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Tax on International credit card spending

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Why in News: A proposal in the Union Budget to levy a higher tax on some types of remittances of funds abroad came into the limelight again this week after a notification was issued for its implementation from July 1.

Present Provision

The use of an international credit card to make payments towards meeting expenses while overseas was so far not covered under the LRS.

The spending on international credit cards was excluded from the LRS by way of Rule 7 of the Foreign Exchange Management (Current Account Transaction) Rules, 2000.

With the new notification, Rule 7 has been omitted. The government has clarified that the changes will not apply to payments for the purchase of foreign goods/ services from India, such as subscriptions to newspapers, magazines, or online streaming services.

It is strictly for transactions under Schedule III (of the FEM rules) and not for payments for purchase of foreign goods/ services. This demand had come from the domestic travel industry

Schedule III to FEM (CAT) Amendment Rules include overseas transactions such as private visits outside India, gift/donation and going abroad for employment.

Recent Amendment

The Centre has amended rules under the Foreign Exchange Management Act (FEMA), bringing international credit card spends outside India under the Liberalised Remittance Scheme (LRS).

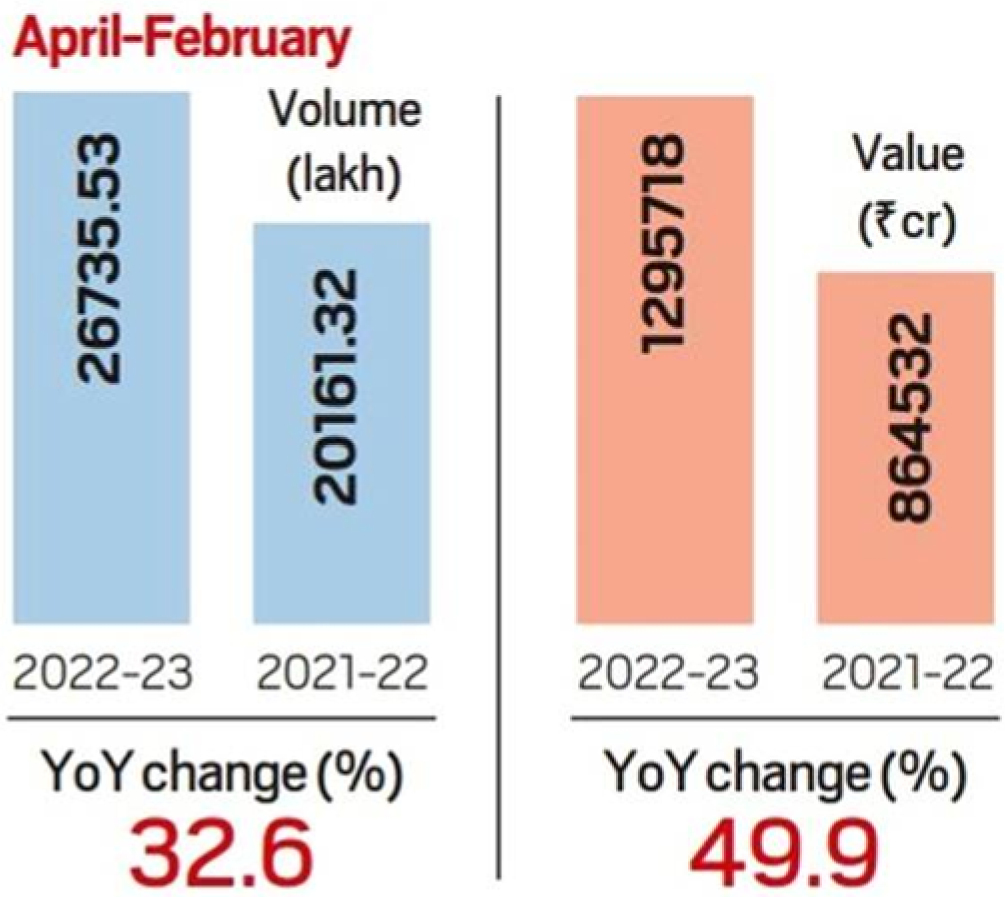
Credit card spends outside India have been brought under the ambit of the LRS — under which all resident individuals, including minors, can remit up to US $2,50,000 (approximately Rs 2.06 crore) abroad per year without prior approval from the RBI.

Also, from July 1, spending on international credit cards will attract a higher rate of Tax Collected at Source (TCS) at 20%.

The government said the decision was taken in consultation with the Reserve Bank of India.

Bringing credit card transactions under LRS enables the levy of a higher TCS, as announced in the Budget for 2023-24. Till June 30, a TCS of 5% will be levied on such spending on overseas tour packages (without threshold) or any other category (beyond threshold of Rs 7 lakh), except for medical and education purposes.

Rationale behind the Changes



The tweak in these rules will help bring parity between the international usage of credit and debit cards, which were already part of LRS.

Also, it said that instances had come to notice where the “LRS payments are disproportionately high when compared to the disclosed incomes”. It also clarified that the LRS does not cover business visits of the employee when the costs are borne by the employer.

Payments by debit cards etc. have been treated as LRS even earlier. Due to the exemption under erstwhile Rule 7, expenditures through credit cards were not accounted for under the specified LRS limit, which has led to some individuals exceeding the LRS limits.

Data collected from top money remitters under LRS reveals that international credit cards are being issued with limits in excess of the present LRS limit of USD 2,50,000.

The differential treatment needed to be removed in the interest of uniformity and equity in the treatment of modes of drawal of foreign exchange and for capturing total expenditures under LRS for prudent foreign exchange management and to prevent by-passing of LRS limits

There has been a surge in spending by Indians on overseas travel — they spent $12.51 billion in the April-February period of fiscal 2022-23, an increase of 104% compared to the same period the previous year, albeit over a low base due to Covid-linked travel restrictions.

According to RBI data, in April-February of FY2022, the total amount spent by domestic travellers on international destinations was $6.13 billion under the RBI’s LRS for resident individuals.

During April-February 2022-23, transactions using credit cards, in volume terms, increased 32.6% to Rs 267.35 crore. In value terms, spending on credit cards increased almost 50% to Rs 12.95 lakh crore during this period.

The measures for credit cards follow the government's earlier steps to introduce TCS levy for overseas tour packages.

In February 2020, the government in the Budget announced the insertion of a new clause under Section 206C of the Income-tax Act to levy 5% TCS on overseas remittances and for sale of overseas tour packages. It became applicable from October 2020.

Tax on spends abroad

The government had changed the TCS limits for foreign remittances in the Budget for 2023-24. The Budget had stated that on foreign outward remittance under LRS, other than for education and medical purposes, a TCS of 20% will be applicable from July 1, 2023.

Before this proposal, a TCS of 5% was applicable on foreign outward remittances above Rs 7 lakh, and 5% without any threshold for overseas tour packages.

In March, while moving the Finance Bill 2023 in Lok Sabha, Finance Minister Nirmala Sitharaman had said RBI had been asked to look into ways to bring credit card payments on foreign tours under the LRS.

Compliance burden

Experts said the changes for credit card spends will likely add to the compliance burden of banks and financial institutions. They also pointed out that if the move is intended to track overseas transactions, the TCS rate of 20% is probably too high and could have been instead at 1-2%.

On remittances connected with employee business travels, business visits were hitherto covered under LRS and this inclusion remains. However, where an employee's overseas work travel expenses are borne by the employer, the LRS regulations excluded such expenses from the LRS limits of the employee…practical challenges could be faced in ascertaining whether an employee's travel is a business travel or not.