By **Peter Harper** & **Janpriya Rooprai**

Interaction of Indian and U.S. Tax Laws

High-net-worth individuals and global businesses are affected

The number of high-net-worth (HNW) Indians is expected to increase by 71 percent in the next five years. We expect to see a direct correlation with the number of HNW Indians and their global family businesses that permanently depart India. It raises a concern for Indian tax authorities to find the best way to protect its revenue base through the collection of tax and information. Tax transparency administered by an overwhelming set of rules in countries like the United States has forced its citizens and residents to comply with worldwide tax and information reporting due to the application of severe penalties. India is fostering tax transparency and exchange of information as parties to the Base Erosio Profit Shifting (BEPS) project (that is, an international framework to combat tax avoidance by multinational enterprises), led by the Organisation for Economic Co-operation and Development/G-20. Indian tax authorities armed with this information provided by foreign revenue authorities or foreign banks will use it to combat tax avoidance and non-disclosure of information. The privacy of information shouldn't be prized by HNW Indians over creative management of tax costs and compliance obligations. Therefore, up-to-date tax compliance is required both under Indian and foreign country laws.

Tax advisors to HNW Indians in the United States need to consider how their advice is impacting HNW individuals in India, particularly if they haven't been properly disclosing information or paying tax in India.

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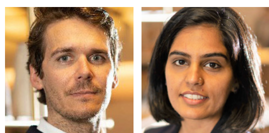

Effect of Globalization

Globalization has had a dramatic impact on India, its citizens and businesses. India's elite is growing at a staggering pace. The number of individuals classified as HNW increased by 20.4 percent in 2017.[1] HNW individuals are generally understood to be individuals with an accumulated net worth in India's highest scale of wealth, which is based on their investable assets[2] or investments, personally or in family businesses.

A big challenge for the Indian government and Indian tax authorities is the drop in tax revenue attributable to the emigration of more than 7,000 ultra-HNW individuals[3] in the last year. This revenue reduction is also because HNW individuals extensively use foundations, trusts and corporate and unincorporated entities not only to protect their assets but also to shield their personal and family wealth from Indian tax authorities.

The leak of confidential financial information as part of various scandals in the last decade (for example, the UBS scandal and the Panama Papers, which revealed the use of secretive financial ecosystems for beating tax in offshore low tax jurisdictions[4]) has shown a pattern of non-compliance by HNW individuals in the context of reporting foreign financial information. This seems like a thing of the past for U.S. citizens and residents as various statutes govern the global information exchange on foreign financial assets and levy severe penalties on any non-compliance. The recent tax reforms in the United States have raised the bar by widening the tax exposure on foreign corporations and financial holdings of U.S. resident shareholders.

Black Money Act

After the introduction of black money (that is, undisclosed foreign income and assets) and the

Imposition of Tax Act (2015) (Black Money Act) in India, Indian residents are mandatorily required to report their foreign financial interests and assets. This information reporting requirement has more recently been extended to include certain non-residents. It's yet to be seen whether this legislation will have a material impact on the attitudes of HNW individuals to privacy and their compliance obligations.

Transition to Other Jurisdictions

Around 45 percent of HNW Indians are moving to jurisdictions like Singapore, the United States and the United Kingdom, where the tax systems and reporting requirements are highly robust. Often, the complexity in administering the global affairs of HNW individuals poses accounting and tax challenges for them. This raises a serious point of discussion—what are the considerations to keep in mind before making this transition from India to other jurisdictions?

It's critical to address the above question specifically when HNW individuals move to jurisdictions like the United States and become U.S. residents. The interaction between Indian and U.S. international tax law shows that when HNW individuals become U.S. residents, they can't follow the same approach to privacy that was the building block of their financial plan in India. It's our experience that HNW individuals having a history of non-compliance in India will be adversely impacted by the U.S. tax system. This is all the more important given that India is one of the 116 countries that are fostering tax transparency and exchange of information as parties to the BEPS project.

This is a watershed moment in Indian tax. The HNW individuals looking to relocate to a country like the United States should reconsider their pattern of non-disclosure.

Tax Residence

The residence rules determine the taxability of a person resident in a country. Both the United States and India tax income of residents on a world-wide basis and non-residents on locally sourced income only. The key difference between the two countries is how they determine whether a taxpayer is a resident. The United States is one of only two countries in the world that classify 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. In contrast, Indian citizens who are non-resident Indians will only be taxed in India on their Indian-sourced income.

Residence rules in India. 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.[5] An individual is an Indian tax resident if he either resides in India for 182 days or more during the current tax year or resides in India for 60 days or more during the current tax year and for 365 days or more during four tax years preceding the current tax year. The period of 60 days is replaced by 182 days when an Indian citizen or a person of Indian origin[6] (PIO) comes on a visit to India, but not for a permanent stay.

> HNW individuals who are Indian tax residents will be taxed on their worldwide income in India.

A natural person isn't ordinarily resident if he either has been a non-resident in India for nine out of 10 tax years preceding the current tax year or has been in India for 729 days or less during seven years preceding the current tax year. An individual not satisfying any of the above requirements will be a non-resident in India during the tax year.

A corporate entity[7] is an Indian tax resident if it's formed and registered under the Companies Act (2013), or its place of effective management (POEM) is in India at any time during the current tax year. POEM means the place where key management and commercial decisions necessary for the business as a whole are in substance made. The Central Board of Direct Tax (that is, the Indian tax department) has also issued guiding principles for determining the POEM of a foreign company.[8]

An unincorporated entity,[9] including a limited

liability partnership (LLP) is an Indian tax resident if even a part of its control and management is situated in India during the current tax year.

There are often directors, shareholders or partners who reside outside of India and exercise control and management with no physical presence in India. In doing so, they don't consider the residency aspect in India, which may result in treating the entity as a non-resident and taxable at higher tax rates. There are also instances in which a foreign limited liability company (LLC) partially controlled and managed in India would be considered an Indian tax resident and taxable on its worldwide income.

Global families use trusts or foundations as models to insulate Indian family assets.

A natural person having economic ties in India may still be a non-resident, and a company having POEM in India, even if a foreign company, may still be an Indian resident. The taxable income base of Indians is determined in accordance with "Taxable Income Base," p. 54.

In addition to the above, the recent tax reform under Indian tax law has introduced a significant economic presence test[10] for establishing whether corporate entities having a business connection should be taxed in India. This widens the scope of foreign entities being taxable as permanent establishments in India. This is an example of how India shows its solidarity to international standards under the BEPS project.[11]

Global families use trusts or foundations as models to insulate Indian family assets. This is because India doesn't have a controlled foreign corporations (CFCs) regime or a transferor trust or grantor trust regime. If these entities are established properly and independently managed, income derived by them won't be taxable in India.

U.S. residence rules. HNW Indians moving to the United States should be mindful of the interaction of U.S. laws with Indian laws. An alien under the U.S. immigration law is a person who isn't a U.S. citizen or U.S. national. An Indian national who becomes a U.S. tax resident may have an additional federal, state and city tax burden on foreign sourced income. He may also have onerous information reporting obligations.

A U.S. alien will be a U.S. tax resident under federal tax laws in one of following three ways:

- Green card test (that is, being admitted to the United States as a lawful permanent resident under the immigration laws);
- Substantial presence test (that is, being physically present in the United States for at least 31 days in the current tax year and 183 days[12] during the past three years including the current tax year); or
- Electing to be taxed as a U.S. tax resident.

In addition to the U.S. federal tax residency rules, state tax residency rules apply. Residence in a U.S. state is typically determined based on the number of days present, economic interests or family ties within a state. It's possible for an individual to be a resident of one or more states in the United States.

When an Indian national is also a U.S. resident during a tax year, then tie-breaker rules under the double tax agreement between India and the United States are applied to determine which country has the taxing right. This may result in taxation of income in both countries. However, in most cases, the source country has a primary taxing right (or source taxing right), and the country where the taxpayer is a resident will provide a credit for foreign tax paid and charge further tax to the extent of any tax rate shortfall. In addition to tax exposure in a country, residence rules create an information reporting burden that's often ignored by HNW individuals moving to another jurisdiction.

HNW individuals need to be careful when establishing Indian business structures in the United States with a possible taxing right being established for the United States under the expanded CFC definition. The Indian domestic law contains a similar burden for foreign structures of HNW individuals in India, specifically when the Indian tax law is applying POEM and economic presence tests adopted pursuant to the multilateral instruments (MLI) under the BEPS initiative. This interaction results in additional reporting requirements even if no income is attributable to the

Taxable Income Base

Resident vs. not ordinarily resident vs. non-resident

Resident	Not Ordinarily Resident	Non-resident
Taxable on worldwide income	*Taxable on income received or accrued or arisen in India*	*Taxable on income sourced in India*
Income received in India	Income received in India	Income received in India
Income accrues or arises in India	Income accrues or arises in India	Income accrues or arises in India
Income deemed to be received in India	Income deemed to be received in India	Income deemed to accrue or arise in India
Income received outside India	Income received outside India, only if business controlled or set up in India	
Income accrues or arises outside India	Income accrues or arises outside India, only if business controlled or set up in India	
Income deemed to accrue or arise outside India	Income deemed to accrue or arise outside India, only if business controlled or set up in India	

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country that's established the expanded taxing right.

Specific Tax Considerations

In India, family-owned and run businesses are the lifeblood of the economy. These recent changes will create greater challenges for family businesses because of structural inflexibility that comes with such intergenerational wealth. HNW individuals who are Indian tax residents will be taxed on their worldwide income in India. Typically, an Indian taxpayer's taxable income is his total income under five heads (salary; house property; profits and gains from business or profession; capital gains; and other sources), reduced by deductions or charitable contributions. Certain incomes are exempt from tax but are still required to be reported on a tax return.

Often the temporary or permanent departure of HNW individuals from India to another country drives decisions to either transfer or pool assets in a trust in India. Dividend income on investments and the transfer of assets by HNW individuals are taxable in India unless exempt. A transfer of capital assets may involve monetary and non-monetary gifts or the actual transfer of assets to a trust. The tax incidence of these events should be considered before relocation.

Capital gains tax and exemption. A resident or non-resident Indian is taxed on capital gains derived from transferring, selling or exchanging capital assets in India unless those gains are specifically excluded from taxation. Gifts or bequests under a will are specifically excluded from the definition of transfer of a capital asset.

Capital gains tax rates are primarily based on the seller's residential status, the form of capital asset and the holding period. Examples of different short-term holding periods are: shares or securities listed on a recognized stock exchange in India, equity-oriented

mutual funds and zero-coupon bonds (less than 12 months), unlisted shares (less than 24 months) and immovable property (less than 36 months).

Capital gains is the difference between consideration and cost of acquisition adjusted by the inflation index, but in certain cases, no indexation is available. Capital gains can be reduced by an exemption for reinvestment of the amount of net consideration or gains in specific situations, subject to conditions.

Dividend income. In general, Indian companies pay tax on a world-wide basis at a tax rate of 30 percent. To the extent companies proceed to declare dividends out of profits, they're liable for dividend distribution tax (DDT) (which has been paid unless such dividend is more than INR 1 million (approximately USD 16,000)), which is levied at the effective rate of 20.36 percent. If a company hasn't paid DDT, the dividend will be taxed at the marginal personal income tax rates of the relevant shareholder.

Transfer of capital assets under gift or will to relatives/non-relatives directly or to a trust with relatives/non-relatives as beneficiaries. As referenced above, gifts among relatives aren't taxable in India. However, a gift of non-monetary nature (including shares in a family business) to an individual or trust, even if not a taxable transfer for the individual making the gift, is taxable income for the recipient if the value of such gift is more than INR 50,000 (approximately USD 833) or such gift is for an inadequate consideration. The taxable income is the difference between the fair market value[13] on the date of transfer and consideration paid.

Transitioning capital assets in an Indian family business to the next generation. HNW Indians and global families generally use trusts or foundations as models to insulate Indian family assets. Ownership of Indian family businesses is held through these trust structures. While a trust structure offers protection of assets and good governance mechanisms, there's a real risk that any foreign structure will be classified as an Indian resident entity if it's managed and controlled by people in India. A trust is considered an Indian tax resident if some or all of its control and management is exercised in India. The taxation is based on the form of trust—public or private.

A public trust set up for a charitable purpose that's registered under the provisions of Indian tax law is exempt from tax in India subject to certain conditions.

A private trust may be revocable or irrevocable. A revocable trust set up by a settlor is disregarded as a trust, and the settlor is taxed for any income of the trust. The settlor has a right to revoke the trust and is entitled to the income and property of the trust for the lifetime of the trust. A trustee of a discretionary (irrevocable) trust that's set up in India will be taxed as a representative taxpayer of the beneficiaries of such trust. However, if it's a foreign trust, then a trustee may be a representative taxpayer of the beneficiaries if all the beneficiaries are Indian residents. A determinant (irrevocable) trust is a fiscally transparent entity, but a trustee may be assessed tax in a representative capacity.

The restriction on the quantum of remittance outside India adds complexity to succession planning, specifically when HNW individuals have no other connection with India apart from the assets in India, and they intend to remit all the funds from an estate to someone outside India in the same financial year.

Distribution from trust to resident/non-resident beneficiaries. Distributions from an Indian trust to a resident or non-resident beneficiary during the lifetime of the settlor have the same tax implications as those expressed above. However, if a non-resident isn't taxable as a result of the application of a tax treaty benefit, then a trustee wouldn't be liable to pay tax. Trust income taxable to trustees isn't taxable to beneficiaries at the time of actual distribution.

Distributions from a foreign trust generally aren't taxable to trustees if the control and management is wholly outside India. No taxability arises until actual

distributions are made by a foreign trust to Indian tax resident beneficiaries.

Distribution of capital or corpus from a trust isn't taxable if the trust was created for specific relatives.

Implication on settlor's death and termination of trust. Under the Indian trust law, trusts cease to exist or terminate if the purpose of the trust is fulfilled, the trust becomes unlawful or fulfillment of its purpose becomes impossible or the trust is revoked. India doesn't have estate tax, but termination of the trust due to the death of the settlor has tax implications for irrevocable and revocable trusts, as illustrated in "Tax Implications of Trust Termination," p. 57.

U.S. citizens and residents need to report transactions associated with foreign trusts on Forms 3520 and 3520-A.

Reporting requirements. The Indian government has been constantly showing its support of the BEPS project with an objective to bring transparency and eliminate shifting of profits from high tax jurisdictions to low tax jurisdictions. India has also renegotiated tax treaties with various countries to facilitate its taxing right and exchange of information on par with international standards. These measures are aligned to ensure HNW individuals residing outside India are making proper disclosures and are tax compliant within India.

A taxpayer is required to obtain a permanent account number (PAN) (similar to a tax identification number) in addition to an Aadhar number (similar to a Social Security number). A PAN is generally used on all income tax correspondence.

The filing of income tax returns is mandatory in specific cases, and delay or non-compliance may result in tax, interest and penalties. A taxpayer claiming tax treaty benefits and an Indian resident having any asset (including financial interest) located outside India or signing authority over any account located outside India are mandatorily required to disclose the asset or signing authority irrespective of whether any taxable income is derived with respect to such assets.

Disclosure of foreign financial interests. The Black Money Act requires tax residents in India to disclose information on their foreign financial interests and assets. But, from tax years 2018 to 2019 and onwards, not-ordinary residents and non-resident Indians are also required to report their foreign financial assets, interest, bank accounts and immovable properties. Further, taxpayers with taxable income more than INR 5 million (approximately USD 80,000) on their tax returns in India are required to provide details of the specified assets and corresponding liabilities in India. Non-compliance with the above may result in significant penalties.

While it may be difficult for HNW Indians to imagine today how these changes are going to play out, they should take the Black Money Act seriously, given how effective the Foreign Account Tax Compliance Act (FATCA) has been in ensuring compliance of U.S. citizens.

Indian Exchange Control Law

The Indian exchange control law provides strict rules in relation to cross-broker transfer or remittance of funds or ownership of certain assets. HNW Indians who become U.S. citizens and are non-resident Indians or PIOs may continue to hold assets like real property in India long after they've moved outside India. A bequeath by a will or gift of assets in India may also result in HNW individuals or their children holding Indian assets.

An investment, ownership, holding or transfer of Indian funds/immovable property by an Indian resident, foreign national of non-Indian origin, NRI, PIO or an Indian entity or branch office established in India by a person resident outside India is governed under the Foreign Exchange Management Act (1999) and by the Reserve Bank of India (RBI). The specific considerations under the Indian exchange control law are discussed below:

Residence. Foreign remittances in and outside India are grouped based on the residential status of the individual and purpose for which the remittance is made. The term "resident" as defined under the Indian exchange control law deliberates on the purpose of stay (based on type of visa granted) in addition to the

Tax Implications of Trust Termination

Depends on if it's irrevocable or revocable

Irrevocable trust	Revocable trust
The property settled under an irrevocable trust is treated as being irrevocably transferred to the trust at the time of creation of the trust. So, at the time of settlor's death, there's no transfer of ownership of the trust property, and it continues to be held by the trust.	Typically, trust property settled under a revocable trust may be re-transferred to the settlor during his lifetime. On the settlor's death, a revocable trust is recharacterized as an irrevocable trust, and there's no transfer of ownership of trust property. The trustee assumes the legal ownership of the trust property until it's distributed to the beneficiaries.
No tax impact on either the settlor, trustee, trust or its beneficiaries.	Income from trust property is taxable to the trustee instead of the settlor's estate, unless property is reverted to the settlor's estate. The settlor's estate may be taxed at the time of reversion if the property is returned to the settlor's estate.

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duration of stay (being more than 182 days during the preceding financial year), which is the primary test for determining residence under the Indian tax law.[14]

Remittance of funds outside India. The residence rules[15] and type of assets group the remittances made by individuals or entities outside India. "Compliance with Residence Rules," p. 58, outlines the circumstances in which a remittance can be made without RBI approval.

However, an approval of the RBI is required if:

- a remittance is made by a non-resident Indian or PIO out of the balance held in his non-resident ordinary rupee account or sale proceeds of assets or assets acquired by way of inheritance or legacy in excess of USD 1 million per financial year and such legacy, bequest or inheritance was made to a citizen of a foreign state, as a resident outside India.
- hardship will be caused to a person if the remittance from India isn't made to such a person.

Resident Indians must comply with the Liberalized Remittance Scheme (LRS)[16] for remitting funds for contributions to offshore irrevocable trusts for the benefit of both resident and non-resident beneficiaries. The settlor may only transfer up to USD 250,000 per financial year per person for any permitted[17] capital[18] or current[19] account transaction without prior approval of RBI.

The restriction on the quantum of remittance outside India adds complexity to succession planning, specifically when HNW individuals have no other connection with India apart from the assets in India, and they intend to remit all the funds from an estate to someone outside India in the same financial year. The monetary limitation on remittance shouldn't encourage HNW individuals to transfer funds privately, as siphoning funds secretly would result in strict scrutiny by regulatory authorities with significant tax and penalties arising under tax and exchange control laws in India.

RBI grants prior permission on a case-by-case basis. RBI will consider cases of genuine hardship. However, the application must outline background facts and substantiate the applicant's claim for hardship.

In our experience, factors like the amount of remittance, the type of asset, the mode of transfer of assets (will, gift or sale of assets), whether assets were maintained in a trust, the number of family members involved in the scheme, the years available to spread the remittance and payment of taxes will impact remittance planning. Also, RBI amends the restrictions placed under the Indian exchange control provisions from time to time, and the modified restrictions should be applied from the date of amendment.

U.S.-India Tax Considerations

India has signed double taxation avoidance agreements with over 90 countries. Indian tax law offers a choice to a taxpayer to claim treaty benefits against domestic

Compliance With Residence Rules

Remittance with or without Reserve Bank of India (RBI) approval

Remittance is made by:	No RBI approval required if the remittance is:
A foreign national of non-Indian origin (other than Nepal/Bhutan/Person of Indian origin (PIO)) who: • has retired from employment in India; • has inherited assets from a person who's an Indian resident; • is a non-resident widow/widower and has inherited assets from her/his deceased spouse who was an Indian national resident in India.	Up to USD 1 million in a financial year.
A non-resident Indian or PIO who remits funds from: • the balances of a non-resident ordinary rupee account but subject to declaration; • sale proceeds of assets; • assets acquired from legacy/inheritance/deed of settlement.	Up to USD 1 million in a financial year.
An Indian entity in relation to the contribution towards a provident/superannuation/pension fund for an expatriate employee who's resident but not permanently resident.	No prescribed limit.
A branch or office established in India by a person resident outside India.	No prescribed limit.

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tax law provisions and vice versa. India and the United States have entered into a double taxation avoidance agreement (Tax Treaty) and agreements to ensure compliance with FATCA.

The sweeping changes in the U.S. tax law enacted under the Tax Cuts and Jobs Act (the Act) offer some tax incentives and carry significant costs for global businesses. The movement of the U.S. corporate tax system to a territorial system is a firm reminder to foreign nationals coming to the United States that you're not in India anymore!

Recent U.S. tax reforms will have a biting impact on some HNW individuals who've chosen to immigrate to the United States over other countries and may force them to reconsider their options.

Tax Treaty considerations. The framework of the Tax Treaty prevents double taxation of the same income by allowing an Indian tax resident to claim a credit against his Indian tax liability for income tax paid in the United States on income arising in such country. It provides guidelines on rules of permanent establishment and lays out beneficial tax rates of income streams including dividends, interests, royalties and fees for technical services against high individual marginal tax rates in India. However, benefits under the Tax Treaty are only available if the limitation of benefits article doesn't deny treaty benefits because a taxpayer doesn't satisfy the ownership requirements set out therein. The United States hasn't signed the MLI under the BEPS project, and accordingly, the new provisions don't affect the India-U.S. tax treaty unless both countries agree to their adoption.

U.S. considerations. Global Indian families that have footprints in both the United States and India need to understand how the two systems interact and the traps to avoid.

While the Act substantially reduced the headline corporate tax rate from 35 percent to 21 percent and

exempted the taxation of dividends paid to U.S. companies from foreign subsidiaries, the new rules will almost certainly have a negative impact on HNW individuals who've immigrated to the United States. This is because of the extension of the definition of U.S. shareholders as having aggregate ownership of more than 50 percent (and individual ownership of 10 percent or more) in value or stock in foreign corporations. As a result, the foreign corporations are treated as CFCs, and their passive income (commonly known as "Subpart F income") is attributed to the U.S. shareholders. The scope of the income is further extended to the introduction of the global intangible low income tax (GILTI).

HNW individuals qualifying as non-resident Indians after migrating to the United States should report and pay tax on income generated from assets sourced in India subject to the application of the Tax Treaty.

Foreign entities that are considered CFCs will also need to be reported on Form 5471 and attached to the personal tax return. Failure to complete and lodge this Form can result in USD 10,000 as a base penalty for each form that wasn't filed and subject to further increase if the default continues. These reforms will have a biting impact for some HNW individuals who've chosen to immigrate to the United States over other countries and may force them to reconsider their business and holding structures to mitigate any negative and unintended tax consequences.

Choice of U.S. entity. The U.S. tax cuts make the United States an attractive place for investment. The decision of choice of entity between a corporate and pass-through entity (that is, an LLC) in the United States is similar to the choice between a corporation and LLP in India.

HNW Indians coming to the United States to do business may be lured by the low U.S. corporate tax rate of 21 percent. This is close to the base corporate tax rate in India, which is 25 percent,[20] where the annual turnover is less than INR 2.5 billion.

Corporation taxation shouldn't be chosen over pass-through taxation solely because of the new low corporate tax rate, as a deduction of 20 percent is available for qualified business income earned through pass-through entities subject to specific conditions. This results in an effective tax rate of 29.6 percent from 37 percent. This rate is also close to the base maximum marginal rate of tax in India, which is 30 percent.

Recharacterization of income from Indian corporations received by HNW Indians who become U.S. shareholders. The circumstances in which an Indian corporation or Indian controlled structure will be a CFC under U.S. law have been expanded by the recent changes. Under the reform provisions, there are circumstances in which an Indian corporation with Indian and U.S. subsidiaries will be classified as a CFC pursuant to the downward attribution rules if a U.S. tax resident holds as little as 10.01 percent. This is a game changer and means that it will be very easy to see a situation in which GILTI and Subpart F income derived by Indian-owned CFCs will be attributed to and taxable to HNW Indians who own a minority stake in foreign corporate groups.

The retroactive application of taxes associated with the Act that concern CFCs has meant that HNW Indians who had recently become U.S. shareholders had no ability to plan for these changes. However, this isn't the case for HNW individuals who are looking to move to the United States after the changes, and they should seek advice from U.S.-Indian tax experts on the best way to structure their entry into the United States.

U.S. grantor trusts rules. Large numbers of first and second-generation Indians are settled in the United States with family businesses and assets in India. It's very common in India for family businesses to be structured through trust and foundation structures as part of a larger tax and family succession plan. We've discussed the taxation of contributions made by a settlor to a trust and subsequent distributions of trust income and trust property from an Indian tax perspective. In the United States, the grantor trust rules apply to tax income of foreign trusts with U.S. resident grantors in a similar

fashion. Therefore, it's important that any tax planning and estate planning for HNW Indians who are immigrating to the United States consider the possible implications of the grantor trust rules under U.S. tax law.

U.S. citizens and residents need to report transactions associated with foreign trusts on Forms 3520 and 3520-A. Failure to complete these forms can result in a penalty as high as 5 percent of the value of the relevant trust's assets.

Choice between an Indian or U.S. trust for Indian assets. Generally, settling Indian assets in an Indian trust offers ease of administration and management of assets together in a single trust. But, when all beneficiaries are non-resident Indians, an Indian trust can only hold certain assets that are restricted or require RBI approval. In our experience, non-resident Indians are more likely to transfer such assets if they transferred them in an Indian trust rather than their own name. Further a restriction on the amount of funds that can be contributed by a settlor in a foreign trust is governed under the LRS (allowing a maximum contribution of USD 250,000 per financial year) or other schemes like remittance of assets under will or gift (allowing a maximum remittance of USD 1 million per financial year in the case of certain foreign nationals, non-resident Indians or PIOs).

The above restrictions placed under various schemes of the RBI often create liquidity issues for foreign trusts in relation to payments of tax, duty and other costs. For example, in relation to a qualified domestic trust (QDOT)[21] created under U.S. law, a U.S. trust may defer the payment of U.S. estate tax on the initial testamentary transfer if it takes property that flows after the first spouse dies. In effect, the payment of the estate tax is at the death of the surviving spouse provided certain conditions are satisfied. One of these conditions require a QDOT to have enough assets to assure taxability under the U.S. tax net. This may be a challenge in cases in which a QDOT receives Indian assets under a will and the RBI doesn't approve the remittance of all the assets, as these assets are more than USD 1 million in a financial year. Consequently, the remittance will have to be spread over a number of financial years and will cause liquidity issues, as the QDOT will be unable to meet the assurance of the U.S. tax liability because of limitations under the Indian exchange control law.

Advisors should keep HNW individuals informed of the risk of the RBI restrictions on remittance of funds and assets outside India right at the planning stage, as these rules are strictly applied. It's important to note, however, that the RBI has been attentive to cases with genuine hardship and has allowed remittances of higher amounts. As a starting step, clients should prepare a list of assets that are in India and make conscious decisions whether they intend to retain the assets or transfer them. When there's no intention to hold the assets in India, it's best to transfer these assets and remit funds out of India. Conversely, when a client intends to hold the assets, then segregating assets into an Indian or foreign trust is a critical planning exercise, and the client needs a clear understanding of the tax and exchange control laws in India and the applicable foreign jurisdiction.

FATCA

HNW Indians becoming U.S. tax residents also need to consider their U.S. information reporting obligations.[22] These include the completion of Foreign Bank Account Reporting (FBAR) Form Fincen 114, which concerns specific interests in bank and financial accounts and FACTA filing requirements on Form 8938, which concerns foreign financial assets. FATCA addresses the tax compliance requirements of U.S. citizens and residents by requiring them to attach the Fincen 114 and 8938 to their personal tax returns.

FBAR filing is in addition to FATCA filing and requires U.S. citizens and residents to report their interest in, or signature or other authority over, foreign financial accounts with an aggregate value that exceeds $10,000 at any time during the U.S. calendar year.

Way Forward

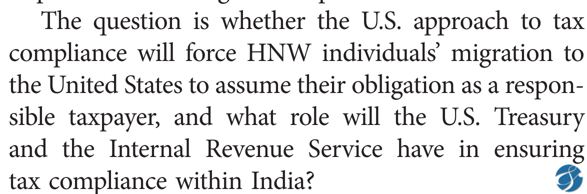
HNW individuals migrating to the United States from India should always be cautious of their tax residency status and ensure they meet their tax and information return compliance obligations in both India and the United States. HNW individuals qualifying as non-resident Indians after migrating to the United States should report and pay tax on income generated from assets sourced in India subject to the application of the Tax Treaty. This may also raise tax obligations in the United States, and to ensure HNW individuals aren't double taxed, foreign tax credits will need to be claimed in a timely filed tax return.

The different tax treatment of direct and indirect

ownership structures in India, such as foundations, closely held corporate groups and trusts, compared with their treatment in the United States under the CFC rules and grantor trust rules is material, and careful consideration should be given to the most appropriate way to structure or restructure the family businesses of HNW Indians in light of these differences.

The Act further highlights just how different the two tax systems are and the expansion of the definition of CFCs, and possible CFC ownership and attribution rules, to a minority shareholder of a foreign corporate group are prime examples of this. However, it's not these reforms that we believe will be the biggest challenge for HNW individuals—it's their view that non-disclosure of financial information to tax authorities is the best way to proceed because privacy of their family affairs is more important than being tax compliant.

The question is whether the U.S. approach to tax compliance will force HNW individuals' migration to the United States to assume their obligation as a responsible taxpayer, and what role will the U.S. Treasury and the Internal Revenue Service have in ensuring tax compliance within India?



Endnotes

1. "Capegemini World Wealth Report 2018," *https://www.capgemini.com/ch-de/wp-content/uploads/sites/26/2018/06/Capgemini-World-Wealth-Report-19.pdf.*
2. "Capegemini World Wealth Report 2018" classifies high-net-worth (HNW) individuals based on investable assets of USD 1 million or more, excluding primary residence, collectibles, consumables and consumer durables, *www.worldwealthreport.com/download.*
3. Euromoney classifies HNW individual clients of private banks with wealth ranging from USD 5 million to 30 million and ultra-HNW individuals with wealth more than USD 30 million, *www.bloomberg.com/news/articles/2018-05-03/the-big-winners-from-india-s-cash-clampdown-are-private-bankers.*
4. Greg Farrell and David Kocieniewski, "UBS, HSBC Offshore Dealings Thrust Into Panama Papers Spotlight," *Bloomberg* (April 5, 2016), *www.bloomberg.com/news/articles/2016-04-05/ubs-hsbc-offshore-dealings-thrust-into-panama-papers-spotlight.*
5. The annual tax year in India is called the "assessment year" and as a general rule, follows the financial year beginning from April 1 to March 31 in the next year.
6. A person of Indian origin has parents or grandparents who were born in undivided India.
7. A corporate entity includes a company formed and registered under the Companies Act (2013), a company formed under corporate laws of another country or an institution, association or body declared by general or special order of the Indian tax department.
8. Circular No. 06 of 2017.
9. Unincorporated entities in India include Hindu Undivided Families, firms or other association of persons. In recent years, limited liability partnerships offering a hybrid mix of corporate and partnership firm features are commonly used in India.
10. "Significant economic presence" means either a transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or a systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India, through digital means subject to certain specifications.
11. Base Erosion Profit Shifting project Action Plan 7 provides for purpose of determining permanent establishment with respect to a dependent agent to include an agent having authority to conclude contracts or playing a principal role leading to conclusion of contracts. India, under Article 12, by signing multilateral instruments, incorporated this modification suggested under Action Plan 7.
12. One hundred and eighty three days during the year including the current tax year is counting presence in the United States for: all the days in the current year, one-third of the days in the first year before the current tax year and one-sixth of the days in the second year before the current tax year.
13. The fair market value (FMV) of the shares traded on a recognized stock exchange is the average of the opening price and closing price of a share as on the date of exercise on the recognized stock exchange that records the highest volume of trading in the share on such date. If there's no trading on the exercise date, the FMV is determined on the closest date when the shares are traded. The FMV of unlisted shares is the value determined by a Category I merchant banker in India registered with the Securities and Exchange Board of India.
14. Section 2(v) of Foreign Exchange Management Act (1999).
15. Reserve Bank of India, Frequently asked questions, Remittance of Assets, *www.rbi.org.in/scripts/FAQView.aspx?Id=33#AN2.*
16. Master Direction—Liberalised Remittance Scheme (LRS) (June 20, 2018), *https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10192&Mode=0.*
17. Reserve Bank of India, Frequently asked questions, LRS, *www.rbi.org.in/Scripts/FAQView.aspx?Id=115.*
18. *Supra* note 14, Section 2(e).
19. *Ibid.*, Section 2(j).
20. This base tax rate of 25 percent doesn't include surcharge and cess (that is, a tax or levy).
21. Internal Revenue Code Sections 2056(d) and 2056A.
22. *www.irs.gov/newsroom/taxpayers-with-foreign-assets-may-have-fbar-and-fatca-filing-requirements-in-june.*