

## Tax Hotline

January 09, 2007

### THE AUTHORITY FOR ADVANCE RULINGS OVERTURNS ITS OWN DECISIONS THE FIDELITY GROUP HELD TAXABLE IN INDIA AFTER ALL

Deviating from its own rulings in earlier cases, the Authority for Advance Rulings ("AAR") held, in the matter of 39 American and Canadian Fidelity group entities, that the income of a Foreign Institutional Investors ("FI") would be characterized as capital gains and not business income - suggesting that FIs may legally only *invest* in shares and not *trade* in shares.

This position not only differs from the decisions of the AAR in the matters of *In re: Fidelity Series VIII* and *In re: General Electric Pension Trust*, but also appears to digress from the soon to be finalized *draft instructions issued by the Central Board of Direct Taxes ("CBDT")* on the various factors that would be determinative of the nature of income from trading in shares as 'income from business'. This is surprising given that the structure and method of operation of the Fidelity entities in these cases was substantially similar to that followed by the applicants in the earlier cases, in respect of which the AAR had held that income from transacting in securities on a frequent basis would be business income. This new decision appears to deviate from various classic judgments, including decisions of the Supreme Court.

Although an advance ruling is binding only on the tax department and the applicant in the matter, the decisions of the AAR no doubt have persuasive value in all other similar cases. The tax department is likely to use this new decision of the AAR to revisit the tax treatment of the income of all FIs. The AAR had so far taken into account the volume and frequency of trade, manner and method of operation, etc and ruled that the income of FIs being its 'business income' would not be taxable in India in the absence of a permanent establishment ("PE") under the applicable tax treaty. As a result, FIs, especially from treaty countries such as the USA were not taxable in India in the absence of a PE. This has apparently changed.

Now, irrespective of the existence of a PE in India, capital gains from trading in Indian shares would be taxable in India. The FIs that will not be adversely effected by this ruling are those investing through jurisdictions like Mauritius or Singapore.

While one hopes that this will not unsettle the booming Indian capital markets, it must be noted that the decision is indeed a blow to the ends of stability and certainty in taxation of non-residents; the end with which the AAR had been constituted.

- **Annapoorna Jayaseelan & Bijal Ajinkya**

Source:

- *The Economic Times, January 9, 2007*
- *Business Standard, January 9, 2007*

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