NRI investment and taxation in India

NRIs can use many of the investment avenues available in India either for their own selves or for building up capital for their loved ones.

Every year several Indians leave the shores of their native land in search of better prospects and a better life. However, the one common strain amongst those who left long ago and those who left even yesterday is that they continue to retain their ties with the homeland. Most, if not all have left family behind whom they would like to take care of. Again, most if not all, may look to retire back in India when the time comes.

This much being said, let us have a look at various investment opportunities that India offers. NRIs can use these avenues either for their own selves or

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for building up capital for their loved ones. Newly become NRIs will benefit immensely, veterans can use this as a sort of refresher material. In any case, suffice it to say that there are certain very attractive avenues in India where NRIs may freely invest on a repatriable or a non-repatriable basis. The Reserve Bank of India (RBI) has given general permission to invest in this regard and hence it is not necessary for NRIs to seek permission or license for every investment they intend to make in these avenues. Following is a brief description of such avenues and the related tax implications thereof.

Bank Deposits

These are in the form of NRE/FCNR/NRO accounts. NRE is a rupee denominated repatriable account whereas FCNR is a forex denominated repatriable account. NRO is a rupee denominated non-repatriable account; it essentially serves as a savings bank account for the NRI.

Earlier, the interest rates on NRE and FCNR were attractive as well as tax-free making these deposits good investments in themselves. However, of late the interest has fallen steeply and is subject to caps based on LIBOR and therefore the utility of such deposits has diluted. Now these may be used at best as a temporary parking place for making repatriable investments. For example, overseas funds may be first transferred to the NRE account and then the account may be debited with the amount of investment in, say a mutual fund. When such investment is sold, it can be credited back to the NRE account and then transferred if need be to any overseas account.

Equity Shares

NRIs may invest in the Indian stock market freely. However, this cannot be done in the usual way the NRI would have traded when he was a Resident. Now, as an NRI, he will have to approach an Authorised Dealer (bank) for applying for a Portfolio Investment Scheme (PINS) account.

Portfolio Investment Scheme (PINS)

An NRI has to designate a branch of an Authorised Dealer (AD) for routing purchase and sale of shares only through the branch so designated.

Specific PoA may be granted in favour of the bank, to carry out the formalities in respect of :

1. Applying to RBI for approval, if necessary.
2. Buying and selling shares and debentures.
3. Subscribing to new issue of shares and debentures.
4. Collecting dividend and interest.
5. Holding shares/debentures in safe custody.
6. Renunciation of right entitlement and
7. Arrange for repatriation if the investment is repatriable.

RBI does impose certain caps on NRI investment. However that need not bother an NRI investor. Whenever he or she desires to buy shares of any company, the bank will provide information on whether it is possible to do so or not in light of the outstanding limits. These limits are monitored by RBI on an on-line basis depending upon the inputs provided by the banks.

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Speculation Barred

The NRI should take delivery of the shares purchased and give delivery of shares sold. In other words, speculation in terms of margin trading or short selling is not allowed.

Joint Holdings

The shares can be held in joint names. There is no restriction on the residential status of the other joint holders (maximum 2) but in the case of death of the first holder, the second holder will lose the repatriation right, if any, if he is a Resident. This will be so even if he becomes a non-resident sole holder at a later date.

Repatriation of Refunds

Sale proceeds under the PINS are repatriable after payment of taxes due if any. RBI authorises ADs to repatriate surplus funds remitted for purchase of shares in the following cases :

a) Refund of funds received towards allotment of shares.

b) Surplus funds received for purchase of rights shares.

c) Remittance on account of surplus funds received for purchase of shares or on account of cancellation of trade, under two-way fungibility of ADRs/GDRs.

Tax Benefits

No wonder they call India a tax haven when it comes to investing in equity. The following are the four tax benefits that all investors, NRIs or Residents enjoy on their equity investment :

a) Long-term capital gains are tax-free

b) Short-term capital gains are taxed at the concessional rate of 10%.

c) Dividend is tax-free, however subject to a dividend distribution tax @15%

d) The capital is repatriable if the original investment was made through forex remitted from abroad or through NRE accounts.

If directly investing in the market is not your cup of tea, then Mutual Funds provide a very attractive alternative. These while broadly delivering the advantages of the equity market also obviate the pitfalls associated with it.

Mutual Funds (MFs)

Currently, MFs offer the best mix of return, risk, tax efficiency and liquidity.

There are multiple products and options available to suit diverse needs and risk profiles. The liquidity is excellent as post sale, the funds are available within five to seven days. There are tax benefits too; these are discussed in more detail later on.

Different Types of MF Schemes

Equity Oriented Diversified Schemes: These are the best investments as of today. These schemes have a diversified equity portfolio with very little component, if any, of debt. Consequently the returns are subject to the same kind of risk as that associated with equity markets. From a plethora of schemes, we have selected seven that have shown a consistent performance over time. The following table displays the returns that the selected schemes have earned.

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Mutual Fund Returns (annualized % pa.)

Scheme Name	1- year	2- year	3- year	5-year
Birla Sunlife Equity	48.3	41.8	54.5	53.7
HDFC Equity	32.5	41.0	48.5	50.7
HDFC Top 200	32.0	40.9	46.9	50.4
Reliance Growth	44.4	36.4	54.8	61.5
Reliance Vision	41.9	43.0	49.6	54.5

In all there are over 300 equity oriented schemes operating in the market and the above is just an example of the well performing ones. There are more schemes which have posted impressive results, however space constraints preclude a comprehensive listing.

Debt Based Schemes

On the other side of the coin are debt based schemes or schemes which invest primarily in fixed income instruments. The returns on such schemes are falling currently in sympathy with the interest rate cycle in India. Since the NAVs of these schemes are marked to market, any fall in the interest rates triggers a rise in the NAV and any rise in the interest rates triggers a fall in the NAV. For the past few years Indian interest rates were on the upswing, leading to a drop in the NAV of such schemes. However, going ahead, interest rates may fall, leading to a renewed interest in such products.

NRIs are eligible to invest in MFs on a repatriable as well as a non-repatriable basis. RBI has granted general permission in this regard and as such no special permission is required each time an NRI desires to invest.

Taxation in the case of MF investments

There are essentially two kinds of incomes that NRI investors would earn from MFs - Dividends and Capital gains (upon redemption of units). Capital gains are further segregated into short-term gains and long -term gains. Taxation treatment differs as per the kind of income.

Dividends from MFs are completely tax-free in the hands of the investor as per Sec. 10(35) of the Income Tax Act. However, there is a distribution tax @14.16% (for individual investors) payable by the MF directly to the exchequer. Equity based schemes are exempted from this tax.

As far as capital redemption is concerned, if the units of any MF are held for more than 12 months, the same would qualify as long-term capital assets. Else, these would be termed as short-term capital assets.

Capital gains taxation differs for equity oriented schemes vis a vis non-equity schemes. For equity oriented schemes, long-term capital gains (LTCG) are tax-free whereas short-term capital gains (STCG) tax is payable at a flat rate of 10%.

In the case of sale of MF units which are non equity oriented, LTCG tax is payable @10% without indexation or @20% with indexation, whichever is lower. STCG are taxed at the normal rates applicable to the investor. These are :

Income up to Rs. 1,10,000 is not taxable. Income from Rs. 1,10,000 to Rs. 1,50,000 is taxed @10%. Income between Rs. 1,50,000 to Rs. 2,50,000 is taxed @20% and above that level, it is @30%. There is a surcharge of 10% of the income tax for income over Rs. 10 lakh. In such cases the surcharge payable is limited to the income over Rs. 10 lakh. Surcharge is payable by both Residents and NRIs.

TDS Provisions

Since the dividends from units are tax-free in the hands of the investor, there is no question of TDS thereon. However, capital gains are subject to TDS.

Since the LTCG on equity oriented schemes is nil, there is no TDS too. The TDS on STCG is @10%. On other schemes (non equity oriented), the TDS on LTCG is @20% and on short-term gains is @30%. If either income is more than Rs. 10 lakh a surcharge of 10% would be levied on such rates. There is an education cess of 3% applicable on all taxes.

NRIs may also invest in Real Estate / Immovable property. However, there are elaborate rules framed as far as investment and repatriation in this class of asset is concerned. For a detailed discussion on NRI investment in real estate, watch this space.

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