Tax Hotline

December 26, 2005

AUTHORITY FOR ADVANCE RULINGS DENIES TREATY BENEFIT TO US FII - HOLDS THE PENSION TRUST TAXABLE IN INDIA

TThe Authority for Advance Rulings ("**Authority**") has held in a recent judgment that the $43bn General Electric Pension Trust ("**GEPT**") is liable to be taxed in India. GEPT's investment in India is over $80m.

GEPT, a trust set up in the US, is registered as a Foreign Institutional Investor in India, and invests in Indian securities, the returns from which are used for General Electric's pension liabilities. It had sought a ruling on taxability of its income in India.

In the case of GEPT, the Authority upheld its decision in the cases of Fidelity and Morgan Stanley to the extent that it classified the income of the FII in India from the trading of securities as profits from business.

However, unlike the earlier cases, where the Authority had held that the business income of the FIIs would not be liable to tax in India on the basis that the FIIs had no permanent establishment in India under the applicable tax treaties, in the case of GEPT, the Authority held that the benefit of the India - US tax treaty was unavailable. The basis for holding as such was that the applicant (GEPT) was a trust and the residential status of a trust under the India- US tax treaty was determined in accordance with the provision of clause (1)(b) of Article 4 of the treaty. GEPT enjoys a tax exemption in the US and it would appear that the Authority held that GEPT was ineligible to treaty benefits on this ground. The immediate consequence of the denial of tax treaty benefits to the US based FIIs structured as trusts, is that the business income of these entities could become taxable in India. As opposed to this, had the income of these FIIs been classified as capital gains, where the trading of securities had been done on a recognized stock exchange, the liability to tax in India would have been either 0% or 10% depending on whether the gains were long term or short term. This change in the tax situation would have a significant negative impact on the business costs of FIIs.

It may be noted that this clause regarding residential status of trusts is not a standard feature in India's tax treaties, and is absent in many treaties with other countries. The decision is therefore unlikely to affect similarly structured FIIs from other jurisdictions. Thus, where a US pension fund were to invest into India through Mauritius instead of directly, the FII would be tax exempt in India in the absence of a PE, whether its income were to be classified as business income or capital gains.

- **Annapoorna Jayaseelan** & **Shefali Goradia**

Source: The Economic Times, December 24, 2005

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