Does your loan fulfil the AA criteria?

TRUTH BE TOLD

HARSH ROONGTA

I was catching up with Arihant, an ex-colleague and an IIT-IIM (Indian Institute of Technology-Indian Institute of Management) graduate, who now runs a successful company. He described his first brush with financial leverage in the early 2000s when he had just begun working. Despite earning a good salary, Arihant's lifestyle expenses surpassed his earnings. He soon ran up a credit card bill amounting to three months' salary. He had to seek financial assistance from his parents to clear off this debt. After this experience, Arihant curtailed his expenses and soon repaid his parents.

Arihant's story illustrates human beings' evolutionary bias for instant gratification. When our ancestors lived in the jungle, they gratefully consumed any meat that was lying around. That makes humans different from hibernating animals who have an instinct to hoard food for at least a season.

With the advent of civilisation, laws were enacted. Lenders who provide resources for instant gratification can enforce contracts and recover the resources (mostly money) with interest, underscoring the need for prudent borrowing.

Borrowing entails pledging future income to pay for today's gratification. It is not always bad. A good loan contributes to asset acquisition, like the purchase of a house, or enhances earning potential, as happens with a business or an education loan.

A good loan must fulfil the AA (double-A) criteria: it should 'add' to assets or income and should be 'appropriate'. Appropriateness is best judged by the percentage of future income pre-empted for paying back the loan. If all repayments amount to around one-third of income, that is considered fine.

A home loan (which adds to assets) that passes the appropriateness test can be considered a good loan. A vehicle loan does not add to assets but enables one to earn an income. It may be considered a good loan (given the abysmal state of public transportation in most cities) provided it passes the appropriateness test.

Experts suggest reading the fine print before signing a loan agreement. My extensive experience tells me most people would not sign an agreement after reading it, given their one-sided nature (despite which the lenders have trouble recovering their loans from some borrowers).

A good loan must fulfil the AA criteria: it should 'add' to assets or income and should be 'appropriate', meaning EMI shouldn't exceed one-third of income

Here are my suggestions for ensuring a fair deal. One, take a floating rate loan as Reserve Bank of India (RBI) regulations allow them to be prepaid or shifted without incurring any prepayment charges. Two, borrow from a bank and not a Non-Banking Financial Company (NBFC) as the former are subject to tighter regulations by the RBI. And three, take a secured loan. The very act of security creation causes the borrower to pause and rethink and does not provide the same pleasure psychologically as instant gratification until the loan is fully paid off and the secured asset is released.

The prevailing sentiment suggests that the indiscriminate use of easy loans by today's youth may end badly both for them and for lenders. My view is that India's younger generation is wiser than its preceding generations. A vast majority of them use loans sensibly, and the others, like my friend Arihant, will get back to the path of prudence soon.

Truth be told, loans serve as the lubricant that propels the wheels of civilisation forward faster. The home loan sector's growth over the past five decades has demonstrated the transformative impact that responsible borrowing can have on a nation's progress. Homeownership fosters a powerful sense of stability and social cohesiveness. Most home loan borrowers have steady incomes and are less likely to go out and riot on the streets for any cause.

Nevertheless, as with any powerful instrument, loans can create havoc and destroy lives if used indiscriminately and for the wrong ends (think of the 2008 crisis in the US). I am confident that the innate good sense that Indians possess in plenty will steer them (and the nation) towards a positive outcome.

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Assess tax residency status after extended stay abroad

Non-residents must furnish a tax residency certificate and fill Form 10F to claim DTAA benefits

BINDISHA SARANG

The Income-Tax Appellate Tribunal (ITAT), Delhi bench, recently ruled in favour of Devi Dayal, who had been deputed by his employers to work on a project in Austria. The ITAT ruled that salary and allowances earned abroad by a 'non-resident' for services rendered overseas are not taxable in India. The employer disbursed both the salary and compensatory allowance overseas, with the allowance accessible through a credit card valid only in Austria.

"Since he had failed to furnish a Tax Residency Certificate (TRC) from Austria, the tax authorities deemed the allowances taxable in India. However, the ITAT ruled in the taxpayer's favour, stating that since the services were rendered outside India, the salary was not taxable in India," says Varun Chablani, an international tax lawyer.

Many taxpayers find the tax residency rules perplexing. "Under Indian tax laws, tax incidence arises based on residential status, which in turn depends on the number of days spent in India," says Vivek Jalan, partner, Tax Connect Advisory.

Who is a resident?

A person is a tax resident of India if he is physically present in the country for 182 days in a financial year or if he spends 60 days during the relevant period and 365 days in the four immediately preceding financial years.

"Once an individual qualifies as a resident, the next step is to determine if he is a Resident and Ordinarily Resident (ROR) or Resident but Not Ordinarily Resident (RNOR)," says Megha Jain, tax expert, Cleartax.

A person qualifies as an ROR if he has been a resident of India for at least two out of the 10 past years, and has stayed in India for at least 730 days in the seven immediately preceding years. If either of the above conditions is not met, the person's residential status will be that of an RNOR.

"RNORs and NRIs are taxed alike, with their foreign income being exempt from Indian taxes unless it is derived from a business controlled from India or a profession set up in India," says Ankit Jain, partner, Ved Jain & Associates.

Definition of NRI for tax purposes

If you don't qualify as a resident or as an RNOR, your status is that of a non-resident. "Non-residents are liable for taxes in India only on income received, accrued, or deemed to be received or accrued in India," says Rishab J, advocate, Shivadass & Shivadass Law Chambers.

Residents are taxed in India on their global income, while NRIs are taxed only on their income that accrues or arises in India. Says S R Patnaik, partner (head-taxation), Cyril Amarchand Mangaldas: "An NRI's salary is taxable in India if the services are rendered or performed in India since it is considered income earned in India. If salary is paid for services rendered outside India, it is assumed to have been earned outside India."

While considering residency for individuals who have spent more than 60 days outside India, most of the tax disputes arise over the nature of work being undertaken.

"While the tax authorities allege that the person has been outside India not for 'employment' but as an investor or promoter, the individual claims that he is, in fact, an employee," says Kishore Kunal, an advocate.

A recent judgement states that "employment" lacks a technical definition, implying that employment abroad includes self-employment or starting a business or profession overseas.

Resident on temporary foreign assignment

Many multinationals in India send employees overseas, making them liable for taxes in that country. "Before filing an income tax return (ITR) in India, residents must submit Form 67. They can then claim Foreign Tax Credit (FTC) for taxes paid abroad," says Rishab.

Avoiding double taxation

To shield NRIs from double taxation, India has signed a Double Tax Avoidance Agreement (DTAA) with over 80 countries. "DTAA offers protection to those living abroad and having an income in India. DTAA may cover all types of income or only a few specific ones. Both the rules and the tax rates differ from one country to another," says Rajarshi Dasgupta, executive director, Aquilaw.

Non-residents eligible for DTAA can claim its advantages only with a Tax Residency Certificate (TRC) from the tax authority of the country in which they reside.

"Non-residents are required to furnish some additional information in Form 10F electronically," says Suresh Surana, founder, RSM India. Form 10F is a declaration that non-residents need to file in India to provide necessary details to the Indian Income-Tax (I-T) authorities, ensuring that they are eligible for DTAA benefits.

Tax savings for NRIs

NRIs are entitled to certain exemptions and deductions under the old tax regime, but not under the new one. "By investing in specified instruments like NRE (Non-Resident External) accounts, and select mutual funds, NRIs can avail of tax benefits. They can also explore deductions under Section 80C and other sections of the I-T Act," says Jain.

Finally, experts say NRIs' salaries should be structured in such a way that double taxation is avoided. "If double taxation is unavoidable, then maintain proper records to ensure NRIs get tax credit in India," says Patnaik.

KEY ASPECTS OF DTAA EXPLAINED

- Double Taxation Avoidance Agreement (DTAA) is a tax treaty signed between countries to help taxpayers avoid paying double taxes on the same income
- It becomes applicable when an individual is a resident of one nation but earns income in another
- DTAA provisions can apply to income from services provided and salary received in India; interest earned on fixed deposits and savings bank accounts held in India; income from house property in India; and capital gains from the transfer of assets in India
- If an NRI makes use of DTAA provisions, then tax is payable at a lower rate on the incomes mentioned above