

THE CHAMBER'S INTERNATIONAL TAX JOURNAL

DECEMBER - 2020 | CTCITJ. IV | NO. 2



Estd. 1926

ज्ञानं परमं बलम्

A Quarterly Journal of
THE CHAMBER OF TAX CONSULTANTS



Contents

Editorial.....iii
— **Paresh P. Shah**

From the President.....v
— **Anish Thacker**

Chapter No.	Subject	Page No.
1.	Test of Residency – An overview — CA Kaushik Saranjame & CA Meena Khivasara	1
2.	Migration of Individuals in the course of rendering Employment Services - Tax considerations — CA Parizad Sirwalla and CA Nishit Kapadia	19
3.	Migration of Individuals – HNIs — Ashish Mehta, Bijal Ajinkya & Krutika Chitre, Advocates	35
4.	Place of Effective Management – An Overview of Corporate Tax Residency — CA Paresh P. Shah	44

December

Migration of Individuals – HNIs



Ashish Mehta, Bijal Ajinkya & Krutika Chitre, Advocates

A. BACKGROUND

- 1.1 Personal income-tax regimes form a critical part of a country's income-tax code. These systems contain a myriad of intricacies and differ across jurisdictions; however, are united to facilitate cross border trade and movement by setting out rules to determine an individual's tax residence and income-tax obligations in a country.

- 1.2 This article endeavours to discuss some of the nuances around the interplay of citizenship with an individual's tax residence, prevalent reasons for the migration of citizenship, popular choices amongst countries offering citizenship programs, and the considerations to bear in mind while taking up a new residential status or citizenship. Though primarily focussed on India and its systems, the authors¹ have endeavoured to discuss international practices in relevant places.

1. Ms Bijal Ajinkya (Partner), Mr Ashish Mehta (Partner) and Ms Krutika Chitre (Senior Associate) are advocates at Khaitan & Co.

B. THE INTERPLAY BETWEEN CITIZENSHIP AND TAX RESIDENCE

2 Personal income-tax systems across the world are often categorised into two broad categories: 'residence-based' or 'citizenship-based' tax systems.

2.1 Residence-based systems

2.1.1 In residency-based taxation, a 'tax resident' of a country is often taxed on his worldwide income, i.e., on income earned in the home country and outside.

2.1.2 Every country is free to choose the criteria to establish the tax residency of an individual; however, popularly a tax residence test is largely based on the number of days an individual physically spends in the said country and is often disconnected from citizenship. Amongst the two systems, a 'residence-based' system is also more commonly used and followed by several countries, including India (to a large extent).

2.1.3 Under the Income-tax Act, 1961 (IT Act), an individual may be categorised as a resident, resident but not ordinarily resident (RNOR) or a non-resident (NR). The residential status of an individual is of immense importance as it governs the scope of his income taxable in India. A resident individual is subject to tax on his worldwide income (earned in any part of the world), while an NR is only subject to tax on his income that accrues or arises or is deemed to accrue or arise in India.

An RNOR's taxation is akin to that of an NR, except that an RNOR is also liable to tax on income derived from a business controlled or a profession set up / practised in India.

2.1.4 The Indian tax residency criteria are predominantly based on the "physical presence test"; however, an Indian citizen may also be deemed to be a resident of India under certain circumstances.

2.1.5 In the annual budget for the fiscal year 2020, alongside other amendments, a few key changes were those that create an unprecedented nexus between the citizenship and tax liability of an individual, as opposed to tax residence as has historically been the case.

- A Person of Indian Origin (PIO) who has Indian sourced income exceeding INR 1.5 million and who has been on a visit to India for more than 120 days but less than 182 days in the financial year, is deemed an RNOR.

- An Indian citizen having Indian sourced income exceeding INR 1.5 million during the financial year shall be deemed to be an RNOR in that financial year if the citizen is not liable to tax in any other country or territory because of his domicile or residence or any other criteria of similar nature.

2.1.6 The amendment has led to the departure from a purely residence-based

system of taxation to one also focussed on citizenship. The Memorandum to the Finance Bill, 2020 alluded to the rationale behind the amendment and highlighted the possibility for an individual to arrange his affairs in such a manner that he is not liable to tax in any country or jurisdiction during a year. the amendment may be viewed as India's move to plug the erosion of its tax base and also tackle abuse of tax laws, where residents circumvent the day count in order to avoid being within the Indian tax net. Bearing in mind India's large expat population and similar physical presence-based tax residency tests practiced in a lot of countries, the amendment would give teeth to India's enforcement of source-based taxing rights coupled with citizenship in certain cases.

2.1.7 The above change in 2020 was preceded by a similarly intended change in the 2019 budget, wherein the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) which is an act to tax offshore unreported incomes and assets was retrospectively modified to apply to taxpayers that were NR at the time of initiation of proceedings under the BM Act but were residents when such unreported offshore incomes were earned and or offshore assets acquired. It is noteworthy that BM Act when introduced² was only to apply to residents of India as defined under the IT Act.

2.2 Citizenship-based systems

2.2.1 The amendments discussed above make India part of a small club of countries taxing individuals based on citizenship, albeit in certain circumstances only.

2.2.2 The United States of America's (USA) citizenship-based taxation is widely known. USA mandates that all its citizens and green card holders across the globe pay taxes in the USA on their worldwide income, irrespective of the source of income (subject to certain concessions and conditions). 'US persons' are also required to comply with reporting requirements such as FATCA filings.

2.2.3 On similar lines, Eritrea and Hungary also tax their NR citizens on their worldwide income. Hungarian citizens are considered tax residents by default and in case of dual citizenship, a Hungarian citizen may not be considered a tax resident of Hungary if such person does not have a permanent home or habitual abode in Hungary. Myanmar also imposes a tax on the income of its NR citizens (except on salaries). Finland taxes its erstwhile citizens who have given up their citizenship for up to 3 years, subject to certain conditions. Certain countries like Italy and Spain tax their nationals as residents upon their migration to known tax havens / blacklisted countries. A Spanish national who gives up Spanish tax residence is considered

2. BM Act was introduced in Budget 2015 and was made effective from 1 July 2015.

a Spanish tax resident for the year of departure and the next four tax years if the new tax residence is in a tax haven.

2.3 The tie-breaker test

2.3.1 Tax residence and citizenship also intertwine whilst determining the residence of an individual under tax treaties.

2.3.2 The provisions of a tax treaty apply to 'residents' of the two contracting countries. As discussed above, owing to the varying criteria in different countries, a person may be a resident of two or more countries at the same time. In such a situation, most treaties provide for a 'tie-breaker test' to conclusively determine the residence of such a dual resident.

2.3.3 The tie-breaker test usually follows a series of steps to determine the tax residence of a dual resident.

- **Step 1 - 'Permanent Home' test:** An individual is considered a resident of the country where he has a permanent home available. If the individual has a permanent home in both countries, step 2 becomes relevant.
- **Step 2 - 'Centre of vital interests' test:** An individual having a 'permanent home' in both countries is deemed to be a resident of the country with which his personal and economic relations are closer (centre of vital interests). This includes factors

such as the presence of family and social relations, cultural and political activities etc. To determine economic relations, businesses undertaken, profession practiced, or investments of the individual may also be looked into.

If the individual has a permanent home in both countries and the 'centre of vital interest' of the individual cannot be determined, or if the individual does not have a permanent home in either country, it is necessary to evaluate the 'habitual abode' test given in the next step.

- **Step 3 - 'Habitual Abode' test:** 'Habitual abode' refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient. A sufficient length of time may be looked at to determine the stays and whether they are part of the individual's settled routine.

If the individual has a habitual abode in both countries or neither of them, it is necessary to evaluate the nationality of the individual.

- **Step 4 - 'Nationality' test:** If the residency of an individual cannot be determined upon application of step 1 to 3 above, the individual shall be deemed to be a resident of the country of which he is a national.

Migration of Individuals – HNIs

2.3.4 Thus, in case of tie-breaker tests, the citizenship of an individual may be the factor determining his residence under a tax treaty and accord taxing rights to a contracting country accordingly.

2.3.5 If the residency of an individual cannot be determined upon application of step 1 to step 3, and if the individual is a national of both the countries, the competent authorities of the countries settle the question by mutual agreement.

C. POPULAR COUNTRIES FOR INVESTMENT BASED CITIZENSHIP | IMPORTANT CONSIDERATIONS AND POPULAR JURISDICTIONS

3.1 In recent times, a number of high net worth individuals (HNIs) have moved to foreign shores for lifestyle needs, visa free travel, business expansions and the like. Each incidence of citizenship migration has a different rationale; however, a few common considerations before opting for foreign citizenship include ease of global travel, business opportunities, ease in raising finance for businesses, tax planning, the legal system, investment required, better education and medical facilities, reduced administrative and fiscal burden, political and economic stability, arrangements for sharing of information as well as extradition treaties, etc. A 'citizenship by investment' program is the most common route chosen by HNIs to obtain citizenship of a country. This entails investment in specific assets or areas and meeting prescribed conditions such as the minimum period of stay,

participation in national service, clean criminal records, donations to specified institutions, etc.

3.2 Some of the aforementioned factors are discussed below:

- **Strength of passport:** One of the strongest reasons for HNIs relocating to a country outside India is the freedom to travel. A strong passport allowing for visa-free / visa on arrival travel to numerous countries facilitates easy travel, both for business and leisure.
- **Business Opportunities/ease in raising finance:** The presence of potential markets, consumers, raw materials etc. in a jurisdiction, along with increased facilities and opportunities like raising finance in more mature and developed financial markets provide an impetus to migrate.
- **Tax system:** The prevalent tax rates and taxing system strongly impacts the decision in choosing alternative citizenship. Considerations such as the personal income tax rate, other direct incidences such as capital gains, withholding taxes, gift tax, wealth tax and an inheritance tax rate are key considerations.
- **Legal System:** A common law system versus a civil law system in a country often tips the balance whilst choosing a

country. A common law system follows legal precedents and judicial interpretation while a civil law system is based purely on the letter of law.

- **Investment Required:** The requirements for the relevant asset class in which investment must be made differ from country to country. Common investment fora include real estate, treasury bonds, government funds, donations (eg to universities), businesses etc. Each investment offers a different level of return and also forms one of the important considerations in picking a jurisdiction. Coupled with this, the amount of investment required to make one eligible to apply for citizenship is also of utmost importance.
- **Extended visa/citizenship:** A key consideration in choosing a jurisdiction could also be the rights extended and obligations imposed upon family members and future generations.
- **Information sharing/extradition treaties:** Information sharing mechanisms (automatic information sharing, double tax avoidance agreements, tax information exchange agreements, etc.) between the countries could also be a relevant factor in the choice of jurisdiction. Another factor that

could be considered relevant would be whether the jurisdiction has executed extradition treaties as well as its history of extraditing its citizens in response to requests from other jurisdictions. Certain jurisdictions offer a blanket protection to citizens from extradition, irrespective of international treaties entered into and factors such as these may be important considerations in specific cases.

- **Others:** The political and economic stability of a region is also an important factor in choosing a jurisdiction as it impacts the safety of personal wealth, businesses and investments. Medical facilities, educational institutions and overall a better standard of living for family members could also be important factors in deciding migration from a country to another.

3.3 Keeping in mind the aforementioned, below are some popular countries that offer citizenship by investment programmes:

- **Malta:** Malta is chosen by HNIs for migration. Its popularity is, amongst other factors based on the strength of its passport allowing visa-free / visa on arrival travel to more than 180 countries, family residency, EU membership and a short processing period (approx. six

Migration of Individuals – HNIs

months to one year) to acquire citizenship, freedom to travel and a residence and domicile-based taxation system with no inheritance tax.

- **Cyprus:** Cyprus is yet another country that investors popularly choose on account of a swift process ranging from approximately 6-8 months, visa-free travel to 170 plus countries and similar benefits such as Malta on family residency and EU membership. Cyprus also has a moderate tax regime with rates ranging from 0-35% based on income progression.
- Outside the EU, St Kitts and Nevis has increasingly become the choice for investors with its strong passport allowing visa-free travel to over 150 countries and most importantly no requirement of residence or personal visits to the country before attaining citizenship. The investment program is one of the oldest in the world. Furthermore, there is no incidence of direct taxation in St Kitts and Nevis with there being no income or wealth tax or inheritance tax, estate duty, gift taxes, net worth tax.
- Singapore and the UK also have attractive investment-based programmes providing for permanent residency cards as well

as citizenships. Other countries include Portugal, Bulgaria³, Grenada, Montenegro, etc.

D. ACTION POINTS FOR MIGRATION

- 4 A change in citizenship is often preceded by a change in the individual's residence, from a tax and/or regulatory perspective. From an Indian perspective, some of the action items to bear in mind while migrating offshore are as follows:
 - 4.1 **Remittance under Liberalised Remittance Scheme (LRS):** Under the LRS, only a resident individual can freely remit up to USD 250,000 per financial year for any permissible current or capital account transaction or a combination of both. A change in residence from a regulatory perspective would disentitle a person from availing this avenue.
 - 4.2 **Re-designate Indian bank account to NRO Account:** As per prevailing foreign exchange management regulations, deposit accounts owned by an Indian resident vis-à-vis NRI are different. NR accounts are subject to debit and credit restrictions and banks must be informed of a change in residential status in order to re-designate bank accounts.
 - 4.3 **Income-tax filings:** A change in residential status would bring about an important change in the income-tax liability of an individual. One must

3. It is presently unclear whether Bulgaria's residency by investment program is operational or has been suspended.

thus inform the income tax authorities of change in residential status as well as file tax returns in the capacity of a non-resident.

4.4 **Directorships:** An individual's directorship on Indian companies should be re-evaluated on deciding to migrate to ensure it is in sync with the Indian company laws.

4.5 **Others:** An individual may also consider informing credit card companies and mutual fund / investment houses about migration and re-consider positions of power such being a signatory to bank accounts for corporates, etc.

E. **GIVING UP YOUR PASSPORT? WHAT'S AT STAKE?**

5 Before one decides to apply for citizenship in another country, it is important to consider the ramifications in India. Like most countries, India reserves certain rights and privileges solely for its citizens, as discussed below:

5.1 **Dual Citizenship:** Unlike several countries, India does not permit dual citizenship. Thus, it should be borne in mind that acquiring new citizenship would essentially mean relinquishing one's Indian citizenship.

5.2 **Visa-Free Travel:** Several countries worldwide allow their citizens the privilege to travel visa-free / with visa on arrival facilities to over a hundred

countries. The India passport ranks 84th on this list allowing the same to 58 countries.⁴

5.3 **Travel to India:** Relinquishing Indian citizenship and accordingly the Indian passport will require the visiting foreigner to possess the requisite visa granted by the Indian government. In this regard, an Overseas Citizen of India (OCI) is permitted visa-free travel to India, as long as he possesses an OCI card. However, as witnessed during the recent pandemic, the Indian government may at any time suspend visas of foreigners as well as OCI cards on a need basis, making visits and travel uncertain.

5.4 **Voting Rights:** The right to elect representatives to the central and state assemblies can be exercised solely by an Indian citizen.

5.5 **Investments:** India has stringent exchange control regime in place in the form of the Foreign Exchange Management Act (FEMA), related regulations and the Foreign Direct Investment Policy. These prescribe investment avenues along with caps on investments by non-residents and approval routes (automatic and government). As per prevailing law, most investment opportunities are open for Indian citizens who are residents of India and is most regulated for foreign citizens who are non-residents. NRIs and OCIs enjoy certain relaxations.

4. <https://www.henleypassportindex.com/passport>

5.6 **Acquisition of Property:** An Indian citizen may own and hold all kinds of property in India, subject to local legislation (except a non-resident Indian who cannot hold agricultural land). On the other hand, a foreign national of non-Indian origin who is not resident in India for FEMA purposes cannot acquire any property in India, except by way of lease not exceeding 5 years. An OCI cardholder is allowed to acquire any property in India, including immovable property, by way of purchase or gift except for any agricultural property. In terms of inheritance, there is no difference between an Indian and a foreign citizen. Both may inherit any kind of property in India, by a will or intestate succession.

5.7 **Citizenship of Minor Children:** Renunciation of Indian citizenship by an individual leads to an automatic cessation of his minor children's Indian citizenship.

5.8 **Participation in Activities & Opportunities in India:** There are several activities which an individual except an Indian citizen is not permitted to carry on. The following are prohibited for all foreign nationals (including OCIs):

- Registration as a voter, i.e. voting in central / state elections.
- Holding a government post
- Restrictions on admissions to public educational institutions
- Research work

- Missionary activities
- Mountaineering
- Journalism
- Visit to any place notified as a protected or restricted area.

F. CONCLUSION

6.1 There are several open avenues for HNIs to choose from when it comes to relocation, with investment-based citizenship programmes being the most popular. There has been pressure globally on several offering jurisdictions to either stop or modify existing schemes to avoid abuse as well as discourage passport shopping.

6.2 While benefiting from the plethora of options, it is important that the core aspects surrounding the acquisition of a new citizenship are carefully considered. One must be mindful of the viability of the investments that are required to be made to be considered eligible for citizenship, the lock-in periods for which such investments need to be kept, transfer restrictions on such investments post such lock-in period, if any, return on such investments as well as related aspects before deciding to give up Indian citizenship.

6.3 While a passport/citizenship could be the gateway to global business and related opportunities, one will need to consider these financial aspects as well as implications of giving up the citizenship of the home country.

○○