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Taking up foreign citizenship may not help you save taxes in India. Here's why

Citizenship has limited relevance so far as Indian taxation is concerned

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Gautam Nayak

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One often reads newspaper reports about some prominent businessman having taken up foreign citizenship, mostly of some obscure country offering citizenship to persons who

invest a large sum of money there. The speculation generally is that this has been done to obtain income tax benefits. Is this really true?

Under Indian income tax law, the scope of taxability of income is based on the concept of residence, and not on the concept of citizenship. While a resident is taxed on his worldwide income, a non-resident is taxed only on income accrued, received or deemed to be accrued or received in India (Indian income). Therefore, a non-resident gets the benefit of his income outside India not being subjected to tax in India.

Not all residents are subject to tax on their worldwide income. In the concept of resident, there are two categories—resident and ordinarily resident (ROR) and resident but not ordinarily resident (RNOR). While an ROR pays tax on his worldwide income, an RNOR would pay tax only on Indian income, plus any income arising from business controlled from India or profession set up in India. Effectively, in most cases, a non-resident (NR) or an RNOR has to pay taxes only on Indian income, and only an ROR has to pay taxes on his worldwide income.

Residence under tax laws is determined purely by the number of days of physical stay in India during the relevant financial year, and does not depend at all on citizenship, except in one respect. If you have been in India for more than 182 days during the year, you are a tax resident of India, and hence your worldwide income is taxable. Even if you have not been in India for 182 days during the year, you would still be a resident if you have been in India for 365 days or more during the last four years, as well as for at least 60 days during the relevant year.

To this second type of resident qualification, there are two exceptions, under which the requirement of 60 days is replaced by 182 days, where the concept of citizenship matters. Effectively, in these cases, the individual is not regarded as a resident unless he is in India for 182 days or more.

The first exception is for an Indian citizen who leaves India, either as crew of an Indian ship or for purposes of employment, during the year. This exception applies only to Indian citizens, and would not apply to foreign citizens (including persons of Indian origin or PIOs). Therefore, if a PIO comes to India on an expatriate posting, this exception would not apply to him in the year in which he returns to his home country. If he is in India for more than 60 days during the year, he would be regarded as a tax resident of India, assuming that he would have been in India for at least 365 days during the past four years on account of his posting in India.

The second exception applies to both Indian citizens as well as PIOs. This is a case of an individual, who is outside India, and comes on a visit to India during the year. Since it

applies not just to Indian citizens outside India, but also to PIOs, this exception would continue to apply to an individual who has given up Indian citizenship, and taken foreign citizenship.

Therefore, it is clear that citizenship matters only in cases of persons leaving India for employment abroad during the year. That too, in such cases, it is the Indian citizen who gets a benefit, not a foreign citizen. Therefore, taking up foreign citizenship really does not benefit a person under Indian tax laws. It is only by actually staying abroad physically that a person (whether retaining Indian citizenship or taking up foreign citizenship) gets the benefit of becoming a non-resident or an RNOR, and paying taxes in India only on Indian income.

One aspect that needs to be kept in mind is the applicability of tax treaties. Some countries, such as the US, treat their citizens as tax residents of that country, irrespective of the number of days of physical stay in that country. In such situations, a person would be a tax resident of both countries—of India, on account of number of days of physical stay, and of the foreign country, on account of citizenship. One would then have to apply the tie-breaker test contained in the relevant tax treaty, to determine which country the person would be regarded as a tax resident of for the purposes of the tax treaty, and then apply the other treaty provisions to provide any possible relief from taxation in India, which may be available under the tax treaty.

Therefore, citizenship has limited relevance so far as Indian taxation is concerned. A person taking up foreign citizenship, but continuing to stay in India, does not really get any tax benefit. It may be other factors that may have prompted him to take up foreign citizenship.

Gautam Nayak is a chartered accountant

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