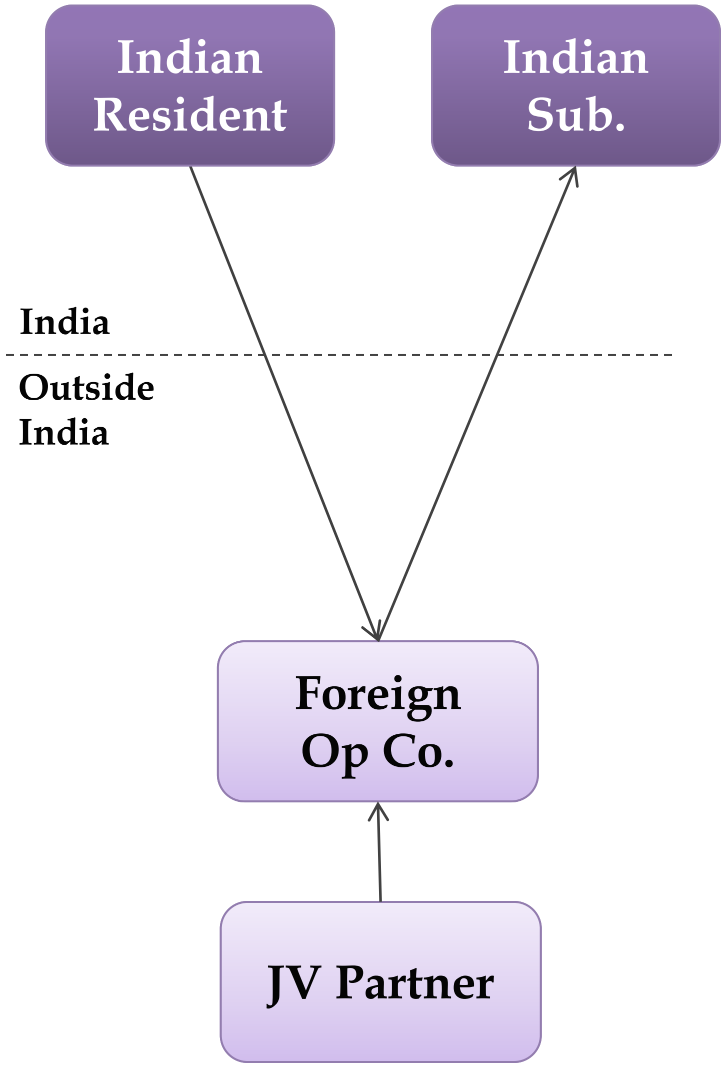


- Not defined - refers to overseas investment by Indian resident which results in investment back in to India
- Harmful practice if undertaken to evade tax
- Nothing stated in FEMA prohibiting Round Tripping
  - However not allowed in practice

Round Tripping

- Can be in various forms:
  - By sending funds abroad which are used to invest back in India
  - By Indian Resident controlling or owning JV/WOS which invests in India
- Prior RBI Approval required if ODI investment results in Round Tripping
  - Approval provided in genuine cases
  - FAQ 64
- Proposed GAAR provisions under Income-tax Act, 1961 provide that an arrangement shall be deemed to lack commercial substance if it involves round trip financing
- Revised SEBI Guidelines for Offshore Derivative Instruments make stringent rules for Offshore Derivative Instruments

Round Tripping – Segregation of funds and business need



- Indian Resident investing under LRS-ODI in JV abroad
- Foreign Co. in Software services
- Foreign Co. invests in Indian Sub. to function as captive BPO

- Indian funds remitted abroad cannot come in as foreign investment
- JV Partner's funds can be utilised for investment into India

Immovable Property Regulations

Immovable Property Regulations - Background

- One of the most unique set of regulations under FEMA
  - FERA had "citizenship" criteria along with "residence"
  - FEMA dropped "citizenship" as a criteria, only "residence" retained
  - However, IP Regulations bring "citizenship" back!
- Government policy at cross-purposes with drafting of law by RBI
  - What is not allowed is technically legal; and
  - What is allowed is not clarified properly
- Short Regulations, but many controversies
- IP Regulations cover only "investment" in IP
  - "Business" in IP covered by Regulations for "Foreign Investment in India" and "Overseas Direct Investment"
  - No specified distinction between investment and business – factual

Immovable Property Regulations - How they operate

- Acquisition of Immovable Property in a cross-border transaction is a Capital Account Transaction

- Section 4 of FEMA prohibits:
  - Blanket prohibition: No person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any **immovable property** situated outside India - Section 4 of FEMA

- Section 6 of FEMA provides the rules and regulations under which capital account transactions can be allowed
- FEMA Notification 21(R) dated 26 March 2018 *covered* "Acquisition and Transfer of Immovable Property **in** India". **Replaced by Ch. IX of Non-debt Instrument (NDI) Rules 2019 from 17th October 2019**
  - Both regulations largely at par

- FEMA Notification 7(R) dated 21 January 2016 covers "Acquisition and Transfer of Immovable Property **outside** India"
  - LRS Regulations contained in Current Account Transaction Rules also relevant
  - No Government notification yet to regulate these transactions and hence FEMA Notification is operational

- No longer valid but practically useful:
  - Master Direction No. 12/2015-16
  - FAQs by RBI on Immovable Properties

Immovable Property Outside India

Immovable Property Outside India - Objective

- The objective is to restrict use of foreign exchange through acquisition of property outside India
- Allowed only for specified Residents for specified purposes
- Such Residents can acquire or hold only through certain routes as explained in next slides

- Regulations do not apply to:
  - Property held by a Person who is a national of a foreign state
  - Acquired before 8th July 1947 and continued to be held with RBI Permission

Immovable Property Outside India - Routes

Immovable Property Outside India	**Purchase**	Through LRS
		By Returning NRI
		Cos. having overseas offices
		From RFC Funds
		Jointly with NRI Relative
	Gift or Inheritance from	Persons u/s. 6(4) - Returning Indian
		Persons who held before 8/7/1947 - Notf. 7(R) Regn. 4(b)
		Persons who acquired as per extant forex provisions

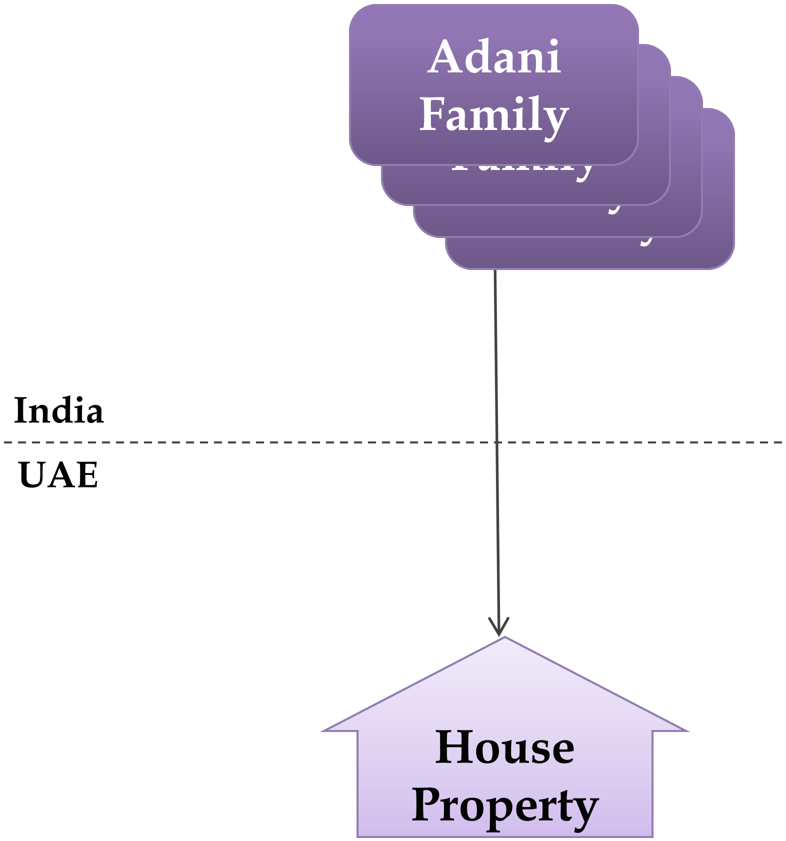
Immovable Property Outside India - LRS

- Resident individual can send remittances under the Liberalised Remittance Scheme for purchasing IP outside India
- Available to all Resident Individuals including minors
- Up to USD 250,000 per financial year can be remitted
  - Introduced on February 4, 2004, with a limit of USD 25,000
  - Limit has increased over the years but reduced in between due to forex reserve position

- Such IP can be:
  - Leased
  - Sold
  - Funds from lease and sale can be retained outside India
  - Funds retained can be reinvested

- Multiple LRS remittances can be clubbed for purchase of high value IP
  - One individual can remit USD 250,000 in foreign bank account over multiple years until sufficient funds are collected to purchase IP
  - However, impractical to wait for the same

Case Study 1 – Investment in immovable property abroad under LRS



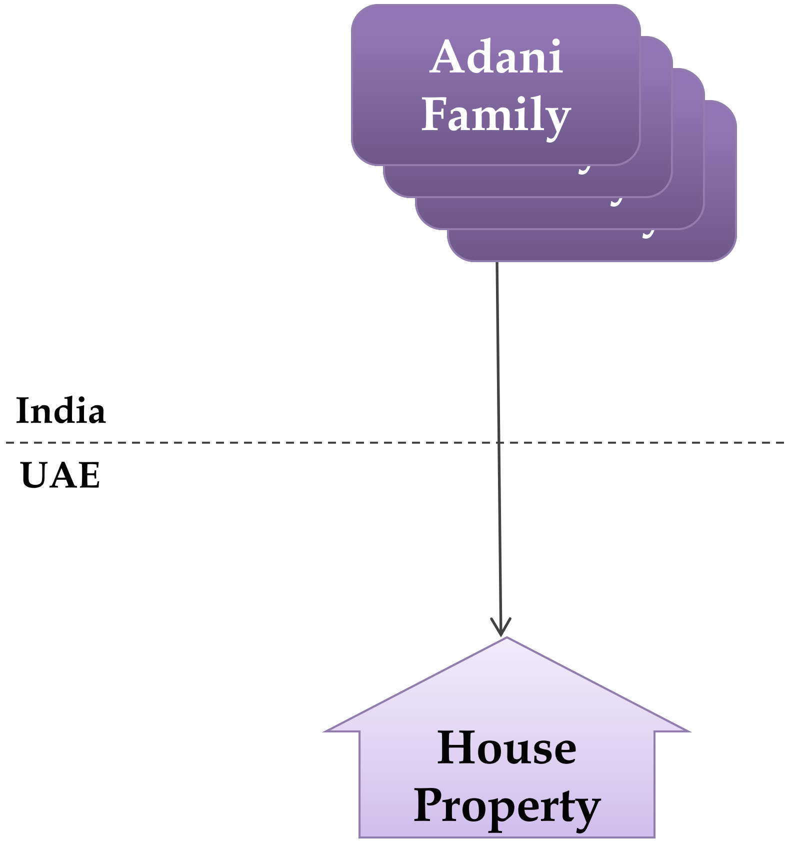
Facts:

- Adani Family intends to purchase immovable property in UAE
- Property investment is of USD 1 Million

Issues:

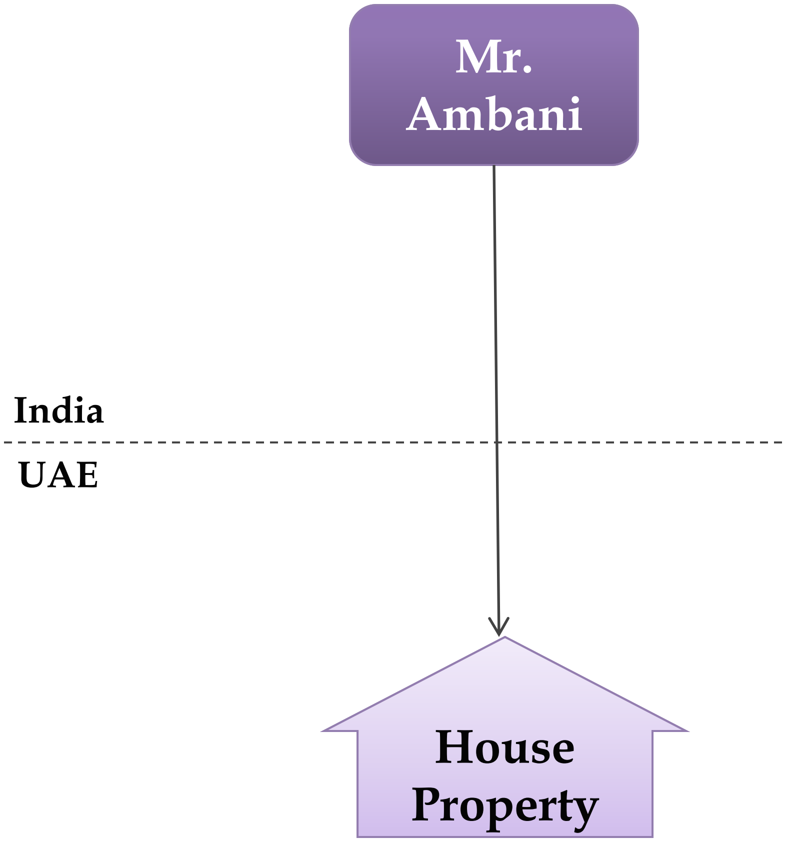
- Can multiple family members invest together?

Case Study 1 – Investment in immovable property abroad under LRS



- Adani Family can jointly purchase property – 4 family members can remit funds of USD 250,000 to invest 1M USD
  - Property has to be in joint name
  - Ownership needs to be in proportion to investment made
  - Family Members covered
    - No definition for family members

Case Study 2 – Investment in immovable property abroad under LRS



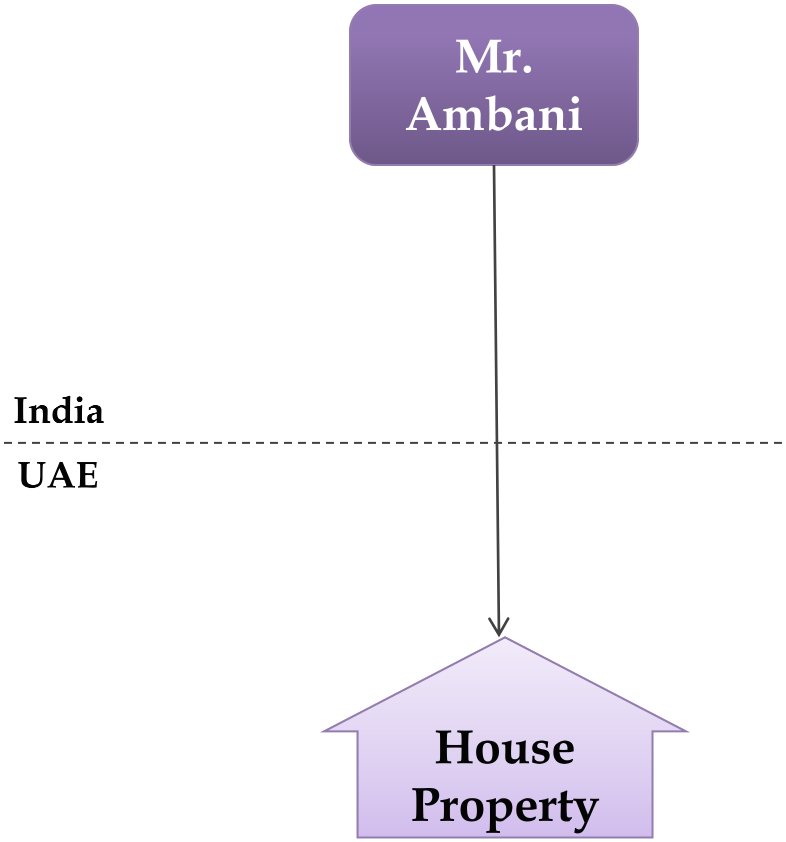
Facts:

- Mr. Ambani intends to purchase immovable property in UAE
- Property investment is of USD 1 Million

Issues:

- Can property be purchased on instalment basis?
- Can property be purchased under EMI or mortgage loan?

Case Study 2 – Investment in immovable property abroad under LRS



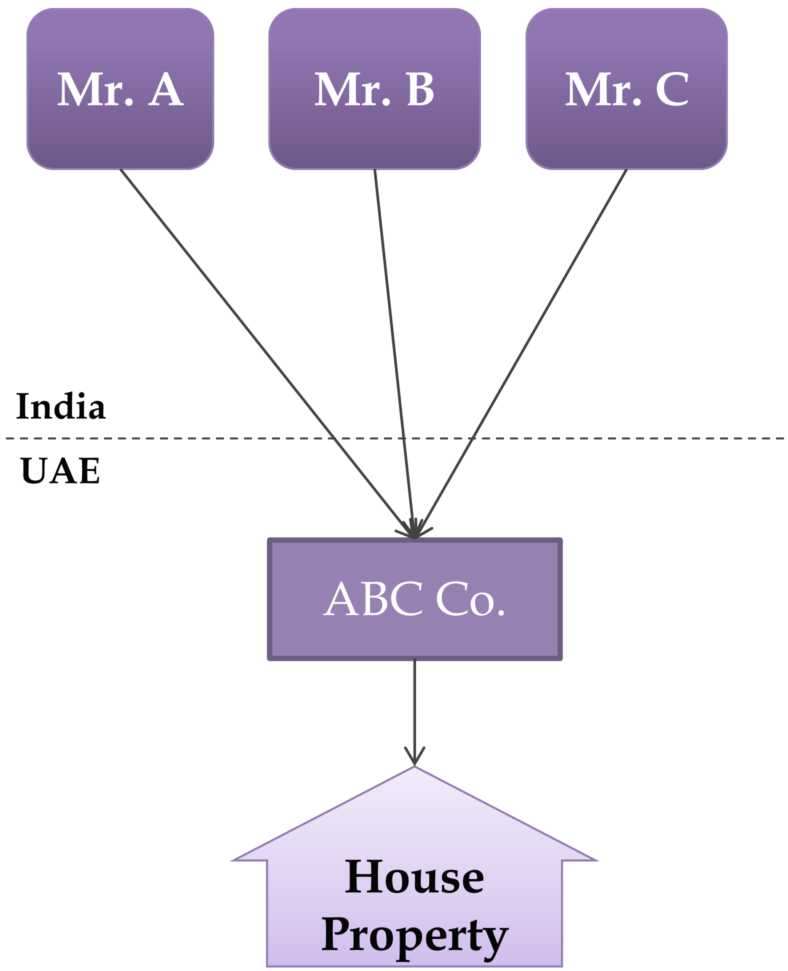
Instalments:

- Financial commitment cannot be over and above LRS limit
- Even AP Circular 32 dated 4.9.2013 allowed payment in instalments within LRS only for pre-existing contracts as of 14.8.2013
  - No such relaxation now

Loans:

- Remittance under LRS cannot be out of borrowed funds in India
- Individuals cannot enter into a loan agreement overseas
  - (Refer Compounding Order dated 19.07.19 in case of Mr. Dharmpal Agarwal).

Case Study 3 – Investment in immovable property abroad under LRS through company



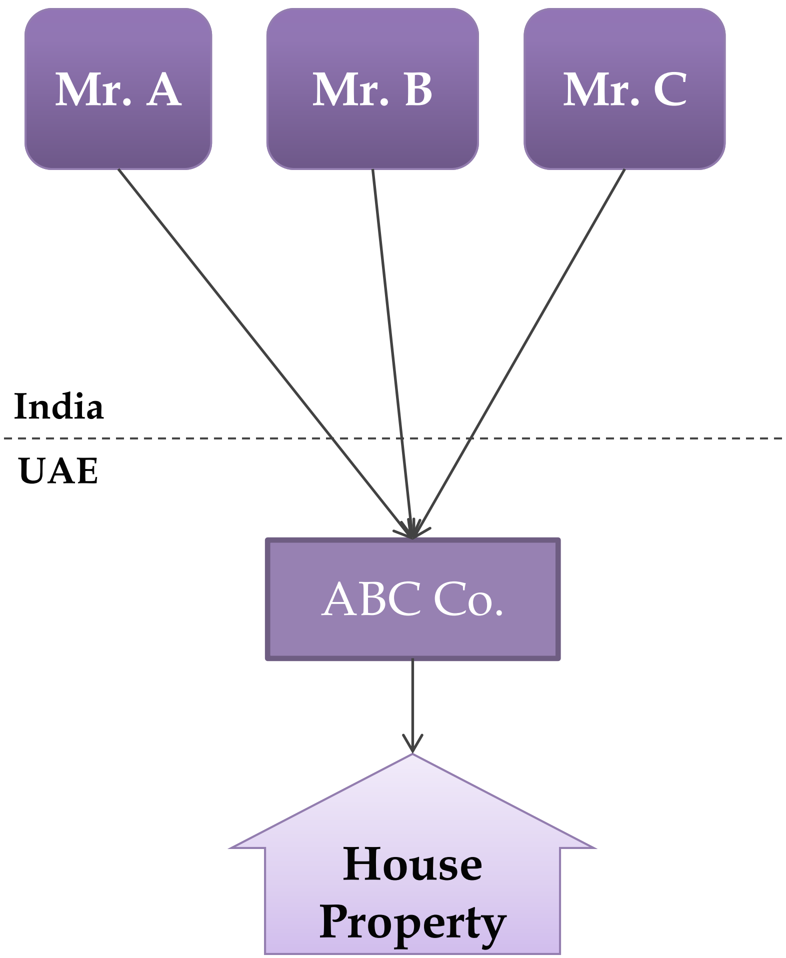
Facts:

- Mr. A, Mr. B and Mr. C incorporate a Co. in UAE through LRS
- ABC Co. purchases immovable property in UAE

Issues:

- Can property be purchased through company under LRS?

Case Study 3 – Investment in immovable property abroad under LRS through company



Topsy-turvy history

- Investment in Company allowed freely under LRS when it was introduced
- LRS limit could be used for any current or capital account transaction
- However, RBI changed its view
- Investment after 5.8.2013 was not permitted in a Company which does not have operating business
- Investment before that was also subject to compounding. RBI has taken an adverse view and advises to:
  - Wind up, bring back proceeds and go for compounding.
  - This is because even today, holding IP through a foreign entity is not permitted.
- If investment was before 8.5.2007, when word "permissible" was inserted, RBI may permit to hold?
- However, even prior to 5.8.2013, loan in foreign co. was not permitted.

Immovable Property Outside India - LRS

- Points to note:
- Remittance to FATF countries not allowed under LRS
- LRS limits can be lowered by RBI – has been done before

- A Resident can acquire property purchased through LRS by inheritance or gift
  - Can retain such IP abroad from 21.1.2016 as per Notf. 7(R), Reg. 5(2)
  - However, on sale of such property, funds will have to be brought back to India
  - Incomes earned on such property will also have to be brought back to India

Immovable Property Outside India – Returning Indian

- Section 6(4) of FEMA allows a person resident in India to hold, own, transfer or invest in any IP situated outside India if
  - Such IP was acquired, held or owned by him when he was a NR
  - Such IP was inherited by him from a person who was resident outside India

- Issues:
  - Is he needed to bring funds back to India on sale of such IP?
  - Can he retain incomes earned on such property outside India?
  - Can Returning Indian convert such IP to another asset?

Immovable Property Outside India – Returning Indian

- Checkered history:
  - FERA through ADMA Circular No. 51 dated 22nd Sept., 1992 and 6 notifications allowed Returning Indians many facilities including retaining IP abroad
  - However, under FEMA, all reliefs were shortened in to Section 6(4)
  - Led to confusion and erosion of institutional memory whereby reliefs were curtailed
  - After sustained representation RBI issued AP series circular no. 90 dated 9.1.2014 clarifying and restoring these reliefs
  - Now, Returning Indian can:
    - Retain funds abroad on sale of assets
    - Retain income earned on such assets abroad
    - Reinvest the sale proceeds into new assets abroad

Immovable Property Outside India – New Relaxation

- Now Resident can acquire by gift or inheritance IP abroad even if IP is received as a gift/inheritance from a 'person resident in India'.
- The Indian resident donor/deceased person should have acquired the IP as permitted under forex provisions at time of acquisition.
- Permitted by Notfn. 7(R), Reg. 5(2) from 21.1.2016.
- Earlier, resident donee/inheritor had to sell IP and bring proceeds back to India in cases except those covered under S. 6(4)

- Reg. 5(2) opens up a lot of possibilities
- IP abroad can be retained as long as the person gifting or bequeathing has acquired it in line with extant provisions
- Effectively IP can be retained over multiple generations and even a chain of persons
- However, care must be taken not to abuse the provision
  - What cannot be done directly cannot be done indirectly

Immovable Property Outside India – Regn. 5(2) - Issues

- **What if the donor or deceased person is not a relative of the donee /inheritor?**
- Notfn. 7(R), Reg. 5(2) allows acquisition from **any person** who has acquired the property as permitted under FEMA/FERA
- Master Direction para 3.2(c) is in line with the provision
- However, RBI in its FAQs at Q.4(d) states that a person can acquire IP as gift or inheritance from an Indian resident who has acquired IP abroad **only if he is a relative**.
  - FAQs are not binding and only for clarification
- However, caution must be taken that the provision is not abused

Immovable Property Outside India – Other Routes

- Indian Resident can use RFC Funds to acquire property abroad
- Company having overseas branch office can acquire IP outside India for its business and for residential purposes of its staff [Notn. 7(R), Reg. 5(3)}
  - Has to be commensurate to the business requirements of the Company and its overseas office
  - Sale of IP requires RBI permission
- Under ODI Route, Indian Party's foreign JV or WOS can acquire IP for its business
  - Has to be commensurate to the business requirements of the Overseas JV/WOS
  - Real Estate trading; and 'buying & leasing' of IP not allowed under ODI
    - Hotel Business example
  - Several additional restrictions for LRS-ODI make it impractical route
- Indian resident cannot acquire IP as remuneration for services rendered. A prior approval from RBI is required.

Immovable Property In India

Immovable Property In India - Objective

- Investment in IP is regulated to avoid unnecessary investment in IP which can lead to price rise of properties in India
- Investment restricted only for genuine purposes with conditions and limits

- In general non-residents are not allowed to buy IP in India
  - As a corollary, residents are allowed
    - This has created a lot of confusion for foreign citizens who are residents
    - Citizens of certain countries are not allowed to hold IP in India
  - NRIs and OCIs allowed to hold as they have Indian connection

- Strict prohibitions for investment by citizens of certain countries
  - Better to follow in spirit than letter as these are considered security issues

Immovable Property In India - Routes

Acquisition of Immovable Property In India	**NRIs & OCIs**	Joint acquisition by Spouse who is not NRI/OCI allowed
	NR having place of business in India	Only for carrying on permitted activity
	Long-Term Visa holders	Only for minorities in Afghanistan, Bangladesh & Pakistan
	Foreign Embassies/ Diplomats/ Consulate Generals	

Immovable Property in India – NRIs and OCIs

- **NRIs & OCIs can:**
- Acquire property for holding/self-use.
- Sell the property & repatriate sale proceeds abroad, most of the times.
- Let out the property on rent & repatriate funds abroad after payment of taxes.
- Bequeath the property to anyone

- **NRIs & OCIs cannot:**
- Buy agricultural land, plantation property & farmhouses ("agricultural property")
- Do Real Estate Trading, or trade in Transferable Development Rights

Immovable Property in India – Major changes

- Notification 21(R) dated 26th March 2018 issued in place of erstwhile Notification 21
- FEMA NDI Rules applicable from 17th October 2019 rescinding Notification 21(R).

- NRI now defined in regulation itself as person resident outside India (PROI) who is a citizen of India
  - Earlier it was not defined separately in Notfn. 21

- OCI category of investors introduced in place PIO
  - PIO now altogether removed as investor category
  - OCI defined as a PROI who is registered as an "OCI Cardholder" u/s 7A of the Citizenship Act
  - Most PIOs eligible to obtain OCI Cards
  - However, those who do not hold OCI Cards will not be eligible to acquire IP in India now
    - Regn. 12 allows PIOs to retain the IP acquired by them if they do not have OCI

- Rules for NRIs and OCIs now at par
  - Earlier language caused differences in restrictions between PIOs and NRIs

Immovable Property in India – NRIs and OCIs

What can they do?	Type of Property	From
Acquire by Purchase	Any IP other than Agricultural Property	Any person
Acquire by Gift	Any IP other than Agricultural Property	Resident, NRI or OCI who is a relative as defined in Companies Act, 2013
Acquire by Inheritance	Any IP	- From PROI who acquired it in line with extant provisions; or - From a Resident
Transfer by sale or gift	Any IP	To a Resident
Transfer by sale or gift	Any IP other than Agricultural Property	To an NRI or OCI

Immovable Property in India – NRIs and OCIs

- As a corollary to the above table, NRIs and OCIs cannot do the following:

- **Agricultural Property:**
- They cannot acquire Agricultural Property by Purchase or Gift from anyone;
  - Slew of compounding orders penalising NRIs for buying agricultural land without RBI permission are in public domain
- Can acquire only by way of inheritance from PROI who acquired it in line with forex provisions at that time; or acquire it from a Resident
- Agricultural Property can be transferred only to a Resident

- No property can be transferred to a Foreign Citizen

Immovable Property in India – NRIs and OCIs

- NRIs and OCIs can do the following:
- **Inheritance/Bequeath:**
- An NRI can acquire property through inheritance.
- An NRI can bequeath property in his will to another non-resident or an Indian resident.

- An Indian resident can also bequeath property to non-resident.
- Even agricultural property can be bequeathed / inherited.
  - However restrictions can be put on use / repatriation.
- Can IP be distributed before death?
  - Indian resident can gift the IP to NRI. LRS limit does not apply.
  - Indian resident should not buy & gift to NRI.
  - One should not do things indirectly which cannot be done directly.

Immovable Property in India – Change of Residence or Citizenship

- **R to NR**
- Can continue to hold property in India.
- Agricultural activities cannot be done in case of agricultural properties.

- **NR to R**
- Non-resident who becomes Indian resident – can continue to hold property. Repatriability is lost.

- **Indian Citizen to Foreign Citizen**
- People who acquire foreign citizenship can continue to hold property in India
  - They should ideally acquire OCI Card

- **Foreign Citizen to Indian Citizen**
- People who become Indian citizens can continue to hold property.

Immovable Property in India – NRIs and OCIs

- **Acquisition formalities:**
- No approval from RBI is required. No declarations have to be filed.

- Payment for purchase can be paid from funds received by inward remittance from abroad through banking channels or from funds held in any non-resident account maintained in accordance with the provisions

- No other payment mode is acceptable including Travellers' cheques or foreign currency notes

Immovable Property in India – Loans by NRIs and OCIs

- NRI / OCI can take a loan from Indian banks or financial institutions and employers. (However conditions not yet prescribed.) [R. 7B(i) of Notification 3(R)]
- Existing loan - Repayment of loan can be made from NRE A/c or foreign funds or NRO A/c.
- Repayment of loan by relatives now NOT permitted. Earlier it was permitted.
- PIO also eligible for the above facility if loan was obtained as per erstwhile Rupee loan notification

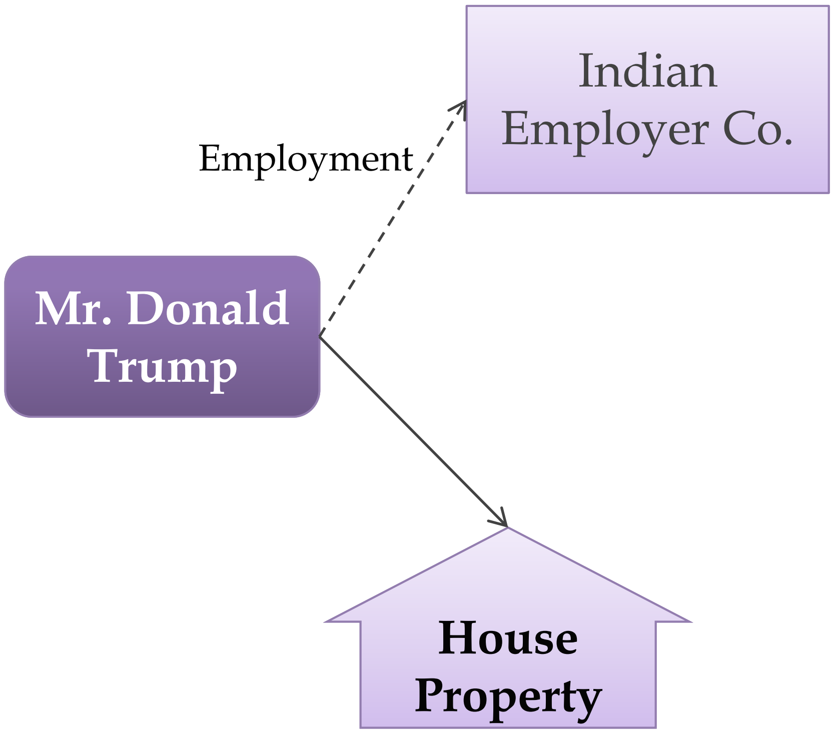
Immovable Property in India – NRIs and OCIs

- **Repatriation on sale:**
- Funds can be repatriated without approvals
- Only for IP other than Agricultural Property
- AD Bank will remit provided:
  - IP was acquired in accordance with the provisions
  - Amount for acquisition was paid out as mentioned above
  - In case of residential property, repatriation of sale proceeds is restricted to 2 such properties
    - The limit seems to be a life-time limit
  - If property was purchased in FX, sale proceeds can be repatriated
    - Earlier restriction of repatriation upto cost of the property has been removed
- On sale of IP, funds eligible for repatriation if loan repaid from NRE A/c / from abroad.
- Non-repatriable investments can still be remitted up to USD 1 Million per FY
  - Limit inclusive of all purposes

Immovable Property in India – Investment under Sch. IV

- NRI / OCI card holders are permitted to invest in India through an entity on non-repatriable basis under Schedule IV of FEMA NDI Rules
- Such entity can own IP for the purposes of its Business
- Entity cannot hold the property without business
- Investment can be for earning lease income

Case Study 4 – Investment in IP in India by a Foreign Citizen



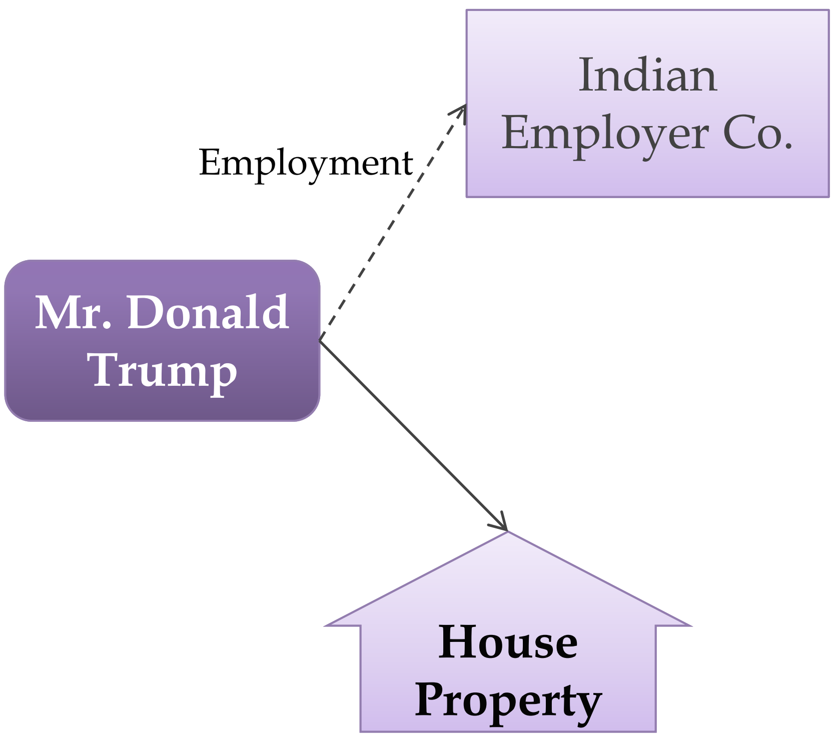
Facts:

- Mr. Trump, a US Citizen, comes to India on employment with an Indian Company
- He is resident of India from the day he joins employment

Issues:

- Can Mr. Trump buy IP in India?

Case Study 4 – Investment in IP in India by a Foreign Citizen



- FEM Act places restriction on Residents, not citizens
- Indian Resident buying IP in India is not a Capital Account Transaction as defined u/s. 2(e) of FEMA
- Therefore, US Citizen resident in India can buy IP in India technically
- Government is not in favour of foreign citizens who are not truly Indian Residents buying IP in India
- Further, NDI Rules restricts Foreign citizens of 11 countries to acquire IP in India

Immovable Property in India – Citizenship over Residence

- Under FERA, restrictions were based on Citizenship and Residence
- FEMA restrictions are based only on Residence and not Citizenship

- Once a foreign citizen is Resident in India, he is not restricted under the Act to purchase IP in India as there is no capital account transaction
  - FAQ 4(b) supports this

- However, many Foreigners on visa in India have purchased properties in Goa and other states – some under FDI Route
  - Cause of concern for RBI & Government – Press Release dated 1.2.2009
  - PR asks state governments to review residential status based on Visa to determine if person is resident in India for "uncertain period"
    - No provision under law to check Visa status
  - Compounding orders available in public domain where foreign citizens have been penalised for acquiring IP in India

Immovable Property in India – Specific Prohibitions

- Citizens of following countries not allowed to acquire IP without prior permission of RBI:
  - **Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Hongkong, Macau or North Korea**
- OCI Cardholder from these countries allowed to acquire
- Lease not exceeding 5 years allowed
- Citizen includes both natural persons and legal entities
- Restrictions based on Citizenship are strictly not as per FEMA
  - However, it is a security issue and hence policy must be followed
  - Practically, registration authorities and/or local government authorities do not process the transfer unless approval is obtained
- Violation can be compounded
  - However, high chance that all gain made from such transaction would be charged as compounding fee

Immovable Property in India- Inheritance by Non-NRIs

- Non-NRIs (foreign citizens who are non-residents) can acquire IP on inheritance u/s. 6(5)
- However, they require approval to sell.

- They can repatriate upto US $ 1 million per FY without approval. [Notfn. 13(R), Reg. 4(1) and 7(1).]
  - However, Master Direction No. 12, para 7.1 states that an approval is required.

- Are foreign entities covered as foreign citizens?

Immovable Property in India – Spouse of NRI/OCI

- Spouse of NRI/OCI who is PROI and not NRI/OCI can acquire
- Only one IP other than agricultural property
- Jointly with her NRI/OCI spouse
- Marriage should be registered and should have subsisted for at least 2 years prior to date of acquisition
- Is otherwise not prohibited from such acquisition
- Acquisition formalities remain the same as for NRIs/OCIs

Immovable Property in India – For Permitted Activity

- PROI who has branch office, project office or other place of business in India can acquire IP in India
  - However, entities of 11 countries mentioned earlier require prior approval
- Only for, or incidental to, carrying on of permitted activity
- Form IPI to be filed with RBI within 90 days of acquisition
- PROI can transfer such property by way of mortgage to an AD as a security for any borrowing
- For sale, RBI approval is required

- Liaison Office cannot buy IP
  - Liaison office can take property only on lease (upto 5 years or up to the RBI approval date)
  - No restriction even on entities or citizens of 11 countries referred to earlier
  - It is not a capital account transaction
  - Can buy IP only with prior RBI permission

Immovable Property in India – Other Routes

- Foreign Embassy / Diplomat / Consulate General can purchase or sell IP (other than agriculture property) if:
  - They obtain clearance from MEA.
  - Payment is made from abroad through banking channels.

- Long-Term Visa Holders from Afghanistan, Pakistan or Bangladesh can acquire if:
  - They belong to minority communities in those countries
  - Only one IP for residential house as dwelling for self-occupation and one IP for carrying out self-employment
  - Several conditions to be met for security reasons

- FDI Route open for Foreigners to invest in an Entity in India for business purposes
  - IP required commensurate to such business purpose can be acquired
  - However, care must be taken that land purchased is utilised for purpose of business – trading in land is not allowed

Immovable Property in India – Creation of Charge in India

- Indian residents can create a charge on IP in India in favour of overseas lender for ECB
- On invocation of charge, the foreign lender can sell IP only to Indian resident & sale proceeds can be repatriated to liquidate the ECB.

- AD in India acting as a correspondent of an overseas lender can create mortgage on IP in India owned by an NRI/OCI being director of a company outside India for a loan to be availed by the company from such overseas lender

Immovable Property in India – Loan abroad

- NRI / OCI can mortgage his IP in India for loan taken from a foreign lender by a foreign company, of which he is a director. Mortgage should be with a Bank in India which is Indian correspondent of an overseas lender.

- Funds should be used by the borrowing company only for its core business purposes overseas.

- In case of invocation of charge, the Indian bank can sell the IP to an eligible acquirer and remit the sale proceeds to the overseas lender. [R. 30(1)(c)]

Consequences

- Violations of IP regulations are taken seriously and not treated as technical violations
- Violator can apply for compounding under Compounding Rules
- Needs to first regularise the transaction before applying for compounding
  - Generally 6 months given to regularise the transaction
  - Regularisation is generally by transfer of IP to Indian resident and 'citizen'
- Most cases of such violations are compounded by RBI by levying a compounding fee
  - In cases where source of funds for acquisition are not through banking channels matter is forwarded to Enforcement Directorate
- Compounding fee is levied as per computation matrix forming part of Master Direction on Compounding
  - Computation Matrix provides for adding "Undue Gain" to compounding fee
  - Review of compounding orders shows that Undue Gain can include both capital gain made by the violator, as also any other income made out of reinvestment of gain
    - Tax deducted at source has been reduced from undue gain in some cases
- Compounding Orders used to be placed on RBI Website resulting in name and shame
  - If Compounding Fee is not paid, matter is forwarded to Enforcement Directorate for adjudication

Practical and Tax Issues

Practical Issues

- **Jurisdictional analysis from non-tax perspective:**
- Hidden Costs to maintain IP
- Economic Strength and Vulnerability
  - Collapse of Dubai Economy
- Political Risks
- Tax Havens under scanner – presumption of guilt
- Foreign laws to be adhered to

Tax Issues

- **In Foreign Jurisdiction:**
- Estate Duty in Foreign Country
- Increased focus on offshore entities owning properties
- Tax credit for Indian taxes based on different computations
- Reliefs available in India may not be helpful

- **In India:**
- Foreign Tax Credits based on different computations and deductions
- Deemed Rental incomes on vacant property can be high
- Disclosure in Income-tax Return forms

- Automatic Exchange of Information

TDS on sale of property u/s. 195

- Deduction on gross amount or capital gain?
  - Section 195(1) says "income"
  - Deduction on Capital Gains
    - Shri Bhagwandas Nagla ITA No. 143/Hyd/2017
- Documents required to correctly compute gain
  - Purchase & Sale Deeds
  - Valuation Report
  - Detailed Application & Representation
  - If deduction to be claimed
    - Indemnity for investment in bonds
    - Purchase Agreement / Capital Gain Account Scheme if deduction to be claimed against purchase of new property
  - PAN Card and Passport
  - Tax Returns
- Can CA give certificate?

Thanks!

- Questions?

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