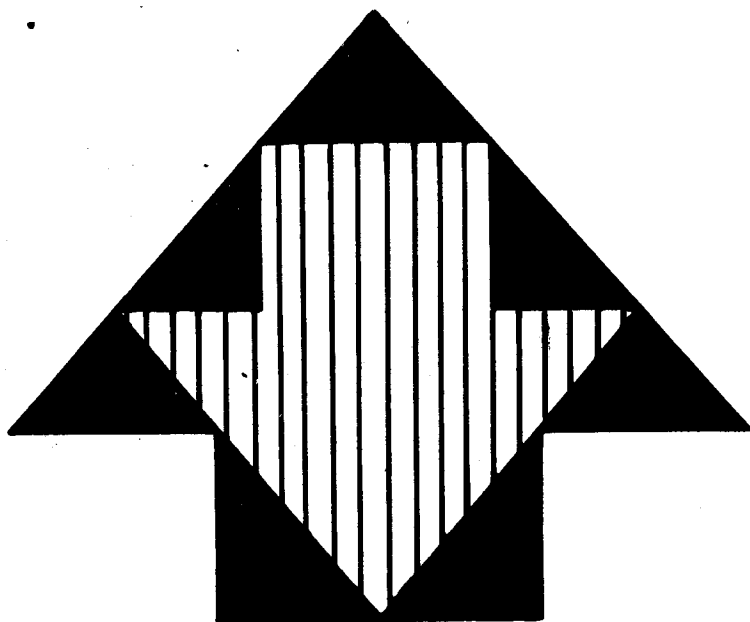


LAW REGARDING NON-RESIDENTS IN INDIA



P. S. GOPALAKRISHNAN

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Preface

The subject of non-resident investment has aroused considerable interest in recent months, the public debate thereon being unduly dominated by an apprehension among business circles about attempted takeovers and by an equally vehement reaction about dynastic rule of corporate bodies. Ignorance generates baseless apprehensions and in the case of non-resident Indians, doubts and suspicions caused by a lack of familiarity with Indian laws have led to understandable reluctance to make remittances and investments.

It is in the country's interest to ensure that non-resident remittances are not frittered away on lavish living, a phenomenon one notices with Indians returning from abroad, or blocked in unproductive avenues like real estate.

This book is intended to bring home to this class of people the opportunities which await them, the pit-falls which they should avoid and the planning they should do to ensure for themselves a reasonably secure future. The coverage of the book is comprehensive, and the relevant provisions of the Income Tax, Wealth and Gift Tax Acts, FERA, Companies Act and Import and Export Policy have been dealt with in as concise a form as possible. The temptation to deal elaborately with case law has been avoided, the principle being stated succinctly; the citations given will enable the reader to refer to the detailed reports.

The book has been divided into two parts—the first part dealing with Income Tax, Wealth and Gift Tax Acts, the Companies Act and the Import & Export Policy, and the

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second part dealing with Foreign Exchange Regulation Act, in view of its special relevance.

The departmental circulars under Income-tax have been reproduced in full so as to enable the reader to appreciate the object of the provisions and to rely on them, if he wishes to do so.

P. S. GOPALAKRISHNAN

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CHAPTER I

Introduction

The subject of non-resident investment has aroused considerable interest in recent months, the public debate thereon being unduly dominated by an apprehension among business circles about attempted takeovers and by an equally vehement reaction about dynastic rule of corporate bodies. The basic issues have been clouded in this unseemly controversy. Non-resident Indians, by their industry and dedication, have contributed to the prosperity of the countries which they have chosen as their second homes, while keeping alive their links with the country of their origin or domicile. They have three basic problems—firstly, they must have a basic knowledge of the fiscal laws of India, since many of them continue to have some sources of income in this country and hope some day to return to their motherland for settlement; secondly, they should be aware of the incentives and concessions provided by the Government of India to attract their investment and thirdly, they need counselling as to how to invest their hard-earned money so as to ensure growth with reasonable return. Ignorance generates baseless apprehensions and in the case of non-resident Indians, doubts and suspicions caused by a lack of familiarity with Indian laws have led to understandable reluctance to make remittances and investments. The sceptre of “high”

taxation has created misgivings in their minds about the utility of putting their savings to good use for their benefit and the benefit of the country.

Investment may assume two forms—direct or portfolio. Portfolio investment seeks an outlet for capital in private hands. Direct investment, in addition, assumes some form of control; it may involve managerial or technical guidance, it could incorporate the dissemination of valuable knowledge or entrepreneurship in the form of R&D, production technology, marketing skills of managerial capability. There is a vast reservoir of scientific and technical skills in the hands of non-resident Indians which is waiting to be exploited. From the country's point of view, non-resident investment will increase availability of investible resources and foreign exchange; it may increase availability of new technology and import substitution; if properly encouraged.

The origin of India's NRI policy can be traced back to the 1970s which witnessed a deterioration in the country's balance of payments position. Invisible receipts of trade showed a decline in 1980-81 and during this period, sterling deposits in India of non-resident investment figures published by the Controller of Capital Issues, which were as high as 40 per cent of the total capital issued in 1978-79, declined to 11 per cent in 1980-81. The actual non-resident investment in capital issues in 1979-80 was 4.2 per cent whereas the same declined to 3.6 per cent in 1980-81. Much of this could be interpreted to mean that there was a slowing down of interest on the part of Indians abroad in sending money to India. This led to the large dose of liberalisation of concessions which were noticed in the 1982 budget. In the range of options for NRI, while the policy permits investment in traded shares of companies, the major avenues emphasised are investment in new issues for the establish-

ment of new companies or expansion and diversification of existing companies, export-oriented units and priority industries. A policy of repatriable and non-repatriable investments balanced by a specification of ceilings on investments shows the hesitancy displayed by government in its approach as if NRI could only be as good as multinational investments. For instance, in the case of public issues of existing or new companies, a non-resident could make investment upon 40 per cent of its equity paid-up capital. The five per cent ceiling applies to traded shares of an existing company. In new priority and export-oriented ventures, upto 74 per cent investment with repatriation rights has been permitted. In a partnership firm, the investment could be as high as 100 per cent without the right of repatriation.

Several issues arise for consideration in this context. Is the policy aimed at promotion of non-resident investment justified? As a potential source of foreign funds, it is certainly worthwhile. The amount may appear small today but given the incentives, it will grow in volume and velocity over a period of time. Non-resident Indians do not have the opportunity to invest abroad and there are restrictions on what they can do abroad, in the same way as foreigners have in making investments in India. It is, therefore, hard economics to permit them to make remittances, their understanding of Indian sensibilities and their concern in improving the industrial base of this country are far greater than those of international lending agencies. The criticism often heard that the government has given away too much by way of concessions in tax rates and otherwise to NRI lacks substance, because they provide the type of motivation than would have been the case otherwise. It is in the country's interest to ensure that non-resident remittances are not frittered away in conspicuous consumption, a phenomenon one notices with Indians returning from abroad, or blocked in

unproductive avenues like real estate. The concessions constitute a hard dose of certainty in an otherwise uncertain world in which the non-resident Indian lives and works.

This book is intended to bring home to this class of people the opportunities which await them, the pitfalls which they should avoid and the planning they should do to ensure for themselves a reasonably secure future. The coverage of the book is comprehensive, and the relevant provisions of the Income Tax, Wealth Tax, Gift Tax Acts, FERA, Companies Act and Import and Export Policy have been dealt with in as concise a form as possible. The temptation to deal elaborately with case law has been avoided, the principle being stated succinctly; the citations given will enable the reader to refer to the detailed reports, if he has the time and the inclination.

Some comment on the provisions of FERA is called for. This piece of legislation understandably, clothes the Reserve Bank with powers to regulate foreign exchange and investment but in a manner which confers too much administrative freedom and too little legislative safeguard. The powers are exercisable in individual cases or in the generality of cases, the latter by notification or circulars. The wording of the notifications is imprecise, they are subject to changes without prior notice or a discussion of the pros and cons and the latest manual which the Bank has issued is of 1978. In as important a subject as foreign investment, the uncertainties created by different pronouncements by the Reserve Bank and by the administrative Ministry noticed recently, could have been avoided. It has not rendered the task of the author easy.

The book has been divided into two parts—the first part dealing with Income Tax, Wealth Tax, Gift Tax Acts, the Companies Act and the Export/Import Policy and the second part dealing with FERA, in view of its importance.

The departmental circulars under Income-tax have been reproduced in full so as to enable the reader to appreciate the object of the provisions and to rely on them, if he wishes to do so. In many cases, they may provide an easier and inexpensive remedy than a costly and protracted litigation.

Before dealing with the provisions of the Indian laws, it will be useful to make a quick review of the position of taxation, exchange control and incentives in a few selected countries. The legislation in each country is based on its economic conditions and political philosophy but a comparison with the measures in force in other countries will lead to a better appreciation of the situation in our country.

POSITION IN UNITED KINGDOM

Exchange Control

The United Kingdom has a system of exchange control administered through a division of territories into scheduled and non-scheduled. Foreign currencies are currencies of all countries outside the scheduled territories. Bonafide currency transactions are permitted to be carried out freely subject to formal permission but there are restrictions on capital transactions. As in India, authority to deal with most of the exchange control matters has been delegated to banks. Under the exchange control orders, transactions in foreign currencies except with authorised dealers are prohibited. The consent of Treasury will be necessary to make any payment in the U.K.; or by a U.K. resident elsewhere, to or for the credit of a person outside the scheduled territories. It will be necessary for a person resident in U.K. to obtain Treasury consent for loans to concerns controlled by persons resident elsewhere, for transactions and securities etc.

Direct investment of capital in new business and the acquisition of shares in existing businesses require consent

but such applications are generally welcomed. Permission for direct investment will normally require the investment to be on a sterling basis. Apart from exchange control, the Control of Borrowing order requires Treasury consent to be obtained to any transaction effected by or on behalf of a person residing outside the U.K., involving the borrowing of money in Britain, where it exceeds £ 50,000 in a year.

Taxation

Residence tests follow the same pattern as in India. The extent of liability of non-resident companies will be limited to profits attributable to a permanent establishment in the U.K., profits for this purpose being arrived at in the same way as in the case of a resident company. Non-domiciled resident employees or non-resident employees are entitled to a deduction of one-half of their earnings and to one-quarter if they are resident in U.K. for nine out of ten years. Capital gains are chargeable in the hands of a non-resident, if they arise from disposal of assets situated in the U.K. and are connected with a permanent establishment. Non-residents are liable to register as VAT tax payers if they make taxable supplies of goods or services in the U.K., exceeding £ 5,000 per annum. On sales made directly to a U.K. importer, a non-resident exporting goods to the U.K. will not be required to register, VAT being payable by the importer.

POSITION IN UNITED STATES OF AMERICA

The United States Government has an open attitude towards foreign investment, both direct and portfolio. The general policy is to admit and treat foreign capital on a basis of equality with domestic capital. There are no general restrictions on foreign ownership of U.S. corporations—public or private—and no restrictions on the acquisition of existing corporations owned by U.S. shareholders. The res-

trictions that do exist are aimed at preventing foreign ownership of certain sensitive industries, such as defence, communications, air transport, coastal shipping and atomic energy.

There are no exchange controls or restrictions in the United States. A foreign investor can not only bring foreign funds into the country but can also borrow in the United States. Free repatriation of capital and profits is permitted. The Federal tax system is neutral towards capital and the movement of capital internationally. Individual states comprising the U.S. have considerable autonomy and independence to enact laws and regulate business in their jurisdiction and although incorporation requirements and tax system are more liberal in some than in others, they do not normally distinguish between the U.S. and foreign-owned investment. The U.S. Government offers no specific incentives to attract foreign investment; a foreign enterprise which acquires or establishes a business in U.S. is entitled to the same tax benefits and other incentives as are available to domestic enterprises.

General Assistance

A number of federal agencies provide technical assistance to the foreigner planning to invest in the U.S. The Department of Commerce provides information on markets, financing and other related areas. An agency called International Trade Association will put the foreign investor in contact with domestic firms seeking to establish a joint venture, licensing agreement or other arrangement; with state industrial development agencies, investment banks etc. Federal assistance to the development of transportation, water and sewer lines, schools and hospitals and housing will be available. Direct loans to business to finance purchase of machinery and technical and advisory service on marketing, accounting and management are also provided.

Export loan credits, export credit insurance, are offered by the Export-Import Bank of the U.S.

Tax Concepts—Corporations

A basic rule of taxation of foreign corporations in the U.S. is the separation of business from non-business income. Business income from U.S. sources is assessed at the rate applicable to a domestic corporation. Non-business income is taxed at a flat rate of 30 per cent on gross income. The foreign income of a foreign corporation is taxable only if (a) the foreign corporation has an office or fixed place of business in the U.S., (b) the income is attributable to that office, and (c) the income falls in certain specified categories.

Tax Incentives

There are no tax holidays to encourage foreign business investment. However, there are certain provisions which encourage capital investment. Gains on sales of properties are treated as capital gains and are subjected to tax at 28 per cent. Tax credit at 10 per cent of the cost of investment in certain depreciable properties, accelerated depreciation on certain properties, R&D costs are some of the other incentives provided for capital investment.

Tax Concepts—Individuals

U.S. citizens and aliens resident in the U.S. are subjected to the same tax rules and are taxable on world income basis. Non-resident aliens are taxable only on non-business income derived from a U.S. source. Business and non-business income are taxed separately, as in the case of corporations. An alien's residence in the U.S. will depend upon his intent, something akin to the provisions of the FERA of our country. The duration of stay will raise a rebuttable presumption of residence. The liability of a non-resident

alien with regard to various sources of income is briefly dealt with below :

(i) *Salary*

A person who renders service within the U.S. is considered to be engaged in a U.S. business and all compensation received for such services will be included in the gross income, wherever paid. However, if the individual is present in the U.S. for a period not exceeding 90 days or the remuneration does not exceed 3,000 dollars or the remuneration is paid by a foreign employer not engaged in a business in U.S., the remuneration will be exempt. Employees of foreign governments stationed in the U.S. will receive exemption from Federal tax on a reciprocity basis.

(ii) *Capital Gains*

This will be taxed if it is connected with a U.S. business. If not connected with a U.S. business, it will be taxed only if the non-resident is present in U.S. for at least 183 days. The rate of tax on net capital gains is 30 per cent.

(iii) *Other Incomes*

Assessable on the same basis as citizens, if the income is connected with a U.S. business.

(iv) *Business*

Basis of assessment of income and deductions is the same for citizens or resident aliens.

Non-resident aliens are subjected to gift tax on the value of tangible property, if located within the United States. The gift tax rates range from 18 per cent on the first 10,000 dollars of taxable gifts to 70 per cent on gift in excess of 5 million dollars. Estate Duty is payable on real and tangible property physically located in the U.S., shares of stock in U.S. corporation, debt obligations etc.

POSITION IN SWITZERLAND

The official name of the country is "Swiss Corporation," which means that it is an association of small states or cantons, each of which is sovereign within the limits of federal constitution. The cantons are autonomous and legislate for taxes. Certain cantons grant tax incentives for new investments in remote areas, on a case-by-case basis. Acquisition of real estate by non-residents and foreign controlled companies will require permission. The general economic condition of the country is such as to need no incentives.

Traditionally, a free-trade country, Switzerland allows the free flow of investments in and out. There are no restrictions on foreign ownership and foreign investment and income can be freely repatriated. Taxation is imposed on the actual profit attributable to a branch and on the capital invested in the branch. Branches of foreign enterprises are treated in the same way as those of local enterprises for tax purposes.