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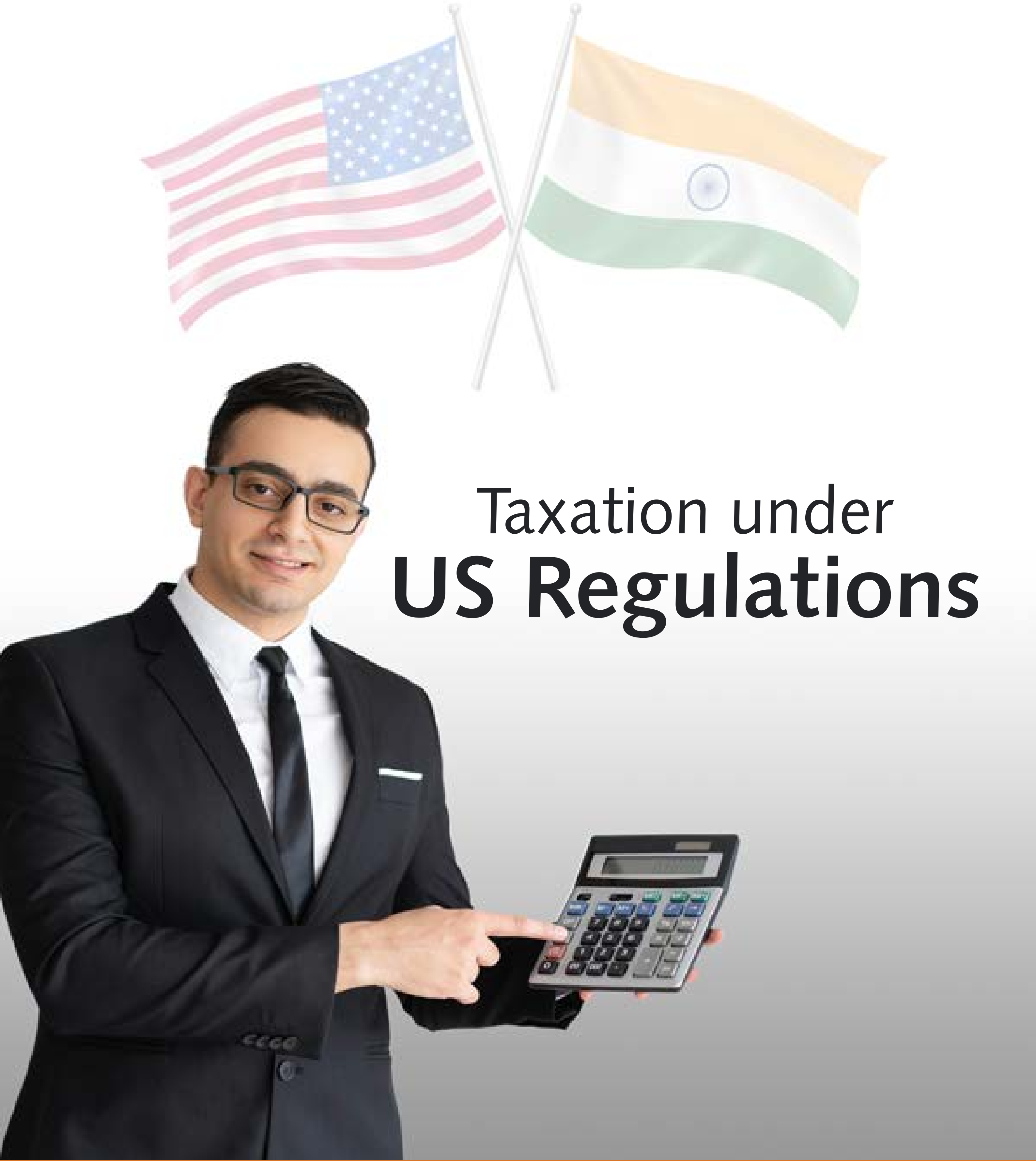
November - December, 2020

WE PLAN, YOU PROSPER



Taxation under US Regulations

From the
Editor's Desk

So far the endeavor of articles in Punji Times was to provide the readers with clarity on investments, market conditions, factors that influence financial decisions etc.

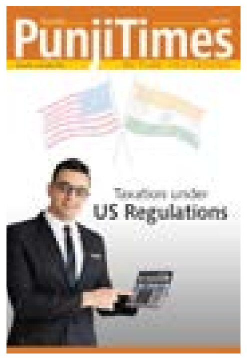
As our reach increased, it came to light that there a large number of readers are either settled in USA or working in USA whilst still holding Indian passport. Majority these readers still have financial interests in India. A number of these readers have approached us with queries related to compliance or reporting to US-IRS for their USA financial interests, transactions and assets.

We at Meri Punji, thought it would be appropriate to dedicate one complete issue of Puni Times covering all these aspects giving overview of their obligation and consequence of non reporting / compliance. The articles are generic in nature and do not cover specific situations.

This basic knowledge is not to frighten, but to enlighten. This edition is in no way a replacement of your tax advisor.

We hope this issues comes in handy and benefits our readers with basic understanding of USA_IRS regulations.

Best,
Team Meri Punji



Punji (*noun / Hindi*) - **Capital** *meaning, wealth in the form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing.*

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CONTENTS

Tax Implication on Gift/ Inheritance in United States (US)

A. Receipt of Gift / Inheritance of property from Non Resident

The receipt of a gift or inheritance is not taxable income to the recipient. However, reporting to Internal Revenue Service (IRS) in specified form (Form 3520) is required, if the aggregate value of gifts/inheritance received by a US citizen or income tax resident from a non resident* during any tax year exceeds a certain threshold. Here, Inheritance refers to the assets that an individual bequeaths to his or her loved ones after he or she passes away. An inheritance may contain cash, investments such as stocks or bonds, and other assets such as jewellery, art, antiques, and real estate etc.

**A non resident is any person other than a citizen or income tax resident of the United States, and includes a foreign estate, foreign corporation and partnership.*

Foreign Estate means an estate the income of which, from sources outside the United States which are not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income for United States federal income tax purposes.

- Reporting in Form 3520:

For purposes of determining whether the receipt of a gift/ inheritance from a non resident is reportable, different thresholds are applied for gifts/ inheritance received from individuals and foreign estates as well as from foreign partnerships and foreign corporations. There is no need to even report if the gift/inheritance received is below the threshold limit. A U.S. person is required to report the receipt of gifts only if the total amount of gifts is more than the following threshold limit:

- From non resident individual or foreign estate: **$100,000** during the taxable year

  (Once the $100,000 threshold has been exceeded, the recipient must separately identify each gift/inheritance that is more than $5,000)

- From foreign corporations or foreign partnerships: **$16,388** during the taxable year

  (Once the threshold has been exceeded, the recipient must separately identify all gifts from foreign corporations and partnerships, including the name of the donor)

Form 3520 is not a tax return, but an informational return. It is submitted in line with personal income tax return due date (15th April) or extended date (15th October).

In above case, tax will not be imposed on the recipient nor on the estate of the deceased if assets are based outside the US. If a foreign individual owns US property and passes away, the US-Situs portion of estate will be taxed. The Executor of the estate must file Form 706-NA and 40% estate taxes will be levied on any amount over $60,000.

- Penalty in case of non-reporting/ mis-reporting:

Financial Penalty of 35% will be imposed for failure to file a complete and accurate report. The penalty is based on the gross value of the gift or inheritance. No penalties will be imposed if the taxpayer can demonstrate that the failure to comply was due to reasonable cause and not wilful neglect.

B. Gift Tax in the hands of Donor

Tax on gifts is levied in the hands of the donor or person making the gift and not the receiver. The gift tax is a federal tax on the transfer of money or property to another person while getting nothing (or less than full value) in return.

The general rule is that any gift is a taxable gift. However, there are many exceptions to this rule. Generally, the following gifts are not taxable gifts.

1. Gifts those are not more than the annual exclusion for the calendar year/lifetime exclusion.
2. If you're paying tuition or medical bills, paying the school or hospital directly can help avoid the gift tax return requirement
3. Gifts to your spouse.

Let's understand the exclusions in some detail:

- Annual Exclusion:

1. Blanket allowance of gifts up to $15,000 to someone in a calendar year. No reporting required at all in such a case.
2. If one gives more than $15,000 in cash or assets (for example, stocks, land, a new car) in a year to any one person, then he/she needs to file a gift tax return. That doesn't mean you have to pay a gift tax. It just means you need to file **IRS Form 709** to disclose the gift.
3. Further, the annual exclusion is per recipient; that means, for example, that one can give $15,000 to his cousin, another $15,000 to a friend, another $15,000 to the neighbour and so on.
4. The annual exclusion also is per person, which means that if one is married, he and his spouse could give away a combined $30,000 a year to whomever without having to file a gift tax return.

- Lifetime Exclusion

1. On top of the $15,000 annual exclusion, one gets $11.58 million lifetime exclusion. That comes in handy when you're giving away more than $15,000.
2. For example, if you give your brother $50,000 this year, you'll use up your $15,000 annual exclusion. In such a case, since annual exclusion is crossed, one needs to file gift tax return but he might not have to pay tax on gifts as excess $ 35,000 simply counts against his $11.58 million lifetime exclusion

- Filing of Return:

1. Only individuals are required to file gift tax returns. If a trust, estate, partnership, or corporation makes a gift, the individual beneficiaries, partners, or stockholders are considered donors and may be liable for the gift and GST taxes.
2. **Form 709 is an annual return** Generally, you must file Form 709 no earlier than January 1, but not later than April 15, of the year after the gift was made. However, in instances when April 15 falls on a Saturday, Sunday, or legal holiday, Form 709 will be due on the next business day.
3. **Extension:** Use Form 8892-Application for Automatic Extension of Time To File Form 709 and/or Payment of Gift/ Generation-Skipping Transfer Tax, to request an automatic 6-month extension of time to file your federal gift tax return.

- CA Monika Mahawar

Disclaimer:
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FBAR – Report of Foreign Bank and Financial

Form FinCEN 114, "Report of Foreign Bank and Financial Accounts", normally referred to as FBAR, is used to report a financial interest or signature authority over a foreign financial account

Requirement of FBAR

A United States person that has a financial interest in or signature authority over foreign financial accounts must file an FBAR if the aggregate value of the foreign financial accounts exceeds $10,000 **at any time** during the calendar year

The definition of foreign bank and financial account includes a host of accounts, apart from the bank account. This includes:

1. Savings account, bank fixed deposit account
2. Brokerage and securities account
3. Commodity futures or options account
4. Insurance policies with cash surrender value
5. Annuities cash value
6. Mutual funds

Generally, an account at a financial institution located outside the United States is a **foreign financial account.**

Note: An account maintained with a branch of a United States bank that is physically located outside of the United States is a foreign financial account. An account maintained with a branch of a foreign bank that is physically located in the United States is not a foreign financial account.

Exception to the rule: But, you don't need to report foreign financial accounts that are:

- Correspondent/Nostro accounts,
- Owned by a governmental entity,
- Owned by an international financial institution,
- Maintained on a United States military banking facility,
- Held in an individual retirement account (IRA) you own or are beneficiary of,
- Held in a retirement plan of which you're a participant or beneficiary, or
- Part of a trust of which you're a beneficiary, if a U.S. person (trust, trustee of the trust or agent of the trust) files an FBAR reporting these accounts.

Due Date

The FBAR is an annual report, due **April 15** following the calendar year reported.

You're allowed an automatic extension to **October 15** if you fail to meet the FBAR annual due date of April 15. You don't need to request an extension to file the FBAR.

Penalty for Non- Filing

A person who is required to file an FBAR and does not properly do so can be liable for up to $10,000 in fines per violation (although the fee may be waived in case of a reasonable cause for failure to file). Willful neglect to file an FBAR is subject to a penalty of $100,000 or 50% of the balance in the account at the time of the violation, whichever is greater.

Special Consideration in case of Joint account with Spouse

The spouse of an individual who files an FBAR is not required to file a separate FBAR if the following conditions are met:

1. All the financial accounts that the non-filing spouse is required to report are jointly owned with the filing spouse;
2. The filing spouse reports the jointly owned accounts on a timely filed FBAR electronically signed; and
3. The filers have completed and signed Form 114a, "Record of Authorization to Electronically File FBAR's" (maintained with the filers' records). Otherwise, both spouses are required to file separate FBARs, and each spouse must report the entire value of the jointly owned accounts.

Details to be filed for FBAR

One must keep records for each account you must report on an FBAR that establish:

- Name on the account,
- Account number,
- Name and address of the foreign bank,
- Type of account, and
- Maximum value during the year.

You must keep these records for five years from the due date of the FBAR.

- CA Mridul Gupta

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United States - Income Tax

Income tax is one of the most well-known forms of taxation. Every person who earns income in the U.S. is supposed to pay income tax on both the federal and state level. Federal taxes include social security and FICAtaxes (US payroll taxes). Federal taxes are progressive, with higher rates of tax on higher levels of income. Each state also has its own form of income tax. Some states have a progressive tax system, while others impose a flat tax rate on all income. Each state also has its own form of income tax. If you earn over a certain amount, you must file both federal and state taxes before April 15th of each year.

Tax payers are required to have the following numbers to file the tax returns:

• Social Security Number (SSN):

SSN is issued by the Social Security Administration (SSA) and is like a personal ID for most Americans. It is issued to people who are either born in the United States or are authorized to work in the US (having Immigration Visa). It is a national ID number for taxation and various other purposes. Its main purpose is to track individuals across a broad range of services offered by the US government. Application for SSN is filed in **Form SS-5**.

• Individual Taxpayer Identification Number (ITIN):

ITIN is issued by the Internal Revenue Service(IRS) and is used for tax filing purposes. An ITIN is issued to those who, for some reason, aren't allowed to have an SSN but have to pay their taxes. So, ITIN is only issued to nonresident aliens and not to the citizens (unless they are ineligible for SSN). It is also issued to unauthorized immigrants. Application is filed in **Form W-7** along with documentation to prove foreign status and identity. Thus, with the help of ITIN, the IRS can identify you as a taxpayer which, in turn, helps you file your taxes.

Residence rule

For the purpose of taxation, individual is defined as a tax resident or non-resident.

Resident:

- All U.S. citizens and U.S. residents are treated as U.S. tax residents.
- For a non-U.S. citizen (alien individual) to be treated as a resident alien, he or she must satisfy either the "green card test" or the substantial presence test.
- Green Card Test - An alien individual will meet the green card test if the individual is a lawful permanent resident (LPR) of the United States. A green card holder is someone who has been granted authorization to live and work in US on a permanent basis. If you are a green card holder (or a US citizen), you are considered a US resident for tax purposes irrespective of where you actually live.
- Substantial Presence Test - An alien individual will meet the substantial presence test if the individual is physically present in the United States for at least:

  1. 31 days during the current calendar year; and
  2. Total of 183 days during the current year and the preceding two years. To satisfy the 183 days requirement, count all of the days you were present in the current year, and one-third of the days you were present in the first year before the current year, and one-sixth of the days you were present in the second year before the current year.

Non-resident:

A foreign citizen is treated as a nonresident unless the individual qualifies as a resident as mentioned above.

Return filing requirements:

- Resident aliens must report their worldwide income
- Non-resident aliens must report their income effectively connected with the U.S. and their U.S. sourced income. (Same as if in India – Non-Ordinary Resident/Non-resident case). The taxation in such a case will be governed by DTAA irrespective of individual tax rules.

United States - Income Tax

Federal Income Tax Brackets and Rates for Single Filers, Married Couples Filing Jointly or Separately and Heads of Households

For Single Individuals	For Married Individuals Filing Joint Returns	For Married Individuals Filing Separate Returns	For Heads of Households	Rate
Up to $9,875	Up to $19,750	Up to $9,875	Up to $14,100	10%
$9,876 to $40,125	$19,751 to $80,250	$9,876 to $40,125	$14,101 to $53,700	12%
$40,126 to $85,525	$80,251 to $171,050	$40,126 to $85,525	$53,701 to $85,500	22%
$85,526 to $163,300	$171,051 to $326,600	$85,526 to $163,300	$85,501 to $163,300	24%
$163,301 to $207,350	$326,601 to $414,700	$163,301 to $207,350	$163,301 to $207,350	32%
$207,351 to $518,400	$414,701 to $622,050	$207,351 to $311,025	$207,351 to $518,400	35%
$518,401 or more	$622,051 or more	$311,026 or more	$518,401 or more	37%

Standard Deductions Vs Itemized Deduction:

- Under the federal tax system, taxpayers can claim either a standard deduction or itemize their deductions to reduce the tax.
- Standard deduction is $12,400 for single taxpayers, $18,650 for head of household filers, and $24,800 for married couples filing jointly
- An itemized deduction is an expenditure on eligible products, services, or contributions that can be subtracted from adjusted gross income (AGI) to reduce the tax. Itemized deductions are listed on Schedule A of Form 1040.

Due Date of Tax Returns:

Individual income tax returns are generally due on **15th April**. The time for filing can be automatically extended for **6 months** by filing *IRS Form 4868 - Application for Automatic Extension of Time to File US Individual Income Tax Return*. However, the time for payment of tax cannot be extended. If April 15 falls on a weekend or legal holiday, you have until midnight the next business day following April 15 to timely file either Form 4868 or your tax return.

Various Return forms:

- **Form 1040:** Annual income tax return filed by citizens or residents of the United States
- **Form 1040 SR:** U.S. tax return for seniors (age 65 or above)
- **Form 1040 NR:** Income tax returns for non-residentalien
- **Form 1040 NR-EZ:** Income tax return for certain non-resident aliens withno Dependents
- **Form 1040C:** U.S. departing alien tax return
- **Form 8802:** U.S. Residency Certification
- **Form 8615:** Tax for certain children who have unearned income.
- **Form W-2:** Wage and Tax Statement by Employer (same as form 16 as per Indian Law)
- **Form 1099:** Information return to report various types of income other than salary (Same as Form 16A as per Indian law)
- **Form W-4:** Employee's Withholding Allowance Certificate (form by employee to employer to instruct them on how much tax to withhold from the gross paycheck)
- **Form 1116:** Foreign Tax Credit-Individual, estate or trust
- **Form 3520:** Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

- Various Credits:

A tax credit is an amount of money that taxpayers can subtract from taxes owed to their government. Unlike deductions and exemptions, which reduce the amount of taxable income, tax credits reduce the actual amount of tax owed. The most common tax credits available to a taxpayer include:

1. Earned Income Tax Credit (EITC):

- Refundable credit available to eligible individuals who meet the income requirements and other statutory requirements.
- Only a social security number (SSN) can be used on the form to claim the credit. The credit is not available to individuals who file tax returns with an ITIN.

2. Child Tax Credit:

- A taxpayer can claim a $ 2,000 credit against taxes owed for each qualifying child for which a dependency exemption has been claimed.
- The qualifying child must be a citizen, national or resident of the United States
- ITIN holders are eligible for the Child Tax Credit (CTC).

3. The American Opportunity Tax Credit:

- Partially refundable tax credit for qualified education expenses associated with student's post-secondary education
- Can be claimed on the tax return of a student, dependent provider or spouse making post-secondary education payments.
- The credit allows up to $2,500 annually

United States - Income Tax

Comparison with Indian Law:

Particular	Indian Law	US Law
Residency rule	A natural person will be an Indian tax resident based on his physical presence in India in a financial year. A natural person may be a resident, non-resident or not ordinarily resident in India during the tax year.	The United States classifies citizens to always be U.S. tax residents. This is the case regardless of how much time a U.S. citizen spends outside of the United States.
Tax slab / Tax brackets	In the Indian tax system, tax rate categories are referred to as 'tax slabs'. They specify tax rates as they apply to specific ranges of taxable income. They differ based on the age of the individual being taxed-Individuals up to age 60, Senior Citizen, Super Senior Citizen.	In the American tax system, these categories are known as 'tax brackets'. They are mainly split based on marital status- Single, Married Filing Jointly, Married Filing Separately, Head of Household.
Tax Exemptions	Under the Indian tax system, an annual taxable income under Rs 2.5 lakhs is considered exempt from tax. This means that an income ranging from Rs 0 to Rs 2.5 lakhs will be levied 0% tax.	Under the American tax system, there is no threshold that is exempted from tax. The minimal tax that must be levied on a taxable income, even if it is $0, is 10%.
Tax deductions	In Indian Law, you can lower your taxable income by availing the standard deduction of Rs 50,000 if you are a salaried individual or various other tax deductions such as section 80 C to 80U.	Tax system in the US does provide all its taxpaying citizens with the option of availing a standard deduction or itemized deduction.
Single Return / Joint Return with spouse	In Indian Law, Separate return is filed for married individuals.	Under US Law, Joint return can be filed for married individuals.
No of Returns	Only one return is required to be filed	Two Returns are filed on both Federal as well as State level.
Due Date	31st July	15th April
Clubbing of Minor Income	In Indian Law, minor income is clubbed with parents.	As per US law, separate return is filed. However, parent can electby filing Form 8814, to set aside the kiddie tax by reporting a child's income directly on the parent's return.
Report of Foreign Accounts	Included in respective ITR Form	Separate form FinCEN Form 114 (FBAR) is filed.

- CA Monika Mahawar

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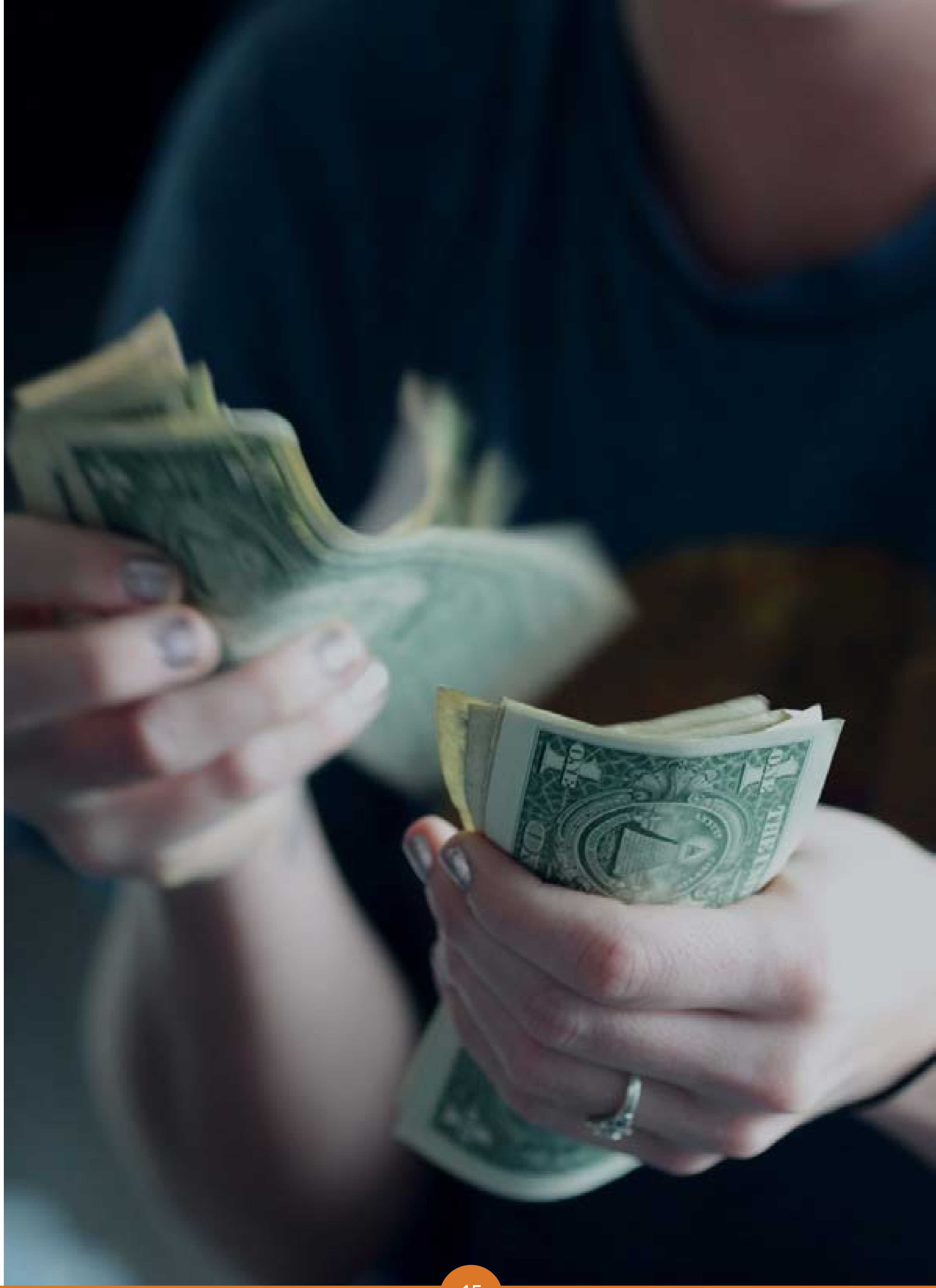
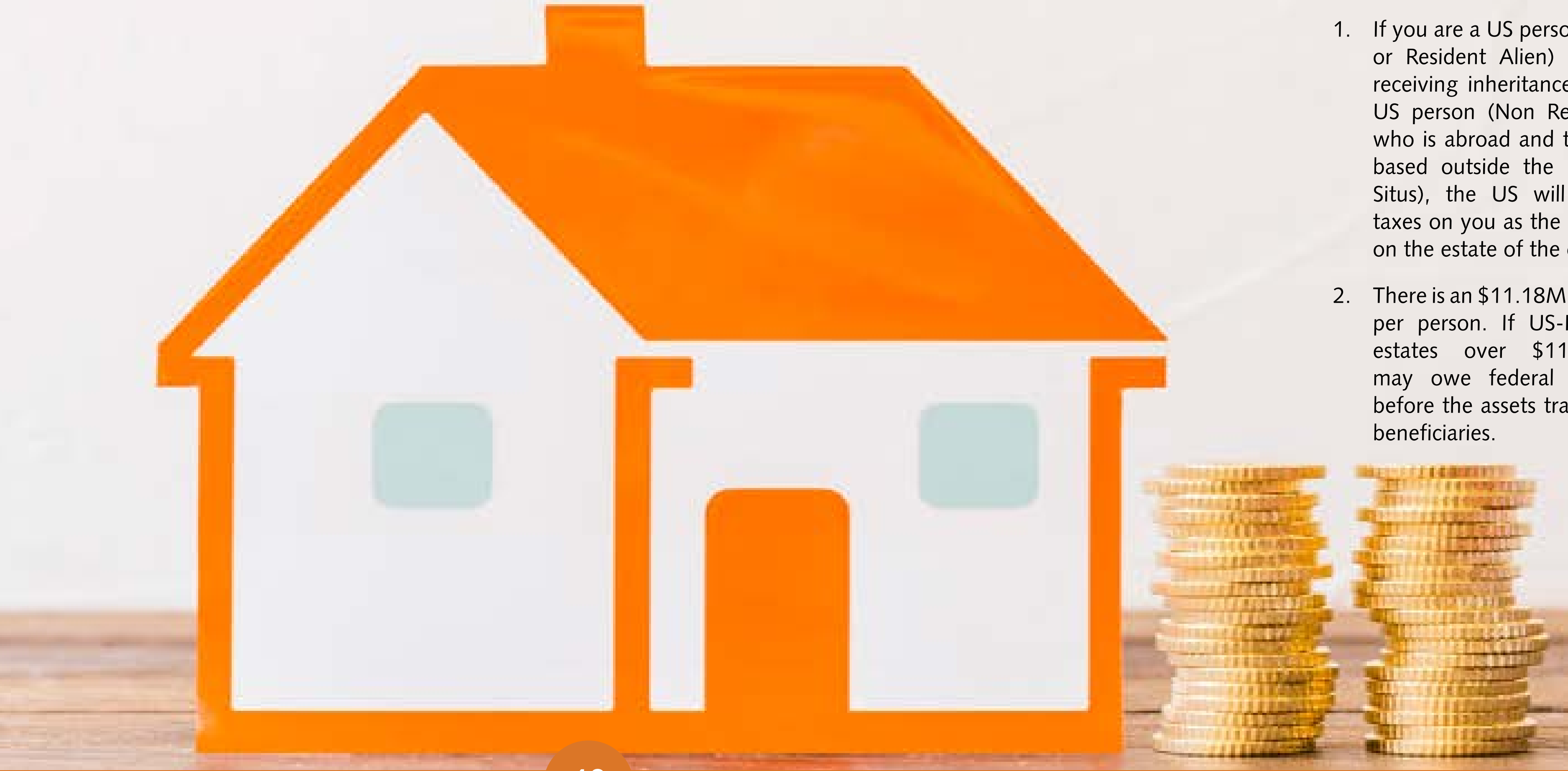


TAX ON INHERITANCE OF PROPERTY

Inheritance is the practice of passing on private property, titles, debts, rights, and obligations upon the death of an individual.

There can be several types of tax when a family member dies because estates can be taxed at the federal and state level.

Type of Tax	Federal or State?	Who pays?
Estate Tax	Federal	Estate of person who dies "donor"
Estate Tax	State	Estate of person who dies "donor"
Inheritance Tax	State	Beneficiary



Federal Estate Tax

1. Estate taxes are always paid by the donor, not the recipient
2. When someone dies and has assets, the federal government taxes some of those assets before they are passed on to heirs.
3. The **estate tax rate is 40%** which means that anything **beyond $11.18M** is subject to a 40% federal tax for US Person.
4. However, If a foreign individual owns US property and passes away, the US-Situs portion of his or her estate will be taxed differently. The Executor of the estate must file **Form 706-NA** and 40% estate taxes will be levied on any amount **over $60,000**.
5. When you receive inheritance from abroad and pay taxes to a foreign government, you must complete form 706-CE for the IRS.

Exemptions from Estate Tax

1. If you are a US person (US Citizen or Resident Alien) and you are receiving inheritance from a non US person (Non Resident Alien) who is abroad and the assets are based outside the US (non-US-Situs), the US will not impose taxes on you as the recipient, nor on the estate of the deceased.
2. There is an $11.18M "exemption" per person. If US-Persons have estates over $11.18M, they may owe federal estate taxes before the assets transfer to their beneficiaries.
3. If the donor is a non-US Person (or Non-Resident Alien), then there will be a $60K estate tax exemption (on US-Situs Assets). Note that Resident Alien in this case is based on domicile.
4. Situs Mean the place to which, for purposes of legal jurisdiction or taxation, a property belongs.
5. US Situs Property includes property in the US, tangible property in the US (like jewelry or cash), and shares of US stock, whether privately or publicly held and including things like US mutual funds or shares in an apartment co-op, regardless of the location of the stock certificates.

State Estate Tax

1. Depending on the state, state estate tax may also be owed. Some have exemptions up to a certain amount. All exempt spouses. Some exempt certain classes of familial heirs.

Inheritance Tax

1. It is a state tax that the recipient pays when they inherit assets from an estate of a person who has died.
2. The beneficiary pays the tax to the state where the individual lived and died or the state where the property was owned. A beneficiary may pay state inheritance tax to multiple states if there is, for instance, property across multiple states.

Inheritance in India

1. If you are a US resident, Green Card holder or citizen and receive inheritance from India. **India does not tax inheritances** at the time when such inheritance is received. Tax is levied only on the income generated by the receiver from the inheritance.
2. If, as a US resident, Green Card holder or citizen you inherited assets in India from an Indian citizen or resident, you will not be subject to inheritance tax. However, you will have to comply with certain reporting requirements
   - Even if there is no tax liability at the time of inheritance, US residents, citizens and Green Card holders who inherit property in India must file **Form 3520** along with their tax return As per IRS regulations, Form 3520 must be filed only in cases where a US citizen, resident or Green Card holder receives inheritance (or gifts) of more than $100,000 from a foreign person or estate
   - This is another reporting that may come up on the event of inheritance of financial assets in India. **Form 8938** requires US residents, citizens and Green Card holders to report any foreign financial assets such as bank balances, mutual funds, shares etc. if the aggregate of such assets exceeds $50,000 for single taxpayers or $100,000 for married taxpayers
   - You must file **the FBAR** if you are a US resident, citizen or Green Card holder and had, at any time in the tax year, an aggregate balance of more than $10,000 in all your overseas bank and financial accounts.

- CA Mridul Gupta

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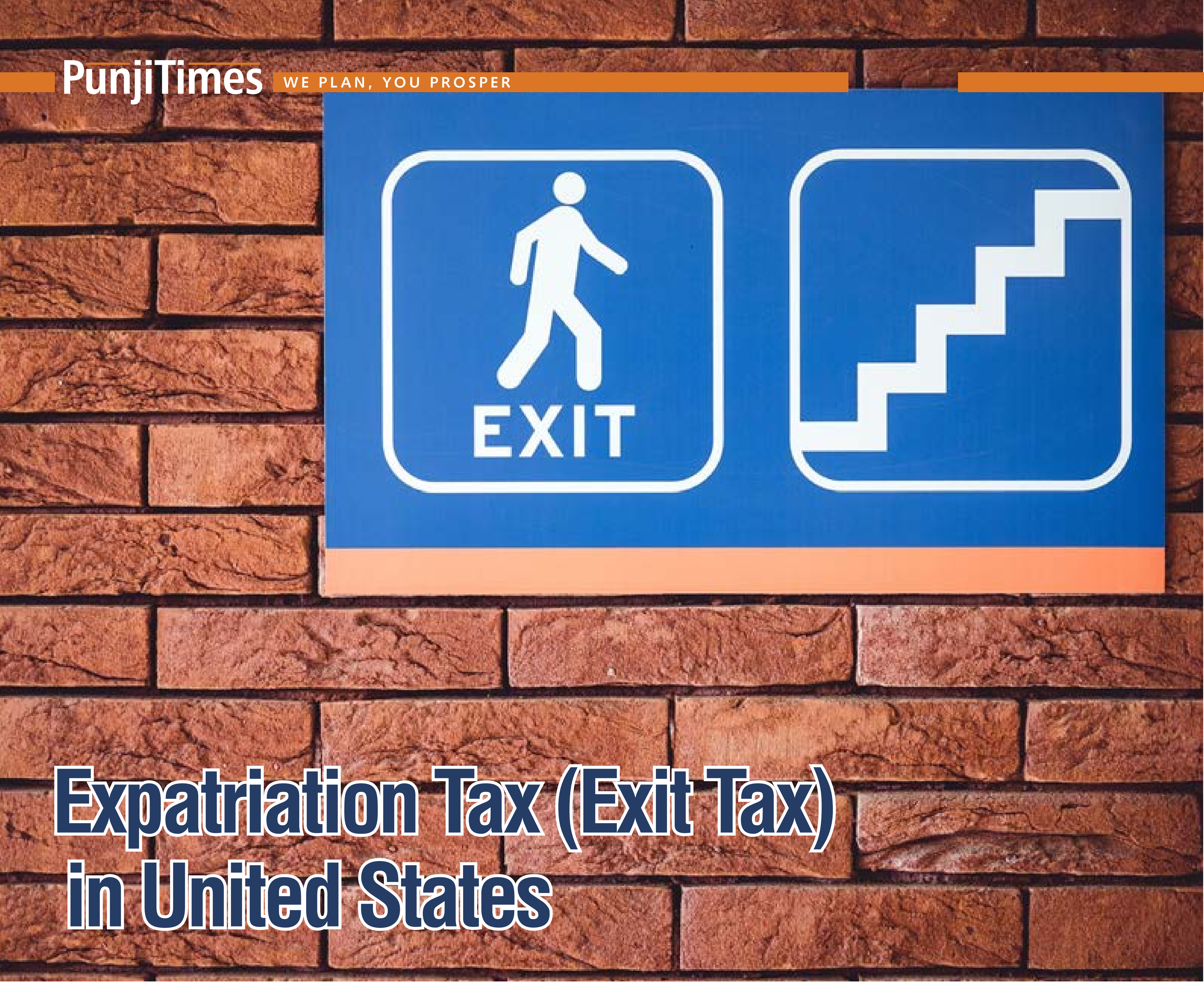

Expatriation Tax (Exit Tax) in United States

U.S. Citizens & Green Card Holders may become subject to Exit Tax when relinquishing their U.S. status. The IRS requires covered expatriates to prepare an exit tax calculation and certify prior years' foreign income and accounts compliance. Therefore, if a person is considering leaving the U.S. permanently, there may be subject to exit tax. The exit tax process measures untaxed income and delivers a final tax bill. Paying exit tax ensures your taxes are settled when you cease to be a US tax resident.

What is U.S. Exit Tax?

U.S. Exit Tax is U.S. Government's way of making individuals who are considered U.S. Citizens or Long-Term Residents* to pay a tax (depending on certain factors) to the U.S. Government upon 'exiting' or 'expatriating' from U.S. If you are neither a US citizen nor a long-term resident, you do not need to pay exit taxes.

**Long Term Residents*: Green card holders who have held a green card for 8 out of the last 15 years is referred as 'long-term residents'.*

Covered expatriates:

As a US citizen or long-term resident you need to file **Form 8854-Initial and Annual Expatriation Statement**, which determines whether you are a "covered expatriate" and subject to the exit tax regime. You are a "covered expatriate" if you meet one or more of the following three conditions:

1. First, your net worth is over **$2 million** on the date of your expatriation or termination of residency - This is the aggregate net value of worldwide assets, not just your U.S. assets. For married taxpayers, each spouse's net worth is calculated separately from the other. If they own their assets relatively equally, a married couple could have a total net worth of up to $4 million without triggering the Exit Tax.

2. Second, your average net annual income tax liability for the 5 years ending before the date of expatriation or termination of residency is over **$171,000** (2020) - This is not your taxable income, but your tax liability on that income. If you are married and filing taxes jointly, you must use your net tax liability on your joint returns, even if only one of you is expatriating. This trigger can sometimes be avoided with the filing of separate tax returns (not joint return).

3. Third, if you do not certify **five years** of U.S. tax compliance preceding the date of your expatriation or termination of residency. If you have not complied with your US tax obligations for the last five years, the exit tax will apply. If you haven't filed, or haven't filed properly, you will need to fix that too. You can amend your prior tax returns (and other forms) and simultaneously also file a **Form 8854** to expatriate.

How is Exit Tax Calculated?

The Exit Tax is computed as if you sold all your assets at its FMV on the day before you expatriated. Any resulting gains in excess of **$ 737,000** (for 2020) are subject to normal income tax rates. The amount you are due to pay will be dependent on the structure of your personal assets. Depending on the type and source of income, it may be immediately taxable or taxed at a future date, once the income becomes distributed and taxable. An election is available to postpone payment of the exit tax on a given asset until that asset is actually sold, by providing adequate security and paying interest.

Penalty:

Anyone who has expatriated or terminated his U.S. residency status must file Form 8854. A **$10,000** penalty may be imposed for failure to file Form 8854 when required.

- CA Monika Mahawar

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Foreign Trust

What is a foreign trust?

A trust is a structure in which legal title to property is transferred from the owner ("grantor") to another party ("trustee"), who will then administer the property for the benefit of a third party ("beneficiary"). Under US law, a trust that was organized in a foreign country and subject to that country's laws is a foreign trust.

The status of a trust as foreign or domestic will affect the U.S. taxation and reporting requirements of the trust and its beneficiaries. All trusts that do not meet both the "court test" and "control test" are considered foreign trusts.

A. Court test: Any federal, state, or local court within the United States is able to exercise primary authority over substantially all of the administration of the trust (the authority under local law to render orders or judgments).

There are also four so-called "bright-lines rules" for meeting the U.S. court test.

1. A trust will automatically meet the court test if the trust is registered with a U.S. court.
2. In the case of a testamentary trust created pursuant to a will probated within the U.S., the trust will meet the court test if all fiduciaries of the trust have been qualified as trustees of the trust by a court within the U.S.
3. For inter vivos trusts, if the fiduciaries and/or beneficiaries take steps with a court within the U.S. that cause the administration of the trust to be subject to the primary supervision of such U.S. court, the trust will meet the court test.
4. If a trust document specifies that a foreign country's law will govern the trust, this does not necessarily mean that the trust will fail the court test. If the trust specifies that the law of a foreign country governs, but gives a court within the U.S. the authority to exercise primary supervision over enforcing that law, the court test will be met.

In addition to the bright-line rules there is also a safe harbour rule, which provides that a trust will be a U.S. trust where the trust instrument does not direct the trust to be administered outside the U.S.,

The trust is administered exclusively in the U.S., and the trust is not subject to an automatic migration provision.

B. Control test: One or more U.S. persons must have the authority, by vote or otherwise, to make all "substantial decisions" of the trust with no other person having veto power. Substantial decisions mean all decisions, other than ministerial decisions, that any person is authorized to make under the terms of the trust instrument or applicable law.

How is a foreign trust taxed by the US?

For U.S. tax purposes, trusts are taxed as grantor or non-grantor trusts.

When the grantor retains an incidence of ownership over the assets transferred to a trust, it is treated as a **grantor trust** and its income and capital gains are taxed to the grantor as if the assets had never been transferred. The trust itself will not be subject to U.S. income tax.

When the grantor gives up all incidence of ownership over assets transferred to a trust, the trust is taxed as a **non-grantor** trust in a manner similar to individuals. For U.S. income tax purposes, foreign non grantor trusts are not generally subject to U.S. tax, unless the trust earns U.S. source or effectively connected income.

What U.S. tax reporting is required for a foreign trust?

If a foreign trust has a U.S. owner or beneficiary, U.S. tax reporting will be required. Transfers to, distributions from and annual income and expenses of foreign trusts must be reported on **Forms 3520 and 3520-A**. These are filed annually, and reporting is based on US accounting principles.

- Form 3520

In general, a Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts is required to be filed when a U.S. person:

- creates or transfers money or property to a foreign trust or makes a loan to a foreign trust;
- receives distributions from a foreign trust or receives a loan from a foreign trust;
- is treated as the U.S. owner of a foreign trust under the grantor trust rules; and

Form 3520 is submitted in line with personal income tax return due date (15th April) or extended date (15th October).

- Form 3520-A

In addition to **Form 3520**, U.S. persons who are treated as owners of a foreign trust under the grantor trust rules must ensure that the foreign trust timely files a complete and accurate **Form 3520-A**, Annual Information Return of Foreign Trust with a U.S. Owner , and furnishes the required annual statements to its U.S. owners and U.S. beneficiaries.

If a foreign trust fails to file **Form 3520-A**, the U.S. owner must:

1. complete and attach a substitute **Form 3520-A** to a timely filed **Form 3520**, and
2. Furnish the required annual statements in order for the U.S. owner to avoid penalties for the foreign trust's failure to file a **Form 3520-A**.

Form 3520-A is filed by the 15th day of the **3rd month** after the end of the trust's tax year. An automatic 6-month extension may be granted by filing **Form 7004**, *Application for Automatic Extension of Time to File Certain Business Income Tax, Information and Other Returns*

Penalties on Form 3520

If you fail to file **Form 3520** or file the form with missing or incorrect information, penalties will be assessed by the IRS. Initially, assessed penalties will the greater number of either $10K or:

- 35% of the gross value of all the property transferred to the trust which was not indicated on **Form 3520**;
- 35% of the gross value of all received distributions from a foreign trust which were not indicated on **Form 3520**; or
- 5% of the gross value of all trust assets owned by a US Person which were either not reported or incorrectly reported on **Form 3520**.

If you made an honest mistake when reporting **Form 3520**, you may be able to escape penalties if you can prove that you were not wilfully and neglectfully omitting information.

- CA Mridul Gupta

Disclaimer:
You are requested to consult the tax advisor as each fact changed can be needed a different compliance.

Liberalised Remittance Scheme (LRS)

The Liberalised Remittance Scheme (LRS) of the Reserve Bank of India (RBI) allows resident individuals to remit a certain amount of money during a financial year to another country for investment and expenditure. The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.

Resident individuals may remit up to USD 2,50,000 per financial year or its equivalent for any permissible current or capital account transaction or a combination of both. Release of foreign exchange exceeding USD 2,50,000 requires prior permission from the Reserve Bank of India.

This money can be used to pay expenses related to travelling, medical treatment, studying, gifts and donations, maintenance of close relatives etc. The remitted amount can also be invested in shares, debt instruments, and be used to buy immovable properties in overseas market. Individuals can also open, maintain and hold foreign currency accounts with banks outside India for carrying out transactions permitted under the scheme.

Permitted Transactions

Current Account Transactions	Capital Account Transactions
Private visits to any country (except Nepal and Bhutan)	Opening of foreign currency account abroad with a bank
Gift or donation to a person/organization outside India	Purchase of property abroad
Going abroad on employment	Making investments abroad
Emigration	Setting up Wholly Owned Subsidiaries and Joint Ventures outside India
Maintenance of close relatives abroad	Extending loans including loans in Indian rupees to Non-resident Indians (NRIs) who are relatives as defined in Companies Act, 2013
Business trip	
Medical treatment abroad	
Studies abroad	

There are no restrictions on the frequency of remittances under LRS. However, the total amount of foreign exchange purchased from or remitted through all sources in India during a financial year should be within the cumulative limit of USD 2,50,000.

Prohibited Transactions

The remittance facility under the scheme is not available for the following:

I. Remittance for any purpose specifically prohibited under **Schedule I** (like purchase of lottery tickets/sweep stakes, banned/proscribed magazines, etc.) or any item restricted under **Schedule II** of Foreign Exchange Management (Current Account Transactions) Rules, 2000.

II. Remittances for purchase of Foreign Currency Convertible Bonds (FCCBs) issued by Indian companies in the overseas secondary market.

III. Remittance for trading in foreign exchange abroad.

IV. Capital account remittances, directly or indirectly, to countries identified by the Financial Action Task Force (FATF) as "non- cooperative countries and territories" from time to time.

V. Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised by the Reserve Bank to the banks.

Documentation:

The individual will have to designate a branch of an Authorized Dealer through which all the remittances under the Scheme will be made. The resident individual seeking to make the remittance should furnish **Form A2**.

It is mandatory for the resident individual to provide his/her Permanent Account Number (PAN) for all transactions under LRS.

No form 15CA and 15CB is required to be furnished by an individual for remittance under LRS.

TCS Requirement

Authorised Dealer (AD) is required to collect tax at source (TCS) @ 5% on foreign remittance exceeding Rs. 7 lakh in a Financial Year under Liberalised Remittance Scheme (LRS). The limit of Rs. 7 lakh is applicable per AD.

In cases where the amount is remitted for pursuing education paid through a loan obtained from any financial institution, rate of TCS shall be 0.5% on the amount exceeding Rs. 7 lakh.

Liberalised Remittance Scheme (LRS)

Most of the times, the payments for various purposes are made through the credit cards and various intermediaries such paytm etc and the payments could be made in rupee terms or in foreign exchange. The provisions are equally applicable to credit card banks and the intermediaries and hence care should be taken to ensure that the TCS is done on transactions through credit cards or intermediaries.

Grant of loan in Rupees to Non-resident Indian (NRI)/ Person of Indian Origin (PIO)

LRS permits granting of loan **in rupees** to NRI/ PIO relative (as defined u/s 2 (77) of companies Act, 2013) under the Scheme being within the overall limit under the Liberalized Remittance Scheme of USD 2,50,000 per financial year for meeting the borrower's personal requirements or for his own business purposes in India by way of crossed cheque/ electronic transfer credited to the Non-Resident (Ordinary) Rupee Account (NRO) a/c of the NRI/PIO.

The loan shall not be utilized for any of the activities in which investment by person resident outside India is prohibited and shall not be remitted outside India. The loan should be free of interest and the minimum maturity of the loan should be one year.

Rupee Gift to Non-resident Indian (NRI)/ Person of Indian Origin (PIO)

A resident individual can make a **rupee gift** under the scheme to a NRI/PIO who is a relative (as defined u/s 2 (77) of companies Act, 2013) of the resident individual by way of crossed cheque /electronic transfer. The amount should be credited to the NRO a/c of the NRI / PIO. The gift amount would be within the overall limit of USD 2,50,000 per financial year.

Points to consider

- Remittances under the Scheme can be consolidated in respect of family members. However, clubbing is not permitted by other family members for capital account transactions.
- Banks will not extend any kind of credit facilities to resident individuals to facilitate capital account remittances under the Scheme. Such facility can be extended for current account transactions.

- CA Monika Mahawar

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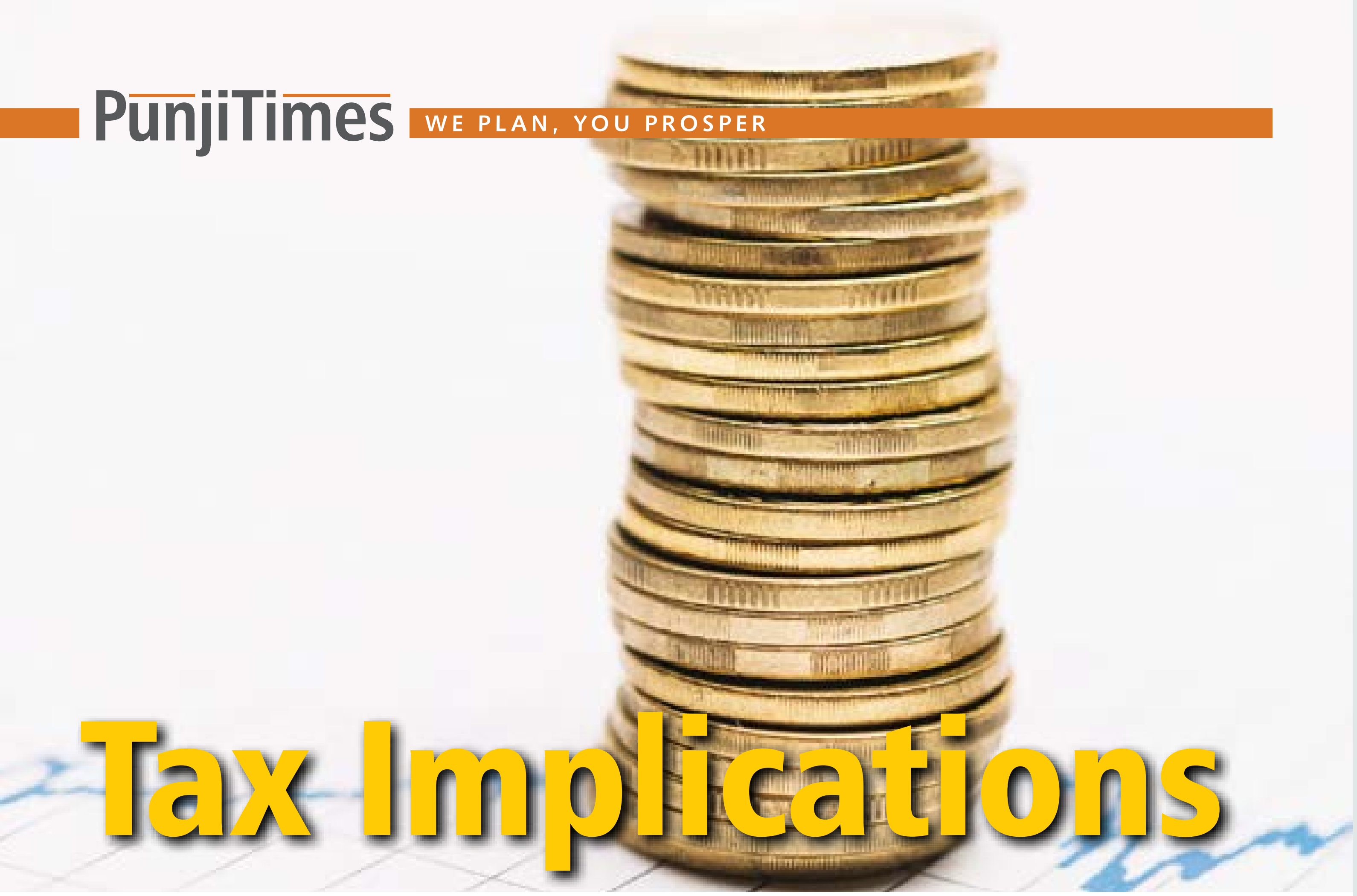

Tax Implications

FOR NRIS RETURNING TO INDIA

(A) INTRODUCTION

The change of residence from the host country changes the NRI status. A person returning to India for permanent settlement will have various implications if tax laws are not followed, as far as declaration of income and tax obligations are concerned.

This article is an attempt to clarify the tax implications for NRIs returning back to India.

(B) NRI TAX RESIDENCY STATUS UNDER FEMA AND INCOME TAX

To identify whether the income earned abroad will be taxed in India, NRIs must first consider their residential status for the financial year and whether the income was earned in India.

As per the Indian law, there are two applicable statutes governing taxation and foreign investment for returning NRIs – the Foreign Exchange Management Act (FEMA) and the Income Tax Act (ITA).

The FEMA regulates foreign investment and transactions of Indian residents outside India. This includes foreign bank accounts and foreign investments in real estate, equity, mutual funds, money transfers, remittances, among others.The ITA, on the other hand, regulates taxation and defines the appropriate tax treatment of such investments.

Residency under FEMA is defined by intent. An NRI permanently residing outside India is treated as an 'NRI under FEMA' irrespective of the number of days of their stay in India. Once an NRI returns to India with the intent to settle permanently, that individual becomes a resident Indian for FEMA purpose.

The Income-Tax Act defines the provision for determining the residential status of a person. Under ITA, the residency status and taxation depend on the number of days an NRI spends in India.Under the Income-Tax law, a person must fall into one of these three categories,

- Non-Resident
- Resident but Nor Ordinary Resident in India (RNOR)
- Resident and Ordinary Resident in India (ROR)

Once you know your residential status, it is relatively easy to figure out other tax implications. If you qualify as a "Resident," your foreign earnings are taxable in India. However, if you are considered as an "RNOR," only the income you have earned in India will be taxed, not your overseas income. After you have attained a status of Indian Resident (ROR), your foreign investments and income will become taxable in India. However, if your global income is already taxed overseas, you can claim tax benefits as per the provisions of the Double Taxation Avoidance Agreement, thus protecting yourself from being doubly taxed.

(C) TREATMENT OF VARIOUS ASSETS

Assets held outside India

Under FEMA, an NRI returning to India is free to hold, own, transfer or invest in assets (properties, investment, stocks, etc.) situated outside India. However, the provision is only applicable if the asset was acquired when the individual was resident outside India or was inherited from a person resident outside India. Alternatively, you could dispose them and remit the proceeds to India. From a taxation point of view, it is advisable to liquidate your foreign investments before you become an ordinary resident.

Assets Held in India

- You need to update records in mutual funds in India, as well as other NRI investments you hold.
- The existing NRI Demat account would also need to be transferred to a newly opened resident Demat account reflecting your new resident status, so ensure you update your status with your depository participant.

Bank Accounts

- Once in India, an NRI returning to India must decide whether he want to continue his overseas accounts or have them closed altogether. Presently, NRIs are only allowed to maintain a Non-Resident External (NRE) account, Non-Resident Ordinary (NRO) account, and Foreign Currency Non-Resident (FCNR) account. If he decides to relocate to India, his NRO can be re-designated as a resident account. You need to convert these accounts to resident accounts within a reasonable period of time of 3 months.
- And, if you wish to retain your foreign earnings without converting them to INR, you have the option to open a Resident Foreign Currency (RFC) account and have the balance funds in your NRE savings account or FCNR account transferred therein.
- You can continue to keep your FCNR deposits until maturity, after which they can be transferred to an RFC account.
- NRE FDR - As per the RBI Master Directions, upon returning to India permanently, the existing NRE FD account of the NRI account holder is required to be converted to Domestic Resident FD account without any changes in the promised Rate of Interest. The interest earned from NRE FD is not taxable, however after it is converted to a Resident FD the earned interest is taxed as per your income tax slab. TDS will also be deducted, if applicable.

(D) TREATMENT OF INCOME FROM VARIOUS SOURCE UNDER ITA

When you are NRI/RNOR

When you are an NRI/RNOR, you will be exempted from income tax in India for your following incomes:

- Capital gain arising from the sale of fixed and financial assets held overseas (like properties and shares)
- Interest received from FCNR and RFC deposits
- Withdrawals or pension from the retirement account or pension scheme held overseas
- Interest or dividends earned in deposit or securities held overseas
- Rent received from properties held overseas
- Interest earned on NRE Account maintained in India.

When you lose the status of NRI/RNOR

Taxability of interest on NRE account

- An NRI can maintain NRE (Non-Resident External) accounts with banks in India and the interest income from them is not taxable. But the account holder has to report to the bank within 30 days of coming back to India for permanent settlement.
- Then the bank will reclassify the account from NRE to an NRO (non-resident ordinary) account and from that day onwards the bank will start deducting tax at source as interest income on that account will be chargeable to tax.

Interest on FCNR account is not chargeable to tax so long as he is non-resident or not ordinarily resident.

NRI or not, any Indian citizen whose annual income, accrued in India, exceeds INR 250,000 is required to file income tax return in India and pay taxes, as the case may be.

NRIs can also retain a bank account and investments outside India even after returning home.

For example, people take LIC (life insurance) policies while abroad and they cannot close the policies as they usually mature after they return to India.

The only condition is that they should **disclose this in their income tax returns** in the subsequent years, so that when they get the money from overseas it is easier for them to explain to the tax authorities.

- CA Mridul Gupta

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