

'FII income from India investments not taxable'

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BANGALORE: A recent ruling by The Authority for Advance Ruling (AAR), will greatly boost FII sentiment. In this ruling, awarded to Fidelity, a resident of the US, the AAR bench has clearly held that all income arising from investments in India, will be treated as business income. Further, such income would not be subject to tax in India.

India can tax the business income of a foreign entity, only if such an entity has a permanent establishment (PE) ? fixed place through which business is conducted ? in India.

A dependent agent in India also creates a PE. The AAR held that the domestic custodian appointed by Fidelity, in accordance with the existing Sebi regulations, cannot be regarded as its dependent agent. The domestic custodian cannot create a PE of the FII in India.

Standard Chartered Bank (SCB) was appointed as the domestic custodian to comply with Sebi guidelines. In its capacity as the domestic custodian, it received dividend, interest and capital gains arising out of investments made by Fidelity. Similar custodial services were provided by it routinely to other entities as well.

The AAR held that SCB is an independent agent of Fidelity, both legally and economically.

In this case, as Fidelity was held not to have a PE in India, the AAR also held that its business profits would not be subject to any tax in India.

According to Nishith Desai, attorney to Fidelity, ?This ruling, which has held the entire income of the FII to be in the nature of business income, would also be beneficial to those FIIs who have not invested in India through favourable tax treaty jurisdictions (like Mauritius or Cyprus) that exempt capital gains from Indian taxes.?

The business of the FIIs is making investments in India and other countries. Thus, FIIs contend that their income arising from investments, including gains on the sale of investments, should be regarded as business income. Such income should be taxed as per Article 7 of the relevant tax treaty.

In this context, the main fear in the minds of most FIIs is that tax authorities may wrongly treat the domestic custodian as their PE in India and thus, subject them to Indian taxes. This ruling, will allay such fears.

Currently, India exempts long-term capital gains arising from the sale of shares on recognised stock exchanges in India. However, short-term capital gains continue to be taxable in India. Moreover, domestic laws are subject to frequent change.

If the entire income arising from investments in India is treated as business income, and there is no PE in India, the FIIs do not suffer any tax incidence in India. ?As this AAR ruling will have a persuasive effect during the course of assessments, it will be extremely beneficial,? said an FII official.

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