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Returning NRIs have a host of sops awaiting them—from tax breaks to exempt foreign income.

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IN THE years leading up to 1992, non-resident Indians (NRIs) wanting to return to India were regulated by the draconian Foreign Exchange Regulation Act (Fera), under which any offence was considered a criminal offence liable for imprisonment. Unlike other laws where everything is permitted unless specifically prohibited, under Fera, nothing was permitted unless specifically permitted. A scary law indeed! Fortunately, post-1992, NRIs returning to India are free from the clutches of Fera, which has been replaced by a set of liberal foreign exchange management regulations. And so, the Foreign Exchange Management Act (Fema) is now applicable. The benefits apply to NRIs who become residents on returning to India.

Residential status.

A person who resides in a foreign country is considered an NRI if he is/was an Indian citizen, or his parents/grandparents are/were Indian citizens. Such a person becomes a resident in India if he comes to or stays in India:

- To take up employment in India;
- To carry on a business or vocation in India;

For any other purpose that indicates his intention to stay in India for an uncertain period.

An NRI does not need any approvals to become a resident Indian. However, depending on the assets he has, he does have to take a few simple steps.

Foreign assets

As the law stands, NRIs can continue to hold assets outside India. Thus, property, shares, mutual funds, securities and other investments can be held outside India without any approval from the Reserve Bank of India (RBI); it isn't even necessary to declare the assets before the RBI. The only condition: the assets should have been acquired when he was an NRI.

Business outside India.

Although there is no clear wording in the law, if a person runs a proprietary business or is a partner in a firm outside India, the intention is to allow the business interests to continue. However, on returning to India, one must take care to route any income that arises abroad back to India just as soon as it is earned abroad. The general practice here is for a person to hold shares in a company through which business is conducted. Returning NRIs can continue to hold these shares without any RBI approval. One must be aware that although the position stands as such, there's much ambiguity in the drafting of the Fema provisions. And so, in many cases, one must refer to the ADMA 51 dated 1992, which is an important circular with regard to the Fema provisions.

Liabilities incurred abroad.

These become a borrowing for the country, and so if the NRI has taken any loans abroad, he will need RBI approval to continue with it. For example, if the NRI has house property abroad that is on mortgage, the loan cannot be continued without RBI approval.

Typically, if a resident earns income outside India, he is supposed to bring it back within a specified period. In the case of returning NRIs, however, the RBI has laid down that any income earned on assets held abroad can be retained outside India. The returning NRI can also sell any foreign assets held abroad and reinvest the proceeds overseas.

Indian assets

Typically, an NRI too may have assets like bank deposits in India. The returning NRI must inform the bank to turn all his bank accounts (savings, fixed deposits, etc.) into resident accounts. Likewise in the case of shares, debentures and other securities, the companies and other relevant entities in India must be informed about the change in residential status. In the case of Foreign Currency Deposits (FCNR), the RBI has given returning NRIs the option of continuing them till maturity on the same rates of interest. On maturity, the balance including the interest can be transferred to a Resident Foreign Currency (RFC) account.

The same is the case with NRE deposits (repatriable); they can be continued till maturity on the same rates. However, on maturity, the deposits will have to be converted into Ordinary Resident Accounts. If the NRI wants the funds to be transferred to an RFC account, then the deposits will have to be prematurely encashed and deposited in the RFC account. This would, of course, result in loss of interest. Any other account would have to be turned into an ordinary resident account.

RFC accounts.

Apart from FCNR/NRE funds, even foreign funds can be deposited in an RFC account that can be maintained in any convertible currency. The benefit of this account is that it is 'free from operations'. That is to say the NRI can incur expenses abroad freely. For example, he may have holiday plans, for which there is a restriction on the amount of foreign exchange a normal resident can draw. There are no such limits with an RFC account. Similarly, if the NRI wishes to buy foreign shares, subscribe to rights and mutual funds abroad, he can do so using this account. On the other hand, an Indian resident cannot invest abroad freely; there are regulations for incurring expenses in foreign currency.

Tax issues

There are two specific benefits that a returning NRI gets. One is a tax exemption on the interest earned in an RFC account. As long as a person is Not Ordinarily Resident (NOR), the interest on RFC deposits is tax-exempt. Once a person becomes Ordinary Resident, the interest, however, becomes taxable. This exemption is available for FCNR deposit interest as well, but not for interest earned on NRE accounts.

Concessional tax rates.

The other benefit is a concessional rate of tax on interest earned on deposits and debentures of Indian companies, and some government securities. This comes under Chapter XII-A benefits, whereby the NRI is liable to pay tax at 20 per cent on income earned on assets if they have been bought in foreign currency. This benefit is available to people even after returning to India—till such time as the assets mature. This allows room for tax planning. To benefit the most, an NRI can stretch the term of his deposits with Indian banks to the maximum possible period before he becomes a resident. If the NRI has income only under Chapter XII-A, he doesn't even have to file returns.

Residential status: Not Ordinarily Resident

The government confers a special status on persons who become residents under the Income Tax Act. If a person has been a non-resident for nine years, he can be an NOR for a year. If a person has been a non-resident for 10 years or more, he can be an NOR for two years. Further, under the Income Tax Act, there is a clause that if he has stayed in India for less than 730 days during the past seven years, he will be given an NOR status for a period of three years.

As an NOR, any foreign income that is received outside India is exempt from tax. Once the NOR status period expires, his foreign income will be taxable in India—subject to the terms of any double taxation treaties, if any. This NOR status has become a sore point with returning NRIs. Earlier, the NOR status benefit was available for as long as nine years. With effect from 1 April 2003, this benefit has been scaled down. That apart, returning NRIs can indeed come back with a smile without too much of a worry about the tax implications of bringing back their foreign assets.;

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