The **Pravasi Bhartiya Divas** was a celebration with a difference. The message was loud and clear, India needs patriotic Non-Resident Indians (NRIs) for the future development of the country. In turn, the NRIs poured their hearts out, stating in black and white what they expected in return from India.

No longer are NRIs accused of brain drain, in fact, their experience and expertise is highly valued today in India. The former Prime Minister of India, Mr Rajiv Gandhi took pride in referring to India as the "Brain Bank" of the world.

The recent years have also witnessed what can be best termed as a “reverse brain drain” and this trend is likely to continue over the coming years. Investments and expertise are pouring into India and hopefully this trend will continue.

Prompted by the enthusiasm and goodwill extended by the NRI community, the Prime Minister of India, Mr Atal Bihari Vajpayee ("The PM") took the initiative to gain an insight into the needs and expectations of the Indian diaspora and their willingness to contribute to the country’s future.

Mr L.M. Singhvi, former High Commissioner to UK, who was entrusted with this task, suggested rejuvenation of ties with the 20 million strong Indian diaspora. The **Pravasi Bhartiya Divas** celebrations held between January 9 and 11, 2003, was just the beginning.

The words of the PM clearly echoed the sentiments of the country. He mentioned: *When you left this country, you carried with you the primary colours of the Indian ethos. A cross-fertilization of cultures over time has added new shades to those vibrant hues. Today, we invite you to brush in some of these new colours into the ever-evolving canvas of India’s development.*

Several eminent NRIs were felicitated, but most important of all, a fair hearing was given to all their ideas and suggestions. However, the so-called pretentious welcome given to the NRIs at the **Pravasi Bhartiya Divas** got quite fizzled out by the non-pretentious amendments by the Finance Act, 2003.

In this article we discuss the issues in relation to the residential status of a non-resident, the recent developments in this context and the tax implications arising therefrom. These issues together with other concepts such as dual residency, taxation of internationally mobile executive, taxability of deferred remuneration in the form of pensions and social security benefits and a final round up of what the future policies may hold in store for the NRI community sums up our article.
Rules for residency

As discussed in this book, section 6 of the Income Tax Act, 1961 ("ITA") discusses the rules of residency for an individual in India. A person can either be a Resident or a Non-Resident. Further, an individual who is a Resident can either be a: “Resident and Ordinarily Resident” or a “Resident but not Ordinarily Resident”, (“RNOR”).

Section 6(1) provides that an individual is a resident in India, if such individual satisfies any one of the following two conditions:

- The individual is in India for at least 182 days in the relevant financial year; or
- The individual is in India for more than 60 days in the relevant financial year and for 365 days or more in the immediately preceding four financial years

Further section 6(6), prior to the Finance Act, 2003, stipulated that an individual is a RNOR if such individual satisfies any one of the following two conditions:

- The individual has not been resident in India in 9 out of the 10 previous years preceding the relevant financial year; or
- The individual has not during the 7 years preceding the relevant financial year, been physically present in India for an aggregate period of 730 days or more

One feature of the definition was that if a person goes out of India even for two years, his status on return will be that of a RNOR.

These provisions are diagrammatically illustrated as under:

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The impact of the residential status is better understood in light of the scope of total income of an individual, which in turn depends upon the residential status of the individual. The scope of income of an individual is defined by section 5 of the ITA as under:

- A ROR is liable to tax in India on his worldwide income;
- A RNOR is liable to tax in India on his income arising and accruing in India. Income earned or accrued outside India is not subjected to tax in India; and
• A NR is liable to tax in India only on his income accruing, arising, or received in India.

**Significance of RNOR**

The concept of RNOR had its place in the Income-tax Act, 1922. It was proposed to be dropped at the time of enactment of the Income-tax Act, 1961 and did not find a place in the Finance Bill, 1961. However, after much thought and deliberation, when the Finance Bill, 1961, was enacted, this concept was reinstated in the ITA.

The intent for introducing this can be traced to section 5 of the ITA, under which RNOR is chargeable to tax only in respect of Indian sourced income. By introduction of this provision, NRIs returning to India had the benefit of a gestation period for settlement in India by not subjecting their worldwide income to tax in India for a period of nine years.

It is interesting to note that India is not the only country that offers this concession. The United Kingdom ("UK") also recognizes a similar concept. ROR individuals are generally subject to tax in the UK on their worldwide income. An individual, who is resident but not domiciled in the UK, is subject to tax on his foreign source income only to the extent it is remitted to the UK. This beneficial tax treatment accorded to the non-UK domiciled individuals, resident in the UK, has come under fire in the UK time and again. For the last four times the UK Government has been proposing to abolish this beneficial treatment. However, each year, it has faced a tremendous opposition and the Government has been forced to postpone its abolition.

The special treatment has attracted wealthy non-UK-domiciled individuals to the UK, since they can live in the UK and manage their finances outside the UK without having to worry about paying taxes in the UK on their worldwide income. Abolition of this provision would not only upset the planning of the non-UK domiciled community, but is envisaged to be detrimental to the interests of the UK as well, since the UK has been benefiting from these non-UK-domiciled residents. Once again, the UK Budget announced this April has proposed to abolish this special treatment, and it has triggered enormous debate there.

In India, one of the suggestions of the Working Group set up for 'Study of Non-resident taxation' ("Working Group") headed by Mr. Vijay Mathur, Director-General of Income Tax (International Taxation), was abolition of the RNOR concept. The relevant extract of the Working Group report giving the reasons for this recommendation is reproduced below:

"Such a provision acts against the grain of 'residence based taxation', which provides for taxation of a resident of a country in respect of income from any source where situated. India follows the concept of 'residence based taxation'. India also is a signatory to more than 65 DTAAs. A person availing of the status of 'not ordinarily resident' in India is not taxed on his overseas income but only on the income earned in India. The overseas income particularly the passive income is taxed at more beneficial rates in the source countries as provided for in the DTAAs. A resident in India escapes taxation on his passive income in India because of the NOR provision and is required to pay tax only at very concessional rates in the other
jurisdiction because of DTAA provisions. Such a resident is not paying tax at full rate in either country. There is no rationale for continuing with the status of 'not ordinarily resident' for the reason that it militates against the concept of taxation on global basis in the case of a resident. By doing away with the status of NOR an individual would be taxable in India on global basis if he becomes a resident and the Tax Department would thereafter have to give credit for the taxes payable in the foreign country in respect of the same income. The individual would therefore not be taxed twice on the same income and the Government would get its share of revenue. The Working Group recommends deletion of the provision regarding NOR."

Fortunately, the debate generated at various fora including the Pravasi Bhartiya Divas meet has refrained the Finance Minister from abolishing the concept of RNOR.

Nonetheless, Mr. Jaswant Singh, Finance Minister, has definitely clipped the benefits currently available to RNORs by an amendment in the Finance Act, 2003

The section 6(6) of the ITA, prior to the Finance Act, 2003, dealing with the RNOR status, was as under:

A person is said to be “not ordinarily resident” in India in any previous year if such person is—

(a) an individual who has not been resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more.

Till then, the settled law in this respect was, that, before return to India, if the individual were a NR for two successive years he would enjoy the RNOR status for nine subsequent fiscal years. This is so because till the completion of 9 years, he would not satisfy the condition of being resident in India in nine out of ten fiscal years, to be an Ordinarily Resident individual.

However recently the Gujarat High court in its order dated May 31, 2002 in the case of Pradeep J Mehta V CIT, has upset this well settled position. In its decision, the Gujarat High Court took the view that the ITA has defined a ‘not ordinarily resident’ situation and not ‘ordinarily resident’ situation. The Hon’ble High Court held that a person would be regarded as a RNOR only if he has been NR for a period of nine out of ten years, thus implying that the RNOR status should be available only for 2 years, i.e. the tenth and the eleventh year.

Alternatively, the individual must satisfy the other test of not being physically present in India for more than 730 days in the preceding 7 years. This ruling has already been contested and there is an appeal pending against it in the Supreme Court of India.

Amendment by the Finance Act, 2003

The amended relevant section 6(6) of the ITA is as under:
A person is said to be “not ordinarily resident” in India in any previous year if such person is—

(a) an individual who has been a non-resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty nine days or less.

This definition, which is in line with the interpretation given to it in the recent Gujarat High Court ruling, clearly states that for an individual to be considered as a RNOR, he should have been a NR in nine out of previous ten years, as opposed to the earlier interpretation where if an individual was a NR for 2 successive years, he would enjoy the RNOR status for next nine fiscal years.

In view of the above, Diagram 1 would stand amended as under:

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From the above discussions, it is evident that if an individual has been NR for a period of nine out of ten preceding years, the RNOR status would be available to him, only for two years.

For better understanding, let us consider an example. Mr. A visited India for business purposes for the first time in the financial year 1992-93. The following table summarizes, the number of days during which he was present in India in that year and subsequent years. The table also applies the modified rules of residency and discusses his status for the subsequent years.
<table>
<thead>
<tr>
<th>Financial Year</th>
<th>No of Days</th>
<th>Days in preceding 7 years</th>
<th>Status</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>40</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1993-94</td>
<td>60</td>
<td>40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1994-95</td>
<td>80</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1995-96</td>
<td>90</td>
<td>180</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996-97</td>
<td>30</td>
<td>270</td>
<td>NR</td>
<td></td>
</tr>
<tr>
<td>1997-98</td>
<td>40</td>
<td>300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998-99</td>
<td>40</td>
<td>340</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999-00</td>
<td>60</td>
<td>380</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000-01</td>
<td>90</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001-02</td>
<td>185</td>
<td>430</td>
<td>RNOR</td>
<td>ROR Condition 1 &amp; 2</td>
</tr>
<tr>
<td>2002-03</td>
<td>300</td>
<td>535</td>
<td>RNOR</td>
<td>ROR Condition 1 &amp; 2</td>
</tr>
<tr>
<td>2003-04</td>
<td>60</td>
<td>745</td>
<td>ROR</td>
<td>Basic Condition 2</td>
</tr>
</tbody>
</table>

Accordingly, Mr A would enjoy the benefits of being a RNOR during the financial years 2001-02 and 2002-03. However, in 2003-04, he would be considered as a ROR when his worldwide income would become chargeable to tax. One would not be talking too soon if one were to say that the change in the RNOR provision could prove to be quite detrimental for India in the long run. This is well illustrated by the following examples:

*Illustration 1:* Mr N, a PIO but currently a resident of Dubai (where there is no tax on individuals), has just got admission in a reputed institute in Chennai. He is thrilled that he will be studying in such a premiere institute and will take back with him to Dubai, sound academic and practical knowledge. Also he is very excited that he will get to meet his cousins at last. But, due to the change in the RNOR status, he too will be taxed in India on his foreign source income, which is a cause of concern to him, especially since no tax is levied in Dubai on his income. He will now face a tax bill, in addition to the education expenses, which would not have been the case had the RNOR provisions in India not been amended. In view of such problems, it is quite likely that the Indian universities may not remain attractive to the foreign students.

*Illustration 2:* A foreign MNC has deputed its NRI executive to India for 3 years, in connection with setting up its Indian subsidiary in the year 2000. The presence of such executive is crucial to the successful launch and development of the business of the Indian subsidiary, wherein the MNC proposes to invest a substantial amount. However, upon finding that his worldwide income would be taxable in India and that there is an exposure to double taxation on some part of his income, the NRI executive decides to return to his home country prior to completing his term in India. This has an adverse impact on the progress of the Indian subsidiary of the MNC. The MNC decides to postpone its investment into the subsidiary. The projected investment into India is lost to this extent.
From the above illustrations, it is evident that this can hardly be setting the tone for the initiative taken by the PM to increase the share of economic participation from the Indian Diaspora.

It is quite evident that the persons expected to be hard hit by the change in the Finance Act, 2003, are students, and retired persons returning to India. Perhaps, the Ministry of Finance, should consider carving out a few exceptions.

Further, the problem does not end with the taxation of worldwide income in India, but it opens up a plethora of other issues such as dual residency; issues relating to availability of credit for foreign taxes paid; taxability of deferred remunerations; to name a few which are briefly discussed in this article.

**Dual Residency**

Section 90 of the ITA provides that where India has entered into an Agreement for Avoidance of Double Taxation ("DTAA"), the provisions of the ITA shall be applicable to the extent they are more beneficial to the taxpayer over the provisions of the DTAA. Accordingly, while considering the tax implications in the hands of a NR in India, it would be relevant to examine the provisions of the relevant DTAA.

As discussed above, once an individual becomes a ROR in India, his worldwide income becomes taxable in India. However, it is quite likely that the individual returning to India may also be a resident of the country from which he is returning to India under the local laws of such country. Hence, for the relevant year(s), the individual would become a resident of both India and the other country. Thus, the individual may become a "dual resident", i.e. resident of two countries for tax purposes. On becoming a dual resident, the question arises as to which country has the right to tax his income. India has entered into a DTAA with over 65 countries. Most of the DTAA's provide for a "tie-breaker" provision under which such determination can be made.

The text of the DTAA of most countries with which India has entered into is a mix of the OECD Model Convention and the UN Model Convention ("UN MC").

Article 4 of the UN MC defines the term "resident" as follows:

"For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management, or any other criterion of a similar nature ......."

Accordingly, a person is considered to be a resident of a contracting state under the DTAA if he is considered to be a resident of that contracting state under the local laws of that country. For instance, if a person were resident under the provisions of the local laws of the UK, he would be considered a resident of the UK, for the purposes of the India-UK DTAA. Further,
assuming that the same person is also resident under the ITA, he would become a "dual resident" under the India-UK DTAA.

In such a situation, the revenue authorities of both countries would have claim over the individual’s worldwide income for the purpose of levying tax. This would clearly lead to a case of double taxation. Article 4(2) of the India-UK DTAA provides a solution to this by providing the tiebreaker rules. These rules are discussed below:

2. **Where by reason of the provisions of paragraph 1 of this article, an individual is a resident of both Contracting States, then his status shall be determined in accordance with as follows**:

   (a) he shall be deemed to be a resident of the State in which he has a **permanent home** available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (**centre of vital interests**);

   (b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an **habitual abode**;

   (c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a **national**;

   (d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by **mutual agreement**.

These principles can be summarized in the following diagram:

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Diagram 3: Tie Breaker conditions for dual residency

- **Person resident under local laws of both countries—Dual Resident**

  - **Level 1**: Country of permanent home
    - In both or neither country
      - **Level 2**: Centre of vital interest
        - In both or neither country
          - **Level 3**: Country of habitual abode
            - In both or neither country
              - **Level 4**: National of which country?
                - Of both or neither country
                  - **Level 5**: Competent authorities to determine taxing right through mutual agreement
The last resort is settlement by the competent authorities of India and the other country through a mutual agreement procedure. Accordingly, till such time that the competent authorities negotiate and determine the taxing right, the individual would in all probabilities face the following problems:

- Withholding tax provisions as per the domestic law would apply to all income received from the respective countries;
- The individual would be required to disclose his worldwide income in both countries and would also be required to file a return of income in both the countries;
- In such a scenario, though the ITA as well as the DTAA prescribe provisions for avoidance of double taxation and for claiming credits in respect of taxes paid in another country, such credit may not be available in all cases, and it is quite possible that the individual may be subject to double taxation even if for a short while. Such double taxation may only be relieved after the issue of his residence and pursuant taxing right of the country is decided and concluded upon by the relevant competent authorities of both the countries. In such a situation the individual would be entitled to refund of taxes in the country, which has agreed to forego taxing rights on him and avail credit for taxes paid in that country.

**Internationally Mobile Executive**

With increased acknowledgement of the potential in the Indian technological skills, many multinational companies are recruiting Indians as employees for their operations outside India. These employees get deputed abroad for training and for providing services there. Additionally, with increased globalization of Indian companies, many such companies are setting up operations outside India to which their Indian employees are deputed. The Indian executive has thus become highly mobile and can be termed as an "internationally mobile executive."

In view of this, it becomes extremely important to discuss the taxation of remuneration and deferred remuneration under the Indian and the international tax scenario.

**Taxability of remuneration**

Section 15 of the ITA is the relevant charging section for salaries/ remuneration in India. This section states that the following income received by a person chargeable to tax in India, shall be taxable under the head "Salaries":

- Salary due from an employer or former employer, whether paid or not;
- Advance salary paid by or on behalf of an employer or former employer; and
- Arrears of salary paid by or on behalf of an employer or former employer

The above amounts could be received from an Indian employer or from a foreign employer. Amounts received from an Indian employer for services provided in India would be
chargeable to tax in India. However, while examining the taxability of remuneration received from a foreign employer or from an Indian employer by a non-resident, in respect of services performed outside India, one would need to examine the provisions of section 9(1)(ii) and (iii) of the ITA and the provisions of the relevant DTAA.

Section 9(1)(ii) of the ITA provides that income under the head "salaries" is deemed to accrue or arise in India if it is earned in India, i.e. if the services under the agreement of employment are or were rendered in India. The main effect of the provisions is to charge NRs on salary earned in India even if it is received abroad.

In this regard Article 15(1) of the Model Conventions lays down the general principle that income from employment (other than pensions) is taxable in the country where the employment is actually exercised, i.e. where he is physically present for performing the activities in respect of which such income is paid to the individual. However, Paragraph 2 of Article 15 provides an exemption, whereby, remuneration derived by a resident of a particular country is taxable in the country of his residence, provided certain conditions as discussed in the illustration below are fulfilled.

Illustration: Mr A, an Indian resident, is employed with an Indian company, I Ltd. However, during the course of his employment, he is required to render services in Country C. As per Article 15 of the India UN MC, his remuneration (except pension) would be taxable as under:

- Remuneration received from I Ltd, would be chargeable to tax in the hands of Mr A in India if he is ROR in India in that year;
- However, since Mr A has rendered services for I Ltd in Country C, the remuneration received/accrued while Mr A was in Country C could be taxable in Country C under the provisions of domestic law of country C, subject to the provisions of paragraph 2 of Article 15;
- Paragraph 2 of Article 15 states that if the following conditions are fulfilled, the above remuneration received in Country C would be chargeable to tax in India:
  - Mr A was present in Country C for a period of less than 183 days in a twelve month period during the relevant fiscal year;
  - The remuneration is paid by the Indian company or on behalf of it by any other entity which is not a resident of Country C; and
  - The remuneration is not borne by a permanent establishment of the Indian company in Country C.

**Taxability of deferred remuneration**

The above provisions relating to remuneration do not apply in respect of the taxability of pensions. Article 18 of the UN MC discusses the taxability of "Pensions and Social Security Payments", and Article 19(2) discusses the taxability of such amounts where such amounts are received in connection with Government service.

Pensions and social security payments are to be taxed as under:
• Amounts paid to an individual in respect of his past services would be taxable only in the country of his residence [Article 18(1)];
• However, amounts paid under a public scheme, which is part of social security system of a country, shall be taxable only in such country [Article 18(2)];
• In the case of an individual in Government service, pension paid by or out of funds created by a particular country, shall be taxable in that country only. However, such amounts can also be taxed in the other country; but only if the individual is a resident and national of such other country. [Article 19(2)]

When the current RNOR status is no longer available, an individual who has spent his working life outside India and retires in India would be faced with the intricate issues of ensuring that he is not taxed doubly.

**What NRIs can look forward to:**

**Dual citizenship**

One of the most welcome announcements at the Pravasi Bhartiya Divas celebration was the one made by the PM for granting dual citizenship to People of Indian Origin (“PIO”). The PM mentioned that the Government was exploring the idea of passing a suitable enactment.

The PIO card scheme greatly disappointed the NRIs because it turned out to be quite a time-consuming and expensive process. The scheme proposed for granting dual citizenship must not follow suit. Instead, it must provide the much sought after flexibility to NRIs in terms of mobility and applicability of exchange control regulations, so that they can participate in India’s progress without the burden of any regulatory hassles.

**Amendment to taxability of pensions and social security payments**

In the earlier sections of this article, we discussed the taxability of remuneration and deferred remunerations. However, there are certain issues, which might arise in the case of internationally mobile executives in respect of the taxability of their pension contributions because of their shifting between countries. The actual problem in this context has been well explained by the OECD commentary (Ed. April 2000) on Article 18, at Pg C(18)-2:

"6. The tax treatment accorded to pension contributions of employees who are assigned to work outside their home country varies both from country to country and depending on the circumstances of the individual case. Before taking up an overseas assignment, employees commonly qualify for tax relief on pension contributions paid in the home country. When assigned abroad, employees in some cases continue to qualify for relief, Where an individual, for example, remains resident and fully taxable in the home country, pension contributions made to a pension scheme established in the home country will generally continue to qualify for relief there. But frequently, contributions paid in the home country by an individual assigned to work abroad do not qualify for relief under the domestic laws of either the home country or the host country. Where this is the case it can become expensive, if not prohibitive, to maintain
membership of a pension scheme in the home country during a foreign assignment. Paragraph 11 below suggests a provision, which member countries can, if they wish, include in bilateral treaties to provide reliefs for the pension contributions of employees assigned to work outside their home country."

10. The aim of the provisions is to ensure that, as far as possible, an employee is not discouraged from taking up an overseas assignment by the tax treatment of contributions made to a home country pensions scheme by an employee working abroad."

The above extract elaborately describes the problem that is envisaged in connection with pension contributions, and also indicates the aim behind providing a special provision to that effect. The solution suggested by the OECD in the above-referred Paragraph 11 is explained below in the context of an individual who is assumed to be an Indian national, rendering services in the US.

Contributions made by the individual rendering services in the US, to a pension scheme established in and recognized for tax purposes in India shall be deducted in the US in determining his taxable income, and treated in the US, in the same way and subject to the same conditions and limitations as contributions made to a pensions scheme that is recognized for tax purposes in the US. However, this deduction is available only if:

- the individual is not a resident of US, and was contributing to such pension scheme immediately before he began to exercise employment in the US; and
- the pension scheme is accepted by the competent authority of US as generally corresponding to a pension scheme recognized as such for tax purposes by US.

This is a recommendatory provision issued by the OECD and it is quite likely that in the near future India might want to adopt the same in the various DTAs executed by it. This would prove to be a big boon for internationally mobile executives.

**Certain suggestions made by the Working Group**

While discussing what could be the futuristic tax scenario for NRIs one cannot afford to ignore the Working Group report, which for a long time would act as a guide for making changes to taxation of NRs. Also, the Finance Minister; while presenting the Bill indicated that the recommendations of the Kelkar Committee and the Working Group would be implemented in a phased manner over the next few years, providing for a period of adjustment. Accordingly, it would be important to evaluate and keep in mind certain important recommendations of the Working Group for taxation of NRs.

**Withdrawal of exemption of interest earned under NRE Account**

The Working Group recommended as under:
4.5.1 Section 10(4)(ii) excludes, in the case of an individual, from computation of income, interest accruing in a Non-Resident (External) Account. The exemption from tax is available only to non-resident Indians (NRIs). Under the existing tax regime, non-residents do not pay any tax in India on the interest on such deposits. They may ordinarily be paying tax in the country where they are resident on such interest income. In this manner tax in any case is being paid in the country of residence. The Working Group is of the view that with more than 65 DTAAAs in place, there is no need for India to forgo any tax in respect of non-residents. In the current scenario the benefit of exemption does not really flow to the taxpayer but to the other country’s treasury. The interest accruing on such deposits should be taxed at source in India at the DTAA rate and credit for the taxes paid can be claimed in the country of residence by the NRIs as provided in DTAAAs. In this manner, double taxation in respect of the same income in the hands of the same individual would be avoided. There is no need for filing of any return in India by the NRI. He would continue to file his return in the country of residence along with his claim for credit of tax payable in India. The deposits in Non-Resident (External) Accounts are substantial and without any loss to the NRIs, India would get its share of revenue. The Working Group, therefore, recommends that the provisions of section 10(4)(ii) be omitted.

Clearly, in the view of the Working Group, by exempting the interest earned on NRE accounts, while there is no gain to the NRI, the Indian Government certainly loses the tax revenues. Accordingly, such interest should be made taxable and the NRI would be able to claim tax credit in respect of these taxes, when he files his return in the country of his residence.

Removal of the chapter on "Special provisions relating to certain incomes of non-residents"

The Working Group recommended as under:

4.10 Chapter XII-A of the I.T. Act deals with special provisions relating to certain incomes of NRIs. Income from long term capital gains or investment income from specified assets are taxable on a gross basis at the rate of ten or twenty per cent respectively. With regard to such income they ordinarily should be paying full tax in the country of residence and getting credit for taxes paid in India. The tax should be neutral to the residential status of a person. In addition the DTAAAs take care that the NRIs would not be taxed twice on the same income. On the basis of the above, the Working Group recommends the abolition of Chapter XII-A in the I.T. Act.

Chapter XII-A of the ITA lays down certain special provisions, relating to long-term capital gains and investment income earned in India by NRIs. The Chapter allows certain benefits like reduced rate of tax, non filing of returns of income in certain cases, etc. Further, the Chapter also states that the provisions of this chapter would apply even after the NRI becomes a resident of India. According to the Working Group, in view of the tax credits available under the DTAAAs executed by India with various countries, an NRI can pay taxes in India, and can then claim credits for the same in the other country. This would avoid double
taxation and would also bring parity in the rates of taxation between Indian residents and NRIs.

The above two recommendations of the Working Group do not take into account the cases of the NRIs living in countries such as Dubai, where there is no tax levied on the income of individuals. The NRIs from these countries heavily invest their savings in the Indian NRE accounts. In some cases, all the savings are so invested. In fact, a substantial portion of US Dollar deposits with Indian banks comes from such investments. Levy of tax on such savings income would mean tax versus “nil” tax in the country of economic activity of such NRIs. It would be too simplistic a calculation to go after revenue by taxing such NRI interest, vis-à-vis attracting those funds in India, which increase the kitty of foreign exchange and deposits of the banking industry and provide the basis for increased economic activity through the use of these deposits.

**Administrative changes**

Besides the above changes in legal provisions, it is proposed that certain changes, if brought about by the Government could ease a lot of administrative hassles faced by NRIs:

- Introducing a different advance ruling cell for NRIs, which will help in disposing their taxation matters on a priority basis in short time;
- Exemption of requirement for filing returns in case of NRIs who have earned only passive income in India, *i.e.* income on which entire taxes have been withheld at source.

**Lessons from Chinese experience**

The Chinese economy has now, since a long time taken initiatives in wooing the Chinese diaspora back to China. Not only that, Dr. L M Singhvi’s report depicted that it has been the Chinese expatriates in the United States who have played an important role in attracting foreign investment in China. The Chinese diaspora has become a strong backbone for China’s economic prosperity since the last two decades. For India to follow suit, it may require a herculean effort to change the mindset of both the Indian bureaucracy and the NRIs. Effective communication of positive structural changes in the Indian economic environment is a must. India Inc. needs to focus on achieving this task. The tremendous and laudable intellectual wealth of the Indian diaspora who are gunning for India’s progress could act as catalyst in this effort.

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