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Date: 13 Feb 2008

Foreign gains, Indian taxes

Burgeoning salaries, booming stock markets and a buoyant economy have all led to an increase in the investible surplus of individuals. Those who lay claim to a higher amount of investible surplus are naturally curious about whether they can diversify their investments in markets abroad.

They are curious about the pros and cons of investing outside India. And what puzzles most investors is how their investments abroad will be taxed.

Will they have to pay tax in two countries?

What tax laws govern their investments?

Let us try to demystify some aspects of this.

Basic regulations

Under the exchange control regulations, transactions are categorised either as ***capital account transactions or current account transactions***.

For resident Indians, transactions related to investments of any kind outside India, transfer of these investments, maintenance of bank accounts in foreign currency, loans and overdrafts granted to any person outside India and the like, are typically classified as capital account transactions.

All transactions other than capital account transactions are called current account transactions (travel, insurance expenditure, etc would qualify as current account spending).

In February 2004, the Reserve Bank of India (RBI) began the process of allowing individuals to freely remit money outside India. The original limit was free remittance up to \$25,000 in a single calendar year for any purpose including in real estate (for individual residents).

Investment in shares was permitted till 2006, only if the company issuing the shares held at least 10% in an Indian listed corporate. However, this condition severely limited overseas equity investments, and ***was scrapped in December 2006***.

At the same time, the limit on overseas remittances was increased to \$50,000. In May 2007, the limit was further raised to \$100,000. In the latest revision in September 2007, the limit has been raised to \$200,000.

The series of increases is a clear signal that the country is moving towards

full capital account convertibility; the latest revision is also the outcome of a series of measures to flush out excess foreign exchange and check rupee appreciation.

So, what does all this mean to you as an individual?

The scheme envisages a free regime for remittance outside India for permissible current as well as capital account transactions. This means that you can actually remit up to \$2,00,000 a year in one shot or in tranches.

This limit is in addition to the existing facilities for remittance for specified current account purposes. These include private or business travel, studies, medical treatment, etc. There is no obligation to repatriate any funds, even if the individual has booked profits from his earlier investments.

Further, the investor can reinvest the proceeds abroad again, giving him an opportunity to watch his money grow overseas. The only conditions are that under this scheme, **one cannot remit to Bhutan, Nepal, Mauritius or Pakistan or countries identified by the Financial Action Task Force**. Also, under the scheme, once the remittance limit has been reached, one cannot remit again even if some proceeds were brought back during the financial year.

Taxing issues

Income tax is applicable to all residents (as defined under the Income Tax Act, 1961) on their ***worldwide income***.

There are no special tax privileges or exemptions on income from overseas investments. The table above gives you a quick overview of an individual's tax liability in case of overseas income.

Apart from the tax laws in India, an individual investing abroad could fall under the purview of the tax laws existing in that country. India has tax treaties with many countries and almost all of them provide for credit for overseas taxes in India.

However, the complex world of taxes needs to be treated carefully lest the money made from investments gets eroded by the tax that the individual may have to pay. For instance, lower taxes in that country may be offset by the additional tax to be paid for when the individual files his returns in India.

Assume a situation where foreign dividend attracts a tax of 10% in the overseas country, the overall tax impact would be 33.99% such that the balance 23.99% will have to be paid in India ***after taking*** credit for the 10% tax discharged in the overseas country. Capital gains are exempt in many countries, including the **US and Hong Kong**.

Tax liability on overseas investment

Interest and dividends from foreign investments 33.99%

Capital gains

Long term 26.66%

Short term 33.99%

*Maximum marginal rate taking the highest slab

However, ***capital gains from overseas investments are taxed in India***

The beneficial capital gains tax regime in India is applicable only to Indian listed investments.

Procedural aspects

It's quite simple to remit abroad. One has to fill up an application-cum-declaration form under the scheme for each remittance. The form requires source of funds, mode of remittance, details of beneficiary and remittances made during the financial year.

It also asks for a declaration to the fact that the remittance is within the set limits. Individuals can also open, hold and maintain bank accounts outside India without prior approval of the central bank.

The foreign exchange regime has relaxed and opened the doors for Indians to look at foreign shores for investment and diversification. While it might not mean much to the common man, highnetworth individuals can afford to take some risks and grab their share of the world pie.

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