KrayMan
Years of Demystifying Complexities

Taxation of Expatriates in India

The Industrial Policy of 1991 started welcoming foreign investments into India. Since then, many foreign companies have set up subsidiary / liaison office / branch office in India. No doubt, this has boosted Foreign Direct Investment (FDI) into India. However, the understanding of taxation of income earned by expatriates in India has always been complicated for both the employer as well as the expatriates. This article explains briefly some of the key concepts relating to taxability of expatriates in India.

The term 'Expatriate' means 'out of the country'. The Indian Income-tax Act, 1961 does not specifically define the term 'Expatriate'. However, it refers to an employee who is working in India on deputation or secondment. For ease of understanding, it can be said that an expatriate is a foreign national sent by his / her employer-company to work in India.

Depending on the work requirement, an expatriate may be sent to work in India under any of the below arrangements:

- Business visit
- Short term assignment
- Medium to Long term assignment
- Permanent relocation
- Consultant

The key issues involved in a deputation / secondment arrangement are as below:

1) Immigration

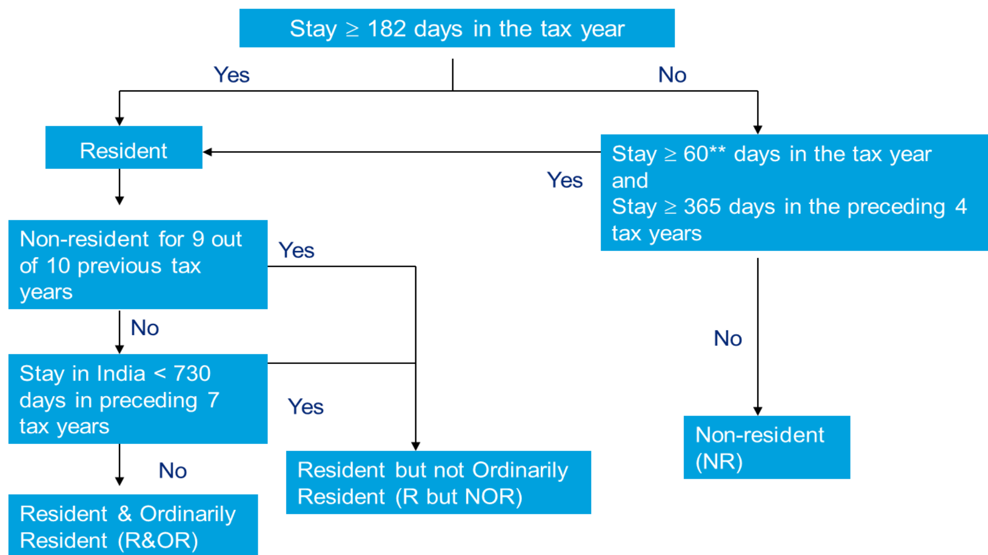
The expatriate must travel on correct visa category (business visa / employment visa / student visa) depending upon the purpose of visit. He / she should get himself / herself registered with Foreign Regional Registration Office (FRRO) in India within fourteen days of arrival in India.

2) Taxability

Salary received by an expatriate for services rendered in India is taxable in India irrespective of its place of receipt, since the 'source' of the income lies in India. What constitutes 'source' of an income in India has been a matter of perennial litigation with the Indian tax authorities and hence this article does not go into the intricacies of it. Basically, any salary / allowance / benefit paid /provided to an expatriate which is related to assignment period in India, is usually taxable in India. Employer is required to comply with withholding tax obligation on such payments. In case of any default, the employer could be liable to deposit interest / penalty in India.

a) Residential status

The scope of taxable income in India of an expatriate depends on the tax-residential status of such person, which in turn depends on such individual's physical stay in India. The following represents manner of determining tax-residential status in India of an individual under the Income-tax Act, 1961.



b) Scope of taxable income

Resident and Ordinary Resident (ROR)	*Non-Resident (NR)*	*Resident but not Ordinary Resident (RNOR)*
An ROR is taxable in India on his worldwide income	An NR is taxable only on income that is received or deemed to be received in India or income that accrues/ arises or is deemed to accrue/ arise in India. What constitutes income that accrues/ arises or is deemed to accrue/ arise in India, has been explained under the Indian Income-tax Act, 1961.	An RNOR is taxed like NR with the only difference that he/ she (i.e, RNOR) is also liable to tax on income accruing overseas if it is from a business controlled from or a profession set up in India

Thus, depending upon its nature, income is taxable in India either on receipt or on accrual basis. Income is said to be received when it actually reaches the hands of the expatriate; however, it is said to accrue or arise when the right to receive such income becomes vested to the expatriate.

c) *Components of salary income taxable in India*

An expatriate working in India is taxable in India on the salary earned for services rendered in India, whether he/ she is on the payroll of the Indian entity or not, subject to certain exemptions provided in the law. The Income-tax Act of India provides a broad definition of 'Salary' income which is taxable in India. It includes not just the basic salary but all other emoluments, perquisites, benefits and allowances such as accommodation, car, services of chauffer, daily allowance, relocation allowance, stock options, gifts, vouchers, etc. received by the expatriate from his / her employer.

d) *Tax Rate*

Once the net taxable income has been determined in India (after considering tax-residential status and income from all relevant sources including salary), the next step is to calculate the tax payable in India based on the slab rates published by the Government of India. Following are the current tax-slab rates in India for Financial Year 2022-23.

<table>
<tr><th rowspan="2">Taxable income (INR)</th><th rowspan="2">Alternative Tax Rates u/s 115BAC of Income-tax Act</th><th colspan="3">Existing Tax Rates</th></tr>
<tr><th>< 60 years</th><th>Senior Citizens (60-80Years)</th><th>Super Senior Citizens (> 80 Years)</th></tr>
<tr><td>< 2.5 Lakh</td><td colspan="4">Nil</td></tr>
<tr><td>2.5 Lakh - 3 Lakh</td><td colspan="2" rowspan="2">5.20%</td><td colspan="2">Nil</td></tr>
<tr><td>3 Lakh - 5 Lakh</td><td>5.20%</td><td>Nil</td></tr>
<tr><td>5 Lakh - 7.5 Lakh</td><td>10.40%</td><td colspan="3" rowspan="2">20.8%</td></tr>
<tr><td>7.5 Lakh - 10 Lakh</td><td>15.60%</td></tr>
<tr><td>10 Lakh - 12.5 Lakh</td><td>20.80%</td><td colspan="3" rowspan="3">31.2%</td></tr>
<tr><td>12.5 Lakh - 15 Lakh</td><td>26.00%</td></tr>
<tr><td>15 Lakh - 50 Lakh</td><td>31.20%</td></tr>
<tr><td>50 Lakh - 1 Crore</td><td colspan="4">34.32%</td></tr>
<tr><td>1 Crore - 2 Crore</td><td colspan="4">35.88%</td></tr>
<tr><td>2 Crore - 5 Crore</td><td colspan="4">39.00%</td></tr>
<tr><td>> 5 Crore</td><td colspan="4">42.74%</td></tr>
</table>

e) *Impact of Double Taxation Avoidance Agreement (DTAA)*

India has entered into Double Taxation Avoidance Agreements (DTAAs) with more than 90 countries to eliminate the possibility of double taxation which could arise in following situations:

- If an expatriate qualifies as tax-resident of both India as well as overseas (home) country, and / or
- The expatriate being tax-resident of overseas country, derives income from India

The DTAA provides for ways and means to ensure that the same income is not landed up being taxed *both* in India as well as overseas country. For an expatriate who qualifies as Non-Resident in India, the provisions of the Income-tax Act or DTAA whichever are more beneficial, are applicable to the expatriate. Usually, if an expatriate works for less than three to six months in a year (exact period depending on which country he /

she belongs to) in India *and* his salary income is paid / borne by the overseas employer, such salary income is tax-exempt in India, often called Short-Stay Tax Exemption as explained below.

f) Short-stay exemption

Depending on number of days' stay in India of the expatriate during a year, a 'Short-Stay Tax Exemption' may be claimed in India as per the Income-tax Act or India's DTAA with the relevant country, as below.

Usually, the benefit of 'Short-Stay Tax Exemption' has been found to be applicable in the first year of visit of an expatriate to India.

Conditions for claiming 'Short-Stay Tax Exemption' in India	
As per section 10(6)(vi) of Income-tax Act	**As per 'Dependent Personal Services' Article of India's DTAA with relevant country ***
The foreign employer is not engaged in any trade or business in India, and	Remuneration is paid by, or on behalf of, a Non-Resident employer
The expatriate's total stay in India during the year is 90 days or less; and	The expatriate's total stay in India during the year is 183 days (usually in most of the DTAAs) or less
Such remuneration is not deductible from the income of the employer chargeable to tax in India under the Income-tax Act	Remuneration is not borne by Permanent Establishment (PE or taxable presence) or fixed base of the Non-Resident in India

* For availing tax benefits under India's DTAA with relevant country, it is mandatory for the Expatriate to have a 'Tax Residency Certificate' (TRC) issued by the overseas tax authorities.

g) Tax equalization and Hypothetical tax

Most of the companies follow a principle wherein an expatriate should be neither better off nor worse off by taking up an international assignment. In other words, he / she should pay no more or no less tax on the salary income than what would have been payable had the employee continued to work in his / her home country. This principle is known as 'tax equalization' which means that a hypothetical tax is deducted from the salary in the home country, and actual taxes in respect of income from employment in home country and India would be borne by the employer and not the expatriate.

Hypothetical tax is a part of the tax equalization policy under which an expatriate is responsible during the assignment for 'hypothetical' or 'stay-at-home' tax, which would be calculated on the remuneration he / she would have earned if he/she continued to live and work in his / her home country. Hypothetical tax is withheld from the expatriate's normal pay and is retained by the employer as a 'tax reserve'. The company would then pay all the taxes in the home country and India on employment income during the assignment.

h) Foreign Tax Credit (FTC)

An expatriate earning income in India may be taxable in India under the 'source' rule and may also be taxable in respect of the same income in home country as per the 'residence' rule. This scenario can lead to double taxation of the said income. In order to avoid the same, the DTAA provides for specific provisions for elimination of such double taxation by allowing credit (off-set) of taxes paid in home country (FTC) against the Indian tax liability. To avail the deduction of FTC, an individual (qualifying as tax resident of India) must furnish Form No. 67 with the India tax authorities before filing return of income under the Income-tax Act.

i) Net-of-taxes contract

Usually, the employer enters into a 'net-of-taxes' contract with the expatriate meaning that the taxes in India are borne and deposited by the employer with Indian tax authorities.

j) Withholding tax obligations of the employer

The Income-tax Act, 1961 casts an obligation on the employer to correctly calculate and deposit the taxes on income earned by an expatriate for services rendered in India, with the India tax authorities. Failure to withhold appropriate taxes exposes the employer to interest and penalties under the Income-tax Act.

Every year, the Central Board of Direct Taxes (CBDT, apex body for tax administration in India) issues an annual circular sometime between December to March to guide employers and employees understand the various nuances relating to withholding tax on salaries. Calculation of correct withholding tax on salaries is a tedious process for any employer but the process must be adhered cautiously to help the employer stay on the right side of law. The annual circular provides meaningful guidance in understanding under one roof all the relevant provisions under the Income-tax Act, circulars, notifications, etc. which an employer and employee should be aware of and comply before the fiscal year end of 31st March. Usually, the circular contains insight to the following regulations:

- Rates of Income-tax for the relevant year
- Scheme of withholding tax on salaries
- Persons / Employers responsible for deducting tax at source and their duties
- Computation of income under the head 'Salaries'
- Permissible deductions while calculating taxable income
- Dos and Don'ts to obtain evidence / proof of claims
- Calculation of tax to be deducted
- Illustrations and Forms

In addition, the circular also explains about computation of tax under the newly introduced concessional tax regime of the Income-tax Act where total income is required to be computed without the benefit of specified exemptions, deductions, set-off of losses and additional depreciation, but the tax liability is calculated at lower slab rates. Basically, it is an option given the Government of India to an individual taxpayer to decide whether he / she would like to be governed by the traditional provisions or new provisions. An individual can select the option which is more beneficial for him / her.

Please Click Here to read the latest Circular (no. 4 dated 15th March 2022) issued by CBDT for deduction of tax at source on salaries for Financial Year 2021-22.

k) Procedural obligations under the Income-tax Act

An expatriate needs to comply with the following obligations in India under the Income-tax Act:

- Obtain Permanent Account No (PAN) in India
- Prepare and submit annual tax return in India based on taxes calculated, withheld and deposited by the employer with Indian tax authorities during the year
- Obtain a 'tax clearance certificate' from the Indian tax authorities at the time of departure of the expatriate back to home country after completion of his tenure in India. The usual tenure of an expatriate in India is three to five years, though it varies from company to company. The objective of requirement to obtain a tax clearance certificate is, assurance to the Indian Government that all taxes which were payable in India on remuneration received by an expatriate during his / her tenure in India, has duly been paid to the tax authorities.

3) Social Security

Social security in India is governed by Provident Fund Regulations under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act). An overseas passport holder working for an establishment covered under the EPF regulations in India, is mandatorily required to contribute under the EPF Act. However, if he / she obtains a 'Certificate of Coverage' (COC) from the overseas social security authorities, then it is possible to claim exemption from the said requirement to deposit social security in India. This is on account of the 'Social Security Agreement' (SSA) signed between the Indian Government and overseas Government.

4) Payment of salary in home country

Usually, it is seen that expatriates working in India prefer to receive part of their salary in home country (in their home country's bank account) to meet their family commitments. Part of the salary is paid in India for administrative convenience and / or to meet the local expenses of the expatriate in India. As per the foreign exchange regulations of India, it is permissible for the expatriates deputed / seconded to India, to receive their entire salary in overseas bank account (i.e., outside India) *provided* the Income-tax as per the tax laws of India is deposited with the Indian tax authorities on the *entire* salary as accrued in India.

5) Permanent Establishment (PE) exposure in India for the overseas employer

The presence of expatriate of an overseas company in India for more than six months could create PE exposure (taxable presence) for the overseas parent company in India. This could lead to the India tax authorities demanding tax from the overseas parent company on the profits earned in India as a result of the activities performed by such expatriate in India. In case of an expatriate seconded / deputed to subsidiary of an overseas parent company in India, ideally the complete tax liability should be borne by the Indian subsidiary because the expatriate is expected to work under the complete supervision and control of the Indian subsidiary. The PE exposure needs to be analyzed on case to case basis. It is important to do this analysis carefully to avoid a situation where the Indian tax authorities land up attributing a higher profitability to Indian operations than the activities actually performed in India, which could lead to a major tax outflow in India for the overseas parent company.

6) Transfer Pricing

The secondment / deputation of an expatriate to India is subject to transfer pricing regulations of India and hence any cost sharing arrangement between the overseas parent company and the Indian subsidiary / branch office, etc. should satisfy arm's length principle.

7) Technical Guide issued by the Institute of Chartered Accountants of India (ICAI)

The Committee on International Taxation of the ICAI has issued a Technical Guide on Expatriate Taxation in India, which is a helpful reference on the matter. Please Click Here to the read the third and latest version of the same issued in June 2017.

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About KrayMan

KrayMan Consultants LLP (KrayMan) is an accounting and consulting firm headquartered in the National Capital Region of India and serving Clients across India. We specialize in India-entry, Accounting, Tax, Regulatory, Transaction Advisory, HR and Payroll services. We are a team of Chartered Accountants, Company Secretaries, Advocates and MBAs. You may kindly refer our website www.krayman.com for further details.

Founded in 2012 by professionals from Big4 Consulting Firms and industry background, we have since beginning been delivering value to a mix of Multinational Clients. We are members of Global Networks such as (a) Cross Border Associates, Germany - Network for Mergers and Acquisitions professionals in 100+ countries, (b) Prime Advisory Network, London - International Accounting Network of Chartered Accountants and Lawyers in more than 60 countries. Further, we are members of associations such as Indo French Chamber of Commerce and Industry (IFCCI), Japan Chamber of Commerce and Industry (JCCII) (including its Tax Committee), Confederation of Indian Industry (CII) and Indian Importers Chambers of Commerce and Industry (IICCI). For the year 2021, the International Business Council of Australia has awarded us under the category 'Small Business Award 2021'. We have a dedicated Japan Desk and EU Desk to facilitate businesses from said countries.

Our Vision is to be the trusted partner and advisor to our Clients in their journey of growth by delivering quality across a wide range of services. Our Values, namely Act with Integrity, Accountability, Respect for stakeholders are deep-rooted in our work environment and catch reflection in the quality and commitment delivered to our Clients. Our people are our biggest strength who create value for Clients. Our thought leadership publications shared with Clients to keep them updated on Indian laws and regulations have received widespread acclaim keeping us inspired to go the extra mile.

For any queries, please feel free to write to us at **communications@krayman.com**.

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