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In Re: Advance Ruling P. No. 10 of

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Court : Authority for Advance Rulings

Decided On : Aug-14-1996

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Judge : S Ranganathan, R Meena

Appellant : In Re: Advance Ruling P. No. 10 of

Judgement :
Appellants: In Re: Advance Ruling P. No. 10 of 1996 Vs.

Income Tax Act, 1961 - Sections 161, 161(1), 161(1A), 164, 164(4), 166 and 245Q; Finance Act, 1970; Double Taxation Avoidance Agreement - Articles 5, 10(2) and 13 CIT (Addl.) v. Surat Art Silk Cloth Manufacturers Association, [1980] 121 ITR 1; K.P. Varghese v. ITO, [1981] 131 ITR 597 (SC); CIT v. Gotla, [1985] 156 ITR 323; CWT v. Trustees of H.E.H. Nizam's Family (Remainder Wealth) Trust, [1977] 108 ITR 555; CIT v. P. Krishna Warrier's case, [1970] 75 ITR 154; CIT v. Balwantrai Jethalal Vaidya, [1958] 34 ITR 187; CIT v. Trustees, T. Stanes and Co., [1995] 200 ITR 396; Trustees of Gordhandas Govindram Family Charity Trust's case, [1973] 88 ITR 47; Mohsinally Alimohammed Rafik's case, [1995] 213 ITR 317 (AAR); In Re: Advance Ruling No. P. 9 of 1995, [1996] 220 ITR 377 (AAR); CIT v. H. E.H. Mir Osman Ali Bahadur [1966] 59 ITR 666 (SC) 1. Very interesting and far-reaching questions arise for consideration in these applications under Section 245Q(1) of the Income-tax Act, 1961 ("the Act"). The two applicants are companies incorporated in Mauritius. They are, for convenience, referred to hereafter as "the investor company" (IC) and "the investment manager" (IM),

respectively.

The facts relating to transactions in relation to which the applications have been filed by the two applicants overlap to a considerable extent and it will, therefore, be desirable and convenient to dispose of both the applications by a common order.

2. The number of entities that have a part to play in these transactions are many and it will, therefore, be useful to present at the outset the dramatis personae involved, The principal motivator of the transactions is an American company having an active participation in economic activities in Asian countries. With its considerable operational and investment experience, it has made a strong commitment to develop third party investment of funds in Asian countries. Towards this end, it constituted an infrastructure fund focussing on infrastructure and infrastructure-related investments to which one of its subsidiaries agreed to contribute up to $100 million. Two other subsidiaries were made advisers. It believes that it is "well-positioned to establish emerging market direct investments bringing together the complex organisational elements, attracting experienced individuals and institutions as partners and fully utilising its own substantial resources and understanding of the region".

3. The transactions now proposed (which give rise to the present applications) are restricted in its operations to the "Indian sector".

The American company in collaboration with an Indian financial service company now proposes to set up another fund. This fund will consist of two tranches (sections or branches), one a rupee tranche called a "contributory trust" holding funds in Indian currency and a Mauritian company (referred to as "the foreign tranche") holding funds in dollars. The rupee tranche is to be set up as a contributory trust (hereinafter referred to briefly as "the CT") constituted under an indenture of trust drawn up between the Indian financial service company and another Indian trust company. The trust company will be trustees of the CT and the trust funds will vest in it under the Indian law. The expression "CT" and "trustees" are, therefore, interchangeably used in the ensuing discussions.

4. Parallel to the CT, the foreign tranche plans to hold funds to the tune of $100 million. The American company has committed to itself to contribute $15 million to this company for investment. Other contributors from several countries are expected to make up the balance of $85 million. As of now, the activities of the CT and of the fund company are intended to be kept separate though perhaps, at a later point of time, they may be combined together. The two tranches are to be managed from abroad by a common manager and propose to enter into a co-investment agreement for providing for investment by the two tranches in approximate proportion to their respective asset sizes. It is agreed that it is not necessary now to consider that eventuality and it may be left out of consideration for the present.

5. The funds of the CT are to be invested in Indian companies and projects in India. In order to decide on the nature, area and investments to be made, a subsidiary of the American company incorporated in Mauritius (IM) has been set up. Its actual functioning, though under the direction and control of its board of directors ("the Board"), will be guided and monitored in three different ways : (i) The IM will constitute an investment committee with four representatives nominated by the American company and three including the chairman nominated by the Indian financial service company which will recommend (acting by majority vote) portfolio investments for approval by the board but with a right of veto to the American company.

(ii) The Indian financial service company which has rich experience in this line of business will act as the principal investment adviser in India to the trust under an advisory agreement. A similar agreement appointing another foreign company also as an investment adviser to the IM in relation to the operations of the offshore tranche will also be entered into.

(iii) Under the advisory agreement, the Indian financial service company and the American company can also constitute "service units" from their respective staff to assist them.

(iv) The management agreement also envisages an advisory board consisting of representatives of industries, institutions, investors and the Asian Development

Bank (ADB) which, as its name indicates, will be purely advisory in character.

6. But though the investment committee, the investment advisers, service units and the advisory board may offer their suggestions and recommendations, the final word and responsibility will rest with the board of the IM which can be convened anywhere in the world except in India and the U. S. A.7. Necessary documents to give effect to the above arrangements have been drawn up and placed before the Authority. These are : (i) Draft indenture of trust (T. D.) between the Indian financial service company and the trust company constituting the CT of which the said company is appointed trustees. [A draft trust deed originally filed with the application was allowed to be replaced by a revised draft trust deed at the time of arguments and it is this revised T. D. that is referred to below].

(ii) Draft contribution agreement (C. A.) between the contributors on the one hand and the trustees and the IM on the other.

(iii) Draft investment management agreement between the trustees and the IM. (iv) Draft advisory agreement between the Indian financial service company and the management company.

8. Arguments before the Authority were addressed on the basis of these draft agreements. However, since the transactions are still in the stage of proposed ones, counsel for the applicant was willing to consider suitable modifications in the agreement in respect of clauses which, as they stand, may create some difficulties for the applicants from the tax angle. These aspects are touched upon in due course while dealing with the arguments put forward by counsel. The modifications agreed to by counsel are indicated in the discussions that follow in bold type. The attention of the Authority has also been drawn to a "private placement memorandum" drawn up for "the fund" which is in the nature of a prospectus inviting contributions and this will be touched upon when necessary.

By this deed, the Indian financial service company makes an initial settlement of Rs. 1 lakh on the trustees on trust. This along with contributions that may be made to the trust fund by others is compendiously referred to in Clause 1(h) of the deed as the "contribution fund". The contributions by various persons is considered in

terms of a unit of one million rupees, fractional units also being permissible [Clause 1(y)]. Thus, with its contribution of Rs. 1,00,000, the Indian financial service company is having 1/10th of a unit in the fund. The contributors are also the only beneficiaries under the trust deed [Clause 1(c)]. The beneficiaries mentioned in the Third Schedule to the deed at present are the IC and the Indian financial service company. To this will be added the names of others who may be making contributions to the fund till the trust deed is signed along with the amounts of their contribution and the number of units held by them. Persons coming forward to contribute to the fund till the execution of the trust deed also enter into a "contribution agreement" (C. A.) with the trustees and the IM [Clause 1(g)]. An agreement on the same lines is to be signed by all the contributors who join up later and such persons will also be included as beneficiaries of the trust. The trustees are to stand possessed of the trust fund, invest the same, hold the income for the benefit of the beneficiaries and distribute the income among the beneficiaries in terms of the C. A. The trust is expected to operate for a period defined as "the trust period" [Clause 1(x)]. This is the period up to the first of the following dates : (i) the day on which shall expire 14 and half years from the date of the settlement ; (ii) such dates as the trustee may appoint by deed at their discretion ; (iv) such dates as shall be determined by the I. M. after six months' prior notice to the contributors ; and 9. Clause 3(a) of the T. D. obliges the trustees to appoint the I. M.to carry out its investment policies.

10. The mode of distribution of the trust fund and income is set out in clause 5 of the trust deed which reads thus : 5. The trustee shall stand possessed of the trust fund and the income thereof shall accrue upon the trust for the benefit of the beneficiaries and the trustee shall make distributions to the beneficiaries/contributors as follows :-- (a) as regards the initial settlement as specified in the second schedule to distribute the same and any income accumulated thereon in equal proportions on termination of the trust amongst the beneficiaries as listed in the third schedule, (b) as regards all additional amounts to be distributed to the beneficiaries in proportion to the contributions made by them and in accordance with the fourth schedule--the contribution agreement." 11. Clause 7 of the trust deed contains a provision to the following effect: 7. (a) The trustee shall have the power at any time or times during the trust period to add as

beneficiaries such one or more persons or class of persons as the trustee shall in their absolute discretion determine.

(b) Any such addition shall be made by a deed signed by the trustee and :-- (i) naming or describing the person or persons or class of persons to be added as beneficiaries ; (ii) specifying the date (not being earlier than the date of the deed but during the trust period) from which such person or persons to be thereby added as beneficiaries ; and (c) It is hereby clarified that such beneficiaries will be entitled to only such share that is in proportion to the contribution made by them and in accordance with the contribution agreement." 12. At the time of hearing, a doubt was expressed by the Authority as to how far a provision conferring an absolute discretion on the trustees to add names of beneficiaries to the trust would be justified in law. Though the authorised representative of the applicant (A. R.) contended that this clause was perfectly in order (citing O.P.Agarwalla on Trust, pages 220-222), he also expressed his willingness to modify clause 7(a) as follows in order to obviate any kind of objection : " 7. (a) The trustee shall, during the trust period, have the power at their discretion to admit as beneficiary any institutional investor which agrees to enter into a contribution agreement." and, consequent on the above, to insert a definition of the expression "institutional investor" in Clause 1 to the following effect : "(1) 'institutional investor' means any entity other than an individual, being a natural person including but not limited to financial institution, company or corporation, Government, State or political subdivision or local authority, that trustees may consider a reputable investor." 13. After a little discussion he was willing also to drop the last seven words which were considered to be somewhat vague.

14. One may pause here to consider whether there could be any valid objections to the constitution of a trust in this manner. The authors of the trust are the IC, the Indian financial service company and others contributing to the trust by the date of the trust deed. Indeed even institutional investors contributing to the trust, in helping the CT achieve its target of 50 million dollars can be considered as supplemental authors of the trust, the C. A. constituting read with the trust deed, the instruments constituting the trust in their cases. The purposes of the trust are, as stated in the TD, to invest the trust funds and distributing the proceeds to the

beneficiaries. This is, in a sense, nothing more than an arrangement by which certain parties agreed to contribute funds for a common purpose and divide the profits amongst themselves. No doubt, the same objective could be achieved by the constitution of a firm or a company but, equally, there seems to be no valid objection if the parties wish to do it in the form of a trust which, under the trust act, merely represents certain obligations annexed to the ownership of property in the form of the contributed funds. The purposes of the trust cannot be said to be forbidden by law or likely to defeat the provisions of any law or fraudulent or involving injury to any person or property or opposed to public policy : vide Section 4 of the India Trusts Act (2 of 1882). It will appear later that, in entering into the present transactions, the parties took into account certain difficulties if the same transactions had been put through the format of a company and also took into account certain financial and tax implications. But these cannot render the purposes of the trust unlawful within the meaning of the Indian statute. The clause which enabled the trustees to admit any one as a beneficiary, the Authority felt, might introduce a degree of uncertainty regarding the element of beneficiaries under the trust. The parties have agreed to modify the clause as indicated above. The result is that now the trustee's choice of beneficiaries is restricted (a) by the overall limit of the fund ; (b) only to institutional investors ; and (c) to persons who agree to subscribe to the C. A. The criteria for persons to become beneficiaries and the shares of income they are entitled to are clearly defined in the deed. The Authority is of opinion, that with the introduction of the modifications referred to above and in the light of the statement of law contained in the passages from Agarwalla's Trust Act cited by learned counsel, there can be no objection to the validity of the modified trust deed. [Parenthetically, however, it may be observed that, in the definition in Clause (1) proposed to be inserted, the words "being a natural person" appears to be a surplusage and may be omitted without detracting from the meaning of the clause. But this has no impact on the validity of the trust deed].

15. Clause 9 specifies the extent of the beneficiaries' interest. It reads : Extent of beneficiaries interest.--The beneficial interest of each beneficiary in the trust fund shall extend to and be limited to the aggregate value of the units subscribed to and held by that beneficiary in the trust fund." 16. It is necessary to mention Clause 14

and paragraph (d) of Clause 17 to which the Departmental Representative raised some objection to which reference will be made later. The provisions read as under : The trustee shall have power to make such reserves out of the income or capital as the trustee deem proper for expenses, taxes and other liabilities of this settlement to pay from income or from capital or to apportion between income and capital any expenses of making or changing investment or selling, exchanging or leasing including broker's commissions and charges and generally to determine what part of the expenses of this settlement can be charged to capital and what part to income and to determine as between separate funds and separate parts or shares the allocation of income, gains, profits, losses and distributions and so that any decisions of the trustee under this regulation whether made in writing or implied from their acts shall so far as the law may permit be conclusive and binding on the beneficiaries and all persons actually or prospectively interested under this settlement.

(d) The following powers of the trustee shall only be exercised by a majority of the directors of the trustee present and voting at a meeting of its board of directors : (i) application of the net profit of the trust otherwise than by way of distribution to the beneficiaries ; and 17. The First Schedule to the T. D. sets out the Regulations that govern the trustee. Attention has been drawn to paragraph 2 and paragraph 8 which read thus : " 2. The trust fund shall be managed by the investment manager in accordance with the investment objectives, policies and restrictions set forth in the private placement memorandum dated November, 1995, which is hereby incorporated by reference herein.

Provided however, they may make investment in shares or projects and may appoint representatives on the management or board of the portfolio investments or projects for the surveillance or protection of such investments." 18. Paragraph 3 provides that the trustee will not be bound to interfere in the business of any company in which the trust is interested. Paragraph 4 gives the trustee power to employ agents, paragraph 5 a power to employ an investment adviser or manager and paragraph 6 a power to employ nominees and custodians to hold the property or investment of the fund in their names.

19. The Second Schedule sets out Rs. 1,00,000 as the initial settlement, the third is to contain the names of the applicant company, the Indian financial service company and others who have agreed to join in the execution of the trust deed and the Fourth Schedule embodies the contribution agreement to which each one of the investors will have to subscribe. This has to be dealt with in greater detail.

The contribution agreement will be between the initial investors set out in the Third Schedule to the trust deed [presumably the same as Schedule A here] the trustee and the investment manager. By a letter dated June 27, 1996, the applicants have indicated an insertion in the preamble of the C. A. of a paragraph (c) as follows : " (c) Indian trust company is a subsidiary of the Indian financial service company and is in an independent business of acting as trustee of trusts. " 20. Every additional investor will have to execute in favour of the trust company and the management company an agreement on the same lines [paragraphs 2.01 and 2.02]. Every contributor, by these agreements, agrees to contribute a stated amount (called his "commitment" amount) to the fund in exchange for a corresponding number of units [paragraphs 1.01(5), (7) and (16)]. Such commitment is valid for five years [paragraph 7.01].

21. Paragraphs 2.04 to 2.06 of the agreement are important and have to be extracted here in full : (a) Capital contributions shall be made by the contributor to the trust for all or a portion of a contributor's unpaid capital commitment on an as needed basis as specified by the investment manager. Each contributor's capital contribution shall be in an amount pro rata to the contributor's capital commitments to the trust. The investment manager shall give the contributor a takedown notice (draw down) in accordance with this agreement (notice clause) within 21 calendar days in advance of the date on which the capital contribution shall be required to be made.

(b) On the draw down date, for any draw down of the contribution amount, if all conditions specified in Article IV (conditions of contributions) are met, each of the contributors will pay their draw down in rupees, payable at par, to the trust's bank account as specified in the investment manager's notice of contribution.

(c) Notwithstanding the above, the investment manager may choose to establish the contribution fund with minimum commitments of Rs. 750 million for the initial closing (the closing) with staged closings for subsequent commitments. Such staged closings will occur not later than 12 months after the closing.

2.05 Upon receipt of draw down amount from any of the contributors, the trustee, shall : - (a) issue, to the respective contributor, units with a total nominal value equal to the instalment amount, credited as fully paid on the date of actual payment ; (b) enter the respective contributor's name in a register of unitholders as the holder of those units ; and (c) deliver to the respective contributor a unit certificate or certificates evidencing valid title to the units, 2.06 Default in payment: In the event that any contributor fails to contribute any portion of its capital commitments within five business days of the date such contribution is due under a takedown notice, the investment manager shall mail (by registered mail) a notice of default to such contributor. If such contributor fails or refuses to pay in full the unpaid capital commitments, or any portion thereof, within five business days after the mailing of such notice, then the investment manager may declare such contributor to be a defaulting contributor and the following provisions shall apply :- (a) such defaulting contributor shall not be entitled to make any further capital contributions to the trust, provided however, that such defaulting contributor shall remain fully liable to the creditors of the trust, to the extent permitted by law, and to the trust, as if such default had not occurred.

(b) such defaulting contributor will not be entitled to participate in any subsequent contributor's vote, consent or any decision to be made by the trust or the investment committee and such defaulting contributor's contributed capital percentage shall be disregarded for purposes of any super majority vote or consent requirement ; (c) such defaulting contributor's capital account shall be reduced to the lesser of (i) the defaulting contributor's unreturned capital contributions determined as on the date of the default and (ii) the defaulting contributor's contributed capital percentage multiplied by the excess of the fair market value of the trust's investments over the liabilities of the trust determined as on the date of the takedown notice with respect to which the defaulting contributor defaulted ; (d) following the date of default, no items of income or loss shall be

allocated to such contributor ; (e) notwithstanding any provisions to the contrary in this agreement, following the date of default, such defaulting contributor shall be entitled to distributions from the trust in liquidation or otherwise, amounting in the aggregate to no more than its capital account adjusted under paragraph 2.06(c) and payable only out of, and to the extent of, that portion of the proceeds of investments made prior to the date of the takedown notice, with respect to which such defaulting contributor defaulted, which corresponds to such defaulting contributor's contributed capital percentage as of such date ; and (f) appropriate adjustments shall be made to the contributed capital percentages of the non-defaulting contributors.

Each of the contributors hereby consents to the application to it of the remedies provided in this paragraph 2.06 in recognition of the risk and speculative damages its default would cause to the other contributors, and further agrees that the available such remedies shall not preclude any other remedies which may be available in law, in equity, by statute or otherwise. " 22. The "initial closing" is to be on the date of the trust deed [Clause 1(k) of the deed] and will be followed by subsequent closings within 12 months from this date [paragraph 4.04]. Investments made subsequent to this date but before any subsequent closing are governed by paragraph 2.09 which reads : " 2.09 Investments prior to second dosing : In the event a portfolio investment by the trust is completed subsequent to the closing but prior to the subsequent closing, there will be a draw down from the commitments of investors participating in such subsequent closing in an amount equal to the pro rata original cost of the equity investment plus interest from the date of the investments completion. Indian investors will be required to pay interest at the Indian prime rate as set by the State Bank of India plus 3 per cent.

Such amount will simultaneously be refunded pro rata to the existing contributor and amounts other than interest will be immediately restored to the unfunded commitments and will thereafter be subject to recall and reinvestment by the fund in other portfolio investments. In addition for investors participating in a subsequent closing interest on the fee paid to the investment and any amounts drawn down by the investment manager will be assessed to interest at the prime rate as set by the State Bank of India plus 2 per cent. " 23. Under paragraph 4.04,

the I. M. may choose to close the contribution fund with minimum commitments aggregating to Rs. 750 millions for the initial closing and paragraph 4.05 disables any contributor from withdrawing from the fund or transferring its interest therein.

24. Article VI deals with the distribution of profits, allocation of income, etc. It may be sufficient to set out here paragraphs 6.01, 6.02, 6.04 and 6.06 : Distribution of profits, allocation of income and loss, cancellation of units and investors rights and obligations : 6.01 Distribution : Income received by the trust in respect of the contribution fund will be a charge on the income of the contribution fund, and will be distributed annually or at such direct intervals as the trustees may in their absolute discretion think fit. The contribution fund may also declare special distributions. The method by which the distribution will be made and the allocation of income between the contributor and the investment manager are as set out in paragraphs 6.02 to 6.07 and will depend upon the source of the income.

6.02 Income from portfolio investments : Contribution proceeds attributable to the fund's portfolio investments (which shall include all proceeds attributable to the disposition of such investments, together with interest, dividends and distributions from such investments, net of operating expenses including distribution of fees and share of profit to the investment manager and capital expenditures as the investment manager shall reasonably determine will be distributed as follows : (a) First, to the contributor until 100 per cent. of capital contribution has been deemed to have been returned plus a 9 per cent. annual rate of return compounded semi-annually on all such capital contributions from the time of draw down ('the priority return').

(b) Thereafter, 80 per cent. to the contributor and 20 per cent. to the investment manager, provided that distributions will be made in accordance with sub-paragraphs (a) above until the earlier of : (ii) the date on which the fund is deemed to be fully invested by the investment manager, or (iii) the date on which the investment manager gives written notice of the dissolution of the contribution fund to the contributor. . .

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6.04 Income and expenses from other sources : All items of income gain, loss or expenses not directly attributable to a particular portfolio investment (e.g., interest or temporary investments, and the contribution fund's share of any advisory fees net of general operating expenses) shall be allocated among the investors in proportion to their capital contributions. . . .

6.06 Special allocation among late entering contributors of organisation and operating expenses : All operating expenses allocated for any period to the capital accounts of the contributors as a group shall be specifically allocated among the capital accounts of the contributors so that such operating expenses are allocated among the capital accounts of the contributors in proportion to their respective contributed capital percentages as at the end of such period : Provided, however, that if the additional contributors are admitted to the trust such operating expenses shall be allocated among the capital accounts of the contributor so that to the extent possible the cumulative operating expenses allocated with respect to such contributor at any time are proportionate to their respective contributed capital percentages." 25. Article VIII, providing for winding-up and dissolution of the trust, reads : 8.01 The trust is expected to wind up and liquidate its assets on the period from the date hereof until whichever of the following dates shall first occur, namely :-- (i) the day on which shall expire 10 years and an additional three year period from the date of this settlement ; and (ii) upon the winding-up of management company, this agreement shall terminate immediately ; (iii) such day as determined by the board of directors of the investment manager upon at least six months prior written notice to the investors. " 26. Article X deals with miscellaneous matters of which it is necessary to refer to paragraph 10.02 : 10.2 Liability of contributor : Except as specifically set forth herein, no contributor shall have any personal liability whatever in its capacity as a contributor whether to the trust, to any other contributor or to the creditors of the trust for the debts, liabilities, contracts or any other obligations of the trust or for any losses of the trust. A contributor shall only be liable to pay its capital commitments to the trust. After its capital commitment shall have been paid in full, a contributor shall not be obligated to make any further capital contribution to the trust or to repay to the trust, any contributor or any creditor of the trust all or any fraction of any negative amount of such contributor's capital account." The management of the trust funds is to be

entrusted by the CT to the IM under an agreement entered into with it. The IM is a limited life company incorporated in Mauritius. It is a 100 per cent.

subsidiary of an American asset management company but it is proposed to restrict its shareholding to 73 per cent. by transferring 22 per cent. to the Indian financial service company and five per cent. to the Asian Development Bank Ltd. (ADB). Its board of directors will also have representatives of the two companies and ADB. The IM is to be responsible for the day-today management of the trust fund "in accordance with the provisions of this Agreement and any directions and instructions of the trustees" [2.01]. Paragraph 3.03 states that "the investment manager shall be responsible for the day-to-day management of the trust fund, which shall be subject to any directions, instructions and guidelines provided by the trustees". Paragraphs 5.01, 6,04 and 7.01 refer to the areas in which the trust funds should be invested and their respective priorities. Paragraph 5.01 provides : "In addition, trust fund investments may include holdings of listed companies that could be of particular benefit of the fund". Under paragraph 6.02, the IM should make best endeavours to maximise capital gains income of the contribution funds. Paragraph 6.05 permits the investment of contributions received "but not yet invested in portfolio investments.... in high quality short-term debt instruments in accordance with quality guidelines set forth in the private placement memorandum". The memorandum has this to say on the strategic objectives of the trust : The fund's investment objective will be to seek to achieve long-term capital appreciation by primarily making direct investments in a portfolio of Indian companies and infrastructure projects in India.

The fund's direct investment participations will generally take the form of equity, quasi-equity, equity-related, preferred stock, and convertible debt instruments. The fund will focus on opportunities that will seek to take advantage of India's expanding infrastructure requirements, increasingly active consumer product appetites and growing new technology base as well as opportunities arising from corporate turn around strategies, privatisation opportunities, business restructuring and reorganisation strategies, among other areas. Investments may be spread across the focus sectors in new projects, expansions and diversifications, opportunities arising from restructurings and reorganisations, product development

efforts, privatisations and the like.

The fund will only invest in projects that at the time of the investment comply with all relevant Indian State and Central Government legislation regarding environmental protection, and such guidelines on environmental protection and social and rehabilitation issues which may be adopted by the Asian Development Bank, a core investor (as defined below).

In addition, fund investments may include holdings of listed companies that could be of particular benefit to the fund." 27. Clause (iii) of paragraph 10.01(a) also needs to be referred to. It says that the functions of the investment manager shall include, inter alia : "To engage professionally skilled and/or experienced personnel to provide the necessary advisory and investment managerial support and/ or guidance to the portfolio investment and the entrepreneurs and if necessary to assist in the administration of the trust fund." 28. Article XIII dealing with delegation of duties envisages an investment committee (paragraph 13.01), an advisory board (paragraph 13.02) and advisory contracts with the Indian financial service company and the American company (paragraph 13,03) but makes it clear (paragraph 13.04) that, regardless of all delegation, the manager shall remain responsible for all decisions and be liable for any delegate's act or omission that it would otherwise have been liable for. Paragraph 14.01 stipulates for the payment to the IM of a fee of 2.5 per cent. of the aggregate capital commitments of the contributors reduced by returns of capital directly attributable to specific investments upon which distributed gains (or losses) of the trust have been realised. At the end of the commitment period, the investment management fee shall be based on the aggregate unreturned capital. To the extent that the balance of capital commitments or unre-turned capital of the trust fund plus the capital commitment or unreturned capital of the "the fund" in the aggregate exceeds US $ 150,000,000 or the equivalent in rupees, the investment management fee with respect to such balance shall be reduced to two per cent. Paragraph 14.04 on distribution reproduces paragraph 6.02 of the C.A. entitling the IM, after a particular stage, to a part of the proceeds attributable to portfolio investments.

29. The I.A.A. is entered into between the Indian financial service company and the IM (there being a similar agreement between the American company and the IM), pertaining to the off-shore tranche.

Paragraphs 2(a) and (b) of this agreement provide for the appointment of "service units". It is sufficient to extract paragraph 2(e) : "Paragraph 2(e).--Notwithstanding the services provided by the advisor, the advisor shall not be authorised to manage the affairs of, act in the name of or on behalf of, or bind the fund or the investment manager. The management, policies and operations of the fund shall be the exclusive responsibility of the investment manager acting pursuant to and in accordance with the investment management agreement(s), (hereinafter referred to as 'agreements') and all decisions relating to the fund, including, without limitation, the acquisition, management and disposition of portfolio investments, shall be made solely by the board of directors of the manager acting pursuant to and in accordance with the agreements." 30. The Authority has been informed that the "initial closing" of the offshore tranche held by "fund" has already been completed with commitments of 70 million US dollars (66 per cent. of which is from international investors) and that a second closing had been targeted for the month of April for an additional corpus of 80 million US dollars.

31. In the background of this configuration, two applications have been filed before the Authority.

(a) The application filed by the IC raised as many as seven questions set out in annexure "I" to the application. After some discussions in the course of the hearing this has been revised in the form of eleven questions (to which one more was orally added). The revised questions are : "1. Based on the facts and circumstances of the case, whether the applicant would be assessed in respect of its proportionate share of income earned by the contributory trust as per the provision of Section 161 of the Income-tax Act, 1961 (the Act)

2. Based on the facts and circumstances of the case, whether the contributory trust would be regarded as a 'see through' or 'transparent entity' vis-a-vis the applicant ; i.e., to say the applicant will be taxed in respect of its proportionate share of income under Section 161 of the Act

3. Based on the facts and circumstances of the case, if it is held that the provisions of Section 161 do not apply to the income of the applicant from the contributory trust because of the power vested in the trustees to add to the list of the beneficiaries on the terms laid down in the indenture of trust and the contribution agreement, then if such power is deleted, would the assessment of the applicant in respect of its proportionate share of income of the trust be made in accordance with Section 161

4. Based on the facts and circumstances of the case, even if it is held that the shares of the additional beneficiaries are indeterminate whether the capital gains arising to the applicant will be charged to tax at the rate of 20 per cent. as prescribed in Section 112 of the Act

5. Based on the facts and circumstances of the case, will there be any tax withholding by the investee companies at the time of distribution of income to the CT

6. Whether, on the facts and circumstances of the case, the character of the applicant's proportionate share in the income of the contributory trust will be the same as in the hands of the contributory trust

7. Based on the facts and circumstances of the case, whether the applicant's share in the dividend earned by the contributory trust will be chargeable to tax and if so at what rate

8. Based on the facts and circumstances of the case, will the applicant's share in the interest earned by the contributory trust be chargeable to tax at the rate of 20 per cent.

9. Whether, on the facts and in the circumstances of the case, will the applicant's share in the capital gains earned by the contributory trust be chargeable to tax

10. Based on the facts and circumstances of the case, whether there would be any withholding tax liability on the CT in respect of the distributions made to the applicant

11. Whether, on the facts and in the circumstances of the case, the applicant's proportionate share in the surplus arising on the realisation of the investments made by the contributory trust would constitute capital gains

12. Whether, in case the answer to question No. 11 is in the negative, the proportionate share of the applicant in such surplus will be chargeable to income-tax in India in the applicant's hands ?" (b) The application filed by the investment manager raises the four questions set out below ; "1. Based on the facts and circumstances of the case, and in view of the provisions of the India-Mauritius double tax avoidance agreement, can it be construed that the applicant does not have a permanent establishment ('PE') in India

2. Based on the facts and circumstances of the case, will the applicant be liable to tax in respect of the management fees received from the CT

3. Based on the facts and circumstances of the case, will the applicant be liable to tax in respect of the carried interest received from the CT

4. Based on the facts and circumstances of the case, if the answer to the above question is yes, will there be a withholding tax liability on the CT, in respect of the payment of management fees and carried interest to the applicant ?"

32. The AR submitted that the phrasing of the first question above in the negative is not correct and that this question may be reframed thus: "

1. Based on the facts and circumstances of the case, and in view of the provisions of the India-Mauritius double tax avoidance agreement, can it be construed that the applicant has a permanent establishment (P.E.) in India ?"

33. There can be no objection to this and it is the question, as thus modified, along with the other three questions that will be considered by the Authority.

34. Though numerous and seemingly involved in their language, the points raised by the applicants lie within a narrow compass. In the case of the IC, the basic question to be decided is whether the assessments of the CT and the IC will be governed by Section 161 or Section 164 of the Act and what rates of tax would be

applicable to the IC's receipts from the CT. In the case of the IM, the very short question that has to be answered is whether it can be said to have a permanent establishment in India within the meaning of the Agreement for the Avoidance of Double Taxation between India and Mauritius (DTAA) and, if not, whether any part of its income can be assessed in India.

35. To understand the points raised by the applicant company, it is necessary to consider the provisions of sections 160, 161, 164 and 166 of the Act. The relevant portions of these sections are extracted below : " 160.--Representative assesses.--(1) For the purposes of this Act, 'representative assessee' means--. . .

(iv) in respect of income which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any wakf deed which is valid under the Mussalman Wakf Validating Act, 1913 (6 of 1913)), receives or is entitled to receive on behalf, or for the benefit, of any person, such trustee or trustees ; 161. Liability of representative assessee.--(1) Every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income ; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions contained in this Chapter, be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him.

(1A) Notwithstanding anything contained in Sub-section (1), where any income in respect of which the person mentioned in Clause (iv) of Sub-section (1) of Section 160 is liable as representative assessee consists of, or includes, profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate : Provided that the provisions of this sub-section shall not apply where such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is

the only trust so declared by him.

(2) Where any person is, in respect of any income, assessable under this Chapter in the capacity of a representative assessee, he shall not, in respect of that income, be assessed under any other provision of this Act, 164. Charge of tax where share of beneficiaries unknown.--(1) Subject to the provisions of Sub-sections (2) and (3), where any income in respect of which the persons mentioned in clauses (iii) and (iv) of subsection (1) of Section 160 are liable as representative assessees or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this section referred to as "relevant income", 'part of relevant income' and 'beneficiaries', respectively), tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate : (i) none of the beneficiaries has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust ; or (ii) the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him ; or (iii) the relevant income or part of relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust was created bona fide exclusively for the benefit of the relatives of the settlor, or where the settlor is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance ; or (iv) the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession, tax shall be charged on the relevant income or part of relevant income as if it were the total income of an association of persons : Provided further that where any income in respect of which the person mentioned in Clause (iv) of Sub-section (1) of Section 160 is liable as

representative assessee consists of, or includes, profits and gains of business, the preceding proviso shall apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

(2) In the case of relevant income which is derived from property held under trust wholly for charitable or religious purposes, or which is of the nature referred to in Sub-clause (iia) of Clause (24) of Section 2 or which is of the nature referred to in Sub-section (4A) of Section 11, tax shall be charged on so much of the relevant income as is not exempt under Section 11 or Section 12, as if the relevant income not so exempt were the income of an association of persons :. . .

(i) any income in respect of which the persons mentioned in Clause (iii) and Clause (iv) of Sub-section (1) of Section 160 are liable as representative assessee or any part thereof shall be deemed as being not specifically receivable on behalf or for the benefit of any one person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed ; (ii) the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is received shall be deemed to be indeterminate or unknown unless the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable, are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

166. Direct assessment or recovery not barred.--Nothing in the foregoing sections in this Chapter shall prevent either the direct assessment of the person on whose behalf or for whose benefit income therein referred to is receivable, or the recovery from such person of the tax payable in respect of such income." 36. Before proceeding to discuss these provisions, it is necessary to deal with two preliminary objections to the maintainability of the application by the IC. It is contended for the

Department that what the application seeks virtually is a ruling on the mode of assessment of the CT (i.e., the trustee company) which is an Indian domestic company-whether it should be assessed on its total income at the maximum rate under Section 164 or whether it should be assessed separately in respect of the portions of income earned by it on behalf of the various beneficiaries under Section 161. The effect of sections 161 and 164, which is sought to be got clarified by the IC, may be explained by a simple example. If a trustee earns an income, say, of Rs. 10,00,000 holding it on behalf of certain beneficiaries, Section 161 calls for an examination whether the beneficiaries and their shares are indeterminate or unknown. Suppose it is clear that the beneficiaries would be A, B, C and D entitled to shares in the ratio 2:2:3:3, then, four assessments would be made on the trustee, one on behalf of each of the beneficiaries, bringing to tax the respective share incomes of Rs. 2 lakhs, Rs. 2 lakhs, Rs. 3 lakhs and Rs. 3 lakhs at the tax rates appropriate thereto. Alternatively, but not additionally, A, B, C and D could also be assessed on such income. On the other hand, if the shares of the beneficiaries should be unknown or indeterminate, the officer would assess the trustee on the entire income of Rs. 10,00,000 at the maximum rate as defined in Section 2(29C) of the Act as the Department would not be able to make assessments on the individual beneficiaries whose identity or shares are not known. Here, the IC wants to know which of these methods of assessing the trust should be adopted by the Assessing Officer and such a question cannot be entertained from it under Chapter XIX-B.37. The Department's objection is that this is a question which really affects the CT--a resident Indian company--and that the IC, though a nonresident, cannot avail of the benefits of Chapter XIX-B for getting clarifications about a resident assessee's liability to income-tax merely because they have some mutual connections. Reliance is placed, in support of this contention, on the ruling given by this Authority in A.A.R. 207 of 1994. In that case, a non-resident applicant sought a ruling on whether, in the assessment of its wholly-owned resident subsidiary running slot machines in India, cash disbursements to the winners in excess of Rs. 10,000 could be disallowed under Section 40A(3) of the Act. The Authority rejected the application "for the simple reason that the question sought to be raised relates not to the applicant but to a resident Indian subsidiary". This objection is not maintainable here in the view of

the Authority. The IC, as a non-resident, is entitled to file an application under Chapter XIX-B and, though the definition of "advance ruling" in Section 245N(a) places no specific restrictions regarding the nature of the questions to be asked, the Authority is of opinion that the question raised should be one which directly involves or affects the income-tax liability of the non-resident. That requirement is fulfilled in the present case. In the case cited, the question pertained to the assessment of an Indian company. The applicant, a totally different entity, was affected only in a remote and indirect manner in that any disallowances of expenses in the hands of the subsidiary might result in larger profit distributions to it. But here the applicant company and the CT are connected as beneficiary and trustee and the provisions of Chapter XV containing sections 161, 164 and 166 really incorporate a method of assessing the beneficiary through the trustee. In other words, they are conferred a common identity for the purposes of the Act. Any assessment on the trustee is only in a representative character and will directly and vitally affect the beneficiary.

Further, if the CT is assessed to income-tax at the maximum marginal rate under Section 164, there will be no assessment at all on the IC.Moreover, not only will the income of the trust distributable to the beneficiaries, including the IC, be correspondingly reduced but if the income-tax is, for some reason, not paid by, or recoverable from, the trust, the Department can take recourse against the beneficiaries (including the IC) in respect of the higher tax charged on the trustee from the distributions received by them. On the other hand, if the assessment is made on the trust under Section 161, the tax leviable in respect of the IC's share thereof will be a much smaller amount. Thus, the investor company is directly and immediately affected by the nature and mode of assessment of the trust. The right of the applicant, therefore, to seek a ruling on the questions raised cannot be denied.

The ruling in A.A.R. 207 of 1994 will not be applicable on the facts and circumstances of the present case.

38. It is argued for the Department that a ruling given by the Authority on its application can bind only the IC and the Department in relation to the IC and that

the trustee or the Department, in relation to an assessment on the trustee, will not be bound. They will be at liberty to proceed independently and take, if so advised, a different stand. It is, therefore, suggested that any ruling by the Authority in the matter would be infructuous or ineffective. It can be by-passed by the trust or the Department whichever was aggrieved by it. Such a ruling, it is said, should be avoided. This contention is also without force. If the view of the Authority on this application and the view of the officer assessing the trust coincide--and it may be reasonably presumed, that though the ruling of the authority in the present application may not be binding as a precedent, the concerned authorities would defer to the view taken by the Authority on a pure question of law--there will be no difficulty. If, on the other hand, the Authority should hold that Section 164 is applicable and the officer assessing the trust should hold--though it is perhaps unlikely--that Section 161 would apply, neither the CT nor the IC would have any grievance. On the other hand, if the Authority should hold Section 161 to be applicable and the officer assessing the trust should take a contrary view and the IC should be affected, it will have to raise a contest but, whether this is done in another application under Section 245Q, or raised before the authorities in some other proceedings, the ruling of the Authority will have to be given effect to. However, what steps should be taken in the matter in that eventuality, is a matter for the IC to decide at the appropriate time, and, if the IC is prepared to "risk a ruling" even now, it is not for the Authority to say "nay" to it. It is difficult to see how any ruling given by the Authority could be infructuous. The objection is overruled.

39. The second objection raised to the maintainability of the application is on the basis of Clause (c) of the proviso to Section 245R(2). It is pointed out that the scheme for making investments in India in infrastructural and other core sectors has been initiated by the American company and the Indian financial service company. The American company could have, therefore, directly contributed to the CT and secured other investors also to participate directly. But, since the interest and dividend income realised, in that event, from India by the American company would not be entitled, under the DTAA between India and USA, to any tax concession, this arrangement has been devised to secure the concessional tax advantages that are available under the DTAA between India and Mauritius by putting up, as a front, a Mauritian subsidiary (the IC) for making the investment. It

is contended that the transaction in question is thus a transaction by the American company designed, prima facie, for the avoidance of Indian income-tax and that the application should be dismissed on this ground. Strong reliance is placed, in support of this argument, on the ruling given by this Authority in another case.

40. In reply to this objection, learned counsel for the applicants contended that there was no substance in this contention and that the location of the IC and the IM in Mauritius was decided upon after taking into account several circumstances. This is not the first experiment of the kind made by the American company and reference has been made to the constitution of other companies by it earlier to focus on infrastructure and infrastructure-related investments in China and Asia. This trust has been patterned on like basis. The present set-up is not confined to India in that, though investments are proposed to be made in India, at some stage a co-investment by both tranches is envisaged and contributions may be invited eventually from international investors belonging to several countries. A central location for the foreign tranche was, therefore, desirable. The shareholders of the IC are three subsidiaries of the American company located in Bermuda, Hongkong and the U. S. and Mauritius was considered centrally located for all of them. Hence, the IC was located at the same place. An additional reason for this, it was said, was that, due to foreign exchange restrictions in India, it will be difficult to secure direct contributions to the CT from a large number of companies and the IC was, therefore, chosen as a single channel of such foreign investment in India to the CT. This difficulty has been explained, as follows, in a note filed by the applicant : " India does not as yet welcome foreign investment in the financial services sector. If the management company were to be set up in India, the foreign investors would need the approval of the Foreign Investment Promotion Board (FIPB). As per the internal guidelines of Ministry of Finance, in case the foreign management company wishes to hold a controlling interest, in the Indian asset management company, it is required to invest a higher amount of capital, e.g., for a 51 per cent.--75 per cent. stake, such companies are generally required to invest US $ 5 million whereas for holding more than 75 per cent. stake, they may be required to invest up to US $ 50 million, although the management company as such, does not require much capital. In one of the cases, we have received a letter from Ministry of Finance stating that the application has been

rejected on the ground that the applicant does not satisfy the capitalisation norms for non-banking finance companies (attachment).

Generally, FIPB takes approximately 90 days to approve a proposal.

In the case of offshore funds, many a time, core investors insist to hold a stake in the management company. It would be a very cumbersome process for making application and obtaining FIPB approval separately for each investor who may be investing at different points in time.

In view of the high capitalisation requirement and hardship involved, it is much convenient for the management company also to be located in the same jurisdiction where the fund is situated, i.e., Mauritius." 41. It was found convenient for this purpose also to locate the IC in Mauritius. The IM was located at Mauritius as it functions as the manager of both the trusts. Mauritius was chosen for locating many of these companies because it has emerged recently as a low cost off-shore financial centre and is preferred by off-shore investors in view of its well-developed low cost financial services sector. It was explained : " Since investors come from a wide range of countries, it is absolutely essential to domicile the fund in a tax neutral jurisdiction. Also, costs for legal, accounting and other professional services are comparatively lower there. " 42. The applicant's counsel also furnished comparative figures of the financial cost incurred in operating from various centres, as follows : 43. Counsel has pointed out that it was not essential to the scheme of the American company to incorporate the IC at Mauritius to gain a tax advantage. The scheme of the American company could have operated in an equally effective manner by investing funds of the off-shore tranche in the CT and secured the same advantages that are now sought. But due to the difficulty pointed out and with a view to keep the contributions of the American company to the CT distinct from its contributions to the off-shore tranche it became necessary to establish the IC and, for the locational advantages already referred to, it was got incorporated at Mauritius. The IC was set up only to demonstrate a commitment of the American company group to contribute to it and give other Indian investors a feeling of confidence inspired by the commitment of a member of the American company family to involve itself therein. It is also pointed out that there is no

reason to doubt the bona fides of the American company's desire to help development of infrastructural sector in India with international help. It should not be overlooked that several benefits flow to India and the Indian financial service company from the arrangements made under this dispensation.

44. The Authority has carefully considered these contentions. The setting up of a large number of subsidiaries of the American company group with their headquarters at Mauritius no doubt generates a first impression that there may be some deeper purpose underlying such creations. In the first place, the share capital of the IC is a nominal amount. Mention has earlier been made that the IC has been incorporated with a share capital of only $4. This might seem to indicate that the company was a mere front, an insignificant entity incapable of substantial investment handling. Such an inference, however, would not be correct, for it is seen that the company advanced a loan of more than 1 million US dollars to a Canadian group through shareholders' capital contributions. Much importance need not, therefore, be attached to this circumstance. Secondly, one would certainly be too naive if one were to believe that self interest and tax considerations did not enter the picture. No doubt the American company and several subsidiaries thereof hope to make substantial profits. No doubt also, tax considerations did enter largely into their calculations. It indeed finds place in the private placement memorandum. At page 40, reference is made to the advantages of the DTAA : In order to benefit from favourable treatment under the India-Mauritius Double Taxation Treaty (the 'treaty'), the company will file with the investee companies in which it owns stock, a no objection certificate from the Indian Tax Department granting benefits under the treaty for the company. Thereafter, dividends received from any Indian company in which the company owns stock will be subject to a withholding tax of (i) 5 per cent. for companies in which the company has a percentage ownership of 10 per cent or more and (ii) 15 per cent. for companies in which the company's percentage ownership is less than 10 per cent. Interest income generated from or received in India will be subject to a withholding tax of 20 per cent. Capital gains of the company generated from or received in India will be exempt from otherwise applicable Indian withholding taxes, including all Indian capital gains taxes. Under current law, such tax treatment will be available so long as the company does not maintain a permanent

establishment in India. The manager intends to operate the fund to ensure to the extent possible that neither the fund nor the company in Mauritius will be treated as having a permanent establishment in India.

However, there is no guarantee that absence of a permanent establishment will be maintained." 45. It then proceeds to refer to Section 161 of the Income-tax Act and says : " The Indian trust will be regarded as a transparent entity and the character of income in the hands of the beneficiaries but each of the beneficiaries will be taxed in respect of their income from the trust. The Indian revenue authorities may choose to assess the trustee company acting in the fiduciary capacity on behalf of the beneficiaries as 'representative assessee'. However, in accordance with the provisions of Section 161 of the Income-tax Act, 1961, even if the trustee company is assessed to tax in respect of income of the beneficiaries, tax shall be levied upon and recovered from the trustee company in like manner and to the same extent as it would be leviable upon and recoverable from the beneficiaries. An advance ruling is being sought from the Indian revenue authorities on this matter. In view of the particularized nature of tax consequences, each investor is advised to consult its own tax adviser with respect to the specific tax consequences of being an investor of the fund." " The company in Mauritius has been established as an 'offshore company' for the purpose of the Mauritian Offshore Business Activities Act, 1992, with the result that its income will not be subject to income-tax in Mauritius unless it elects to pay tax at specified rates not exceeding 35 per cent. It is the intention of the company in Mauritius that it may elect to pay tax on income distributions received from its investments in India at a rate, which, when offset by the credits available in respect of tax withheld in India on payments of income to the company in Mauritius, will result in a net payment in Mauritius in respect of such distributions at a maximum rate of one per cent.

No tax on capital gains will be payable in Mauritius on disposals by the company of its investments in India." and U.S. tax considerations are then dealt with. But it cannot be said that the disabling requirement of Section 245R(2) is attracted here. On behalf of the applicant several circumstances have been indicated which induced the setting up of the IC and the IM in Mauritius and these are certainly relevant considerations. When there are several relevant considerations which

have weighed with the parties to evolve a particular arrangement, it cannot be described as one "designed, prima facie", for the avoidance of Indian Income-tax. The existence of tax concessions under the DTAA was one of the factors taken into account but was not the only, or dominant, object of the transaction. There is, in particular, one important circumstance to show that the transaction was not designed for the avoidance of Indian income-tax. The applicants have pointed out that, on account of restrictions under Indian law, it was found more expedient to channelise all foreign investments into India through one entity rather than to attempt persuading such investors to come to India individually. That being so, the applicant, it may be said, could have channelised its funds through the offshore trust company instead of setting up the IC. It has been explained that the setting up of the IC was intended as an indication of the bona fides of the IC which would encourage other entrants. If the offshore tranche alone had been launched and it had made direct contributions to the CT it would have been beyond the pale of criticism and been welcome in India. Unlike the other ruling of the Authority to which reference has been made, the foreign tranche could not be treated as just a benami or dummy for the American company for the funds invested through it will be flowing from several international sources. The tax advantages suggested now could have been obtained then also. It is, therefore, difficult to characterise the setting up of the IC and the provision of a contribution by it as designed for the avoidance of income-tax. In the light of these considerations, the Authority has come to the conclusion that, certain suspicious features notwithstanding, a ruling cannot be declined on the ground that the transaction was designed for the avoidance of Indian income-tax.

47. With the preliminary objections disposed of, one may turn now to the basic issue raised in one of the applications, viz., whether the CT is assessable to tax under Section 161 or Section 164 of the Act. That the trustee is a representative assessee within the meaning of Section 160(1)(iv) of the Act and that it can be assessed in its name in a representative capacity on the income that it receives or is entitled to receive on behalf of the beneficiaries is beyond doubt. Section 161(1), however, declares that such assessment shall be made and the tax thereon shall be levied upon and be recovered from it "in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him". In

other words, in a case to which Section 161(1) applies, the trustee cannot be assessed on the aggregate income received by it. The assessment in the name of the trustee in terms of the sub-section can be made in two ways. The Assessing Officer may make as many assessments, in the name of the trustee, as there are beneficiaries and levy the tax appropriate to such income at the rate of tax applicable to the total income of each beneficiary. Or, he may make a single assessment on the trustee but indicate therein the share income of each beneficiary and the tax attributable to it. In other words, in the present case, if Section 161 were to apply, the CT cannot be assessed on the total income derived by it from its investments and the assessment qua the IC, should indicate, inter alia, the income distribution made to it and levy the tax appropriate thereto after taking into account such reliefs and concessions as may be available to it. To the above rule, however, three exceptions have been incorporated in the Act : (a) Under Section 161(1A), this rule of apportionment and determination of proportionate tax attributable to the beneficiary will not apply to any income earned by the trustee as profits and gains of a business. The whole of such income shall be taxed at the "maximum marginal rate". A similar proviso occurs also in Section 164(1) restricting benefits where business income is involved.

(b) Under Section 164(1), if the individual shares of the persons on whose behalf and for whose benefit the income is receivable are indeterminate or unknown, such income, again, will be taxed at the "maximum marginal rate".

(c) In certain other circumstances, set out in the proviso to Section 164(1), the relevant income will be assessable not at the maximum rate but at the rate applicable to it as if it were the total income of an association of persons.

48. The Department's case is that the circumstances of the present case attract both (a) and (b) above and this has to be examined.

49. The representative of the Income-tax Department (DR) urged that the income derived by the CT will be in the nature of "profits and gains of a business". He points out that the CT does not just invest in portfolio investments and equity shares of companies (including listed companies). Its activities are much wider and far-reaching. He draws attention to paragraph 5.01 of the C.A., the relevant

part of which may be extracted here : "5.01.--The trust fund's investment objective will be to seek to achieve long-term capital appreciation by primarily making direct investments in a portfolio of Indian companies and infrastructure projects in India. The trust fund's direct investment participations will generally take the form of equity, quasi-equity, equity-related, preferred stock and convertible debt instruments.

The trust fund will focus on opportunities that will seek to take advantage of India's expanding infrastructure requirements, increasingly active consumer product appetites and growing new technology base as well as opportunities arising from restructuring and reorganisation strategies, among other areas. Investment may be spread across the focus sectors in new projects, expansions and diversifications, opportunities arising from restructuring and reorganisation, product development efforts, privatisations and the like.

The trust fund will only invest in projects that at the time of investment comply with all relevant Indian State and Central Government legislation regarding environmental protection and such guidelines on environmental protection and social and rehabilitation issues which may be adopted by the Asian Development Bank, a core investor.

In addition, trust fund investments may include holdings of listed companies that could be of particular benefit to the fund." 50. Under this paragraph, the IC can also invest directly in projects in the infrastructure sectors and this can be on terms and conditions which may amount to the carrying on of a business. Under paragraph 6.05 of the I.M.A., it can, though temporarily, invest in "high quality short term debt instruments in accordance with the quality guidelines set forth in the private placement memorandum", a relevant extract from which has been set out earlier. The DR would describe, at least a part of the income of the CT, as profits and gains from a business of "providing financial assistance and money market operations". He says that its activities are analogous to those of organisations like the Industrial Credit and Investment Corporation of India (ICICI) or the Industrial Development Bank of India (IDBI) which return, and are assessed on, income from business and of the Unit Trust of India (UTI) which is deemed to

be a company and whose income would be assessable as business income but for the exemption it enjoys under Section 52 of the UTI Act, 1963. He also points out that organisations which are entirely engaged in investment can seek approval and claim exemption under Section 10(25F) of the Act. The CT has not chosen to do so, he says, as its income is not restricted to long-term capital gains as envisaged in that clause.

51. On the other hand, the AR draws attention to paragraph 8 of the Regulations contained in the First Schedule to the trust deed barring the trustees from carrying on business. Both paragraphs 5.01 and 6.02 of the I.M.A. outline the trust's objective to seek to achieve long-term capital appreciation. He draws attention to paragraphs 18 and 19 of a letter to the Indian Foreign Investment Promotion Board pointing out how the objectives of the CT could be achieved only by investing in unlisted securities and the clarification given in a subsequent letter of February 23, 1996, that the fund would not invest in any listed security in the primary or secondary market. By their letter dated June 27, 1996, counsel for the applicant have informed the Authority that the last sub-paragraph of paragraph 5.01 of the draft I.M.A. (italicised in the extract in paragraph 34 above) have been deleted. Paragraph 8 of the Regulation only provides for temporary investment in other debt instruments and not to make quick profits. He says that Section 10(23F) does not include the infrastructure sector and that is why the investor company could not seek for any approval thereunder.

52. The Authority is of opinion that this is not a question on which a ruling can be given at this stage. It does appear that the Regulations contemplate only investments and not business operations. But the sense in which this expression is used by parties will not be conclusive.

Whether the activities that may be carried on by the CT will only be in the nature of investment or whether the income resulting from any activities embarked upon by it could or would amount to profits and gains of a business will depend on the facts and circumstances of the activities actually put through. It may be that the primary objective of the CT is only to invest capital and derive income therefrom but it has a very wide range of operations. Even temporary investments in debt instruments,

if indulged in frequently, might give rise to business profits. Even changes in shares and investments carried out systematically at periodic intervals could amount to a business. It cannot be postulated in the abstract that none of the surpluses of the activities carried on by the CT could amount to profits and gains of business at all. All that the Authority can say now is that if any income of the CT is found to be assessable as profits and gains of business, the Assessing Officer will be entitled to assess such income under the provisions of Section 161(1A) or the proviso to Section 164(1), as the case may be, at the maximum marginal rate.

53. Turning then to objection (b) referred to in paragraph 33 (at page 503) above, is the income of the CT liable to assessment under Section 161(1) or are the provisions of Section 164(i) attracted Section 164(1) will not be attracted unless it can be postulated that the shares of the beneficiaries of the income are indeterminate or unknown, having regard to the terms of the Explanation. For this purpose, one has to examine the provisions of the T.D. Paragraph 5 says that the income accruing under the trust shall be distributed among the beneficiaries in equal proportions so far as the initial settlement to be returned on the termination of the trust is concerned and, as regards other distributions, in proportion to their respective contributions and in accordance with the CA. Paragraph 7(c) of the TD is also to like effect. One has, therefore, to turn to the CA. The principal clause in the CA that deals with this topic is paragraph 6.01 which has already been set out. The representative of the Income-tax Department (DR) says that this paragraph is defective in two respects rendering the shares of the contributors vague and indeterminate : (a) It does not set out in definite terms that the allocation of income among the contributors will be in the respective proportions of their contributions to the trust. On the contrary, paragraph 6.04, which says so, concerns income other than that earned on portfolio investments.

(b) It says that the trustees will be at liberty to make special distributions and there is nothing to limit the manner or extent of such distributions.

(c) The words "income ... will be distributed annually or at such direct intervals as the trustees may in their absolute discretion think fit" confer an absolute power on them to distribute dividends in their absolute discretion.

54. The result, the DR says, is that the distributions can be made by the trustees in their absolute discretion. In other words, it is a purely discretionary trust under which the trustees have complete liberty to distribute any part of the income to any beneficiary at any time at their absolute discretion.

55. The AR replied to this saying that these criticisms are not justified as clauses 5 and 7 of the TD are clear on this and the provisions of paragraph 6.01 have to be read along with those of the TD which place the matter beyond all doubt. The Authority is of opinion that the provisions of the TD in this behalf are clear but the provisions of the CA are ambiguous. Paragraph 6.01 no doubt states that the distribution will be made as set out in the succeeding paragraphs but paragraph 6.04, which talks of proportionate distribution, only refers to income other than portfolio investments. Also, special distributions are not even made subject to paragraphs 6.02 to 6.07. But the second criticism of the DR does not appear to be correct : the discretion vested in the trustees pertains to the periodicity of the distributions rather than their mode of distribution. When all this was brought to the notice of counsel for the applicant, he agreed that the parties would be willing to recast the wording of paragraph 6.01 placing this beyond all doubt. The proposed modification was as follows : " 6.01. Distributions.--Income received by the trust in respect of the contribution fund will be a charge on the income of the contribution fund, and will be distributed annually or at such direct intervals as the trustees may in their absolute discretion think fit, in proportion to the contributions made by the contributors. The contribution fund may also declare special distributions. The method by which the distribution will be made and the allocation of income between the contributor and the investment manager are as set out in sections 6.02 to 6.07 and will depend upon the source of the income." 56. However, this alternation also did not answer the second criticism of the DR and the AR agreed that this will also be set right by inserting, after the words "special distributions" in the proposed paragraph, the words "Such special distributions shall also be made to the contributors in proportion to the respective contributions made by them". This has been reiterated by counsel in a letter dated June 27, 1996, addressed to the Authority but the revised paragraph has been couched in the following words : " 6.01. Distributions.--Income received by the trust in respect of the contribution fund will be a charge on the income of the contribution fund, and will be distributed

annually or at such direct (sic) intervals as the trustees in their absolute discretion think fit. The contribution fund may also declare special distributions. Both the distributions shall be in proportion to contributions made by the contributors. The method by which the distribution will be made and the allocation of income between the contributor and the investment manager are as set out in sections 6.02 to 6.07 and will depend on the source of the income." 57. These modifications, it is clear, overcome the objections based on the CA and establish beyond doubt that the distribution of income will be proportionate to the contributions.

58. The DR next objected that the determination of the shares of the contributors becomes indeterminate because the trustees have been empowered to add further contributors (clause 7 of TD) and because of the formula set out in paragraph 6.02 of the contribution agreement.

The first of these causes no difficulty as, after the modification of clause 7 made at the hearing and agreed to by counsel (see paragraph 8 (at page 487) above), the trustees can admit as contributors-cum-beneficiaries only institutional investors who agree to sign an agreement on the lines of the CA. Paragraphs 2.02 and 2.03 of the first CA also permit such a course. In other words, after the modification, the trustees will have no discretion to admit any person as a beneficiary ; the beneficiaries to the trust at any point of time will be an ascertainable and definite body, defined in the TD to be those institutions who have committed themselves to defined contributions and executed the initial CA or entered into a CA on same lines with the trust and the IM later. The Authority would also like to point out that, question No. 3, in the revised list of questions (see paragraph 24 (at page 498) above), indicated that the parties may be willing to delete altogether the trustees' power of addition under Clause 7 of the TD. To do so would alter the scope of the CT and restrict it to the parties to the TD. If, however, the parties are willing for this and modify the T.D. accordingly, the beneficiaries will only be those stated in the TD and their shares will be proportionate to their contribution and the DR's objection would no more be valid.

59. The second objection based on paragraph 6.02 is this. Paragraph 6.02 provides that the distributable income will be determined after adding back the "fees and share of profit to the investment manager" which the DR says, is absurd as it will not be possible to distribute the income without making payment of the fee and share of profit to the IM, He also submitted that the provision in this paragraph enabling the trustees to deduct, in computing the net profits, "capital expenditures as the investment manager shall reasonably determine" also renders the share income indeterminate. The AR contended that this clause does not place any obstacle in the way of determination of the share income of the contributors but would only involve the use of a simple algebraic formula for making the computation. He, however, agreed that, with a view to avoiding any unnecessary controversy in the matter, the parties are willing to delete the words "including distribution of fees and share of profit to the investment manager" occurring in this clause. He contended that the second criticism of this paragraph by the DR is unwarranted as the discretion to the trustees in this regard also may affect the distributable income but not its mode of distribution.

60. The Authority is of the view, as mentioned earlier, that this modification removes the first ambiguity pointed out by the DR. It also agrees with the AR that the second criticism is unjustified. It is for the trust deed (and the CA is part of it) to decide how distributable income should be determined for distribution among the beneficiaries and also indicate, if it results in the retention of any part of the income in the hands of trustees, in what way the trustees should hold such undistributed part of the income remaining in their hands. Under the present clause, the capital expenditure referred to goes out of the coffers of the trust and does not remain in the trustees' hands for distribution at all. The direction of the trustees that such expenses should be met out of the income of the trust to the extent the trustees consider necessary is one they are empowered to make under Clause 14 of the trust deed. It may result in the diminution of the distributable income available to the beneficiaries but does not render the shares of the beneficiaries in any way uncertain or unknown.

61. The DR also next raised three points based on paragraph 6.04 which provides for an allocation among the investors of all income, loss or expenses attributable

to a particular portfolio investment in proportion to their capital contribution. His first point was that a similar rule has not been explicitly stated in paragraph 6.02. This contention has been dealt with earlier and it has been pointed out that the trust deed and paragraph 6.01 (as agreed to be modified) make it clear that even income from portfolio investments is distributable only in proportion to the contributions made. There is, in other words, no difference between the mode of allocation of income arising out of portfolio investments and other investments. His second objection was that it would be difficult for the CT to apportion the income earned from portfolio investment and others, to attribute the income earned to a particular contribution or to allocate expenses as between income arising out of portfolio investment and others. It is no doubt true that these are difficult exercises to carry through but they have to be done in any business and usually achieved by applying a rule of three.

Moreover, these factors may have some impact on the determination or computation of the distributable income but have no impact on the identity of the beneficiaries or in the share of income that is to be distributed to them. His third point was that while under paragraph 2.06, a defaulting contributor will not be entitled to any distribution after the date of his default, this clause provides for a distribution even to such contributors. This, he says, will disturb the inter se proportion vis-a-vis contributions that is sought to be maintained otherwise. The AR stated that as a point of possible conflict has been raised, the parties are prepared to amend paragraph 6.04 to read thus : " 6.04. Income and expenses from other sources.--Subject to paragraph 2.06(3), all distributions of income, gain, loss or expenses not directly attributable to a particular portfolio investment (e.g., interest on temporary investments and the contribution fund's share of any advisory fees net of general operating expenses) shall be distributed to the contributor in proportion to their capital contributions." 62. There is a slight mistake here as the reference in this amendment should really be to both paragraphs 2.06(d) and (e) and the opening words of the revised paragraph 6.04 should read Subject to paragraph 2.06". paragraph 6.04 is, therefore, read with the correction. In fact, by their letter dated April 27, 1996, the applicant's counsel have modified the CA by substituting the words; "Subject to paragraph 2" in the opening words of paragraph 6.04. It is clear that, with this amendment, the DR's objection is

overcome.

63. The DR also drew attention to Clause 17(d)(i) of the trust deed and submitted that the shares of the beneficiaries in the net profits would become indeterminate if such portion of it, as the trustees may determine, could be applied "otherwise than by way of distribution to the beneficiaries". The answer to this criticism is also the same as discussed above. Any amount applied by the trustees for other purposes would just cease to be part of the distributable income like the capital expenses on repairs and would affect the quantum of income available for distribution but not the mode of its distribution. It will also be seen that Clause 17(d) is not a clause conferring any special power on the trustees in this behalf : it only provides that the decision regarding such application, even if arrived at in conformity with the other provisions of the trust deed, shall not be effective unless voted for by a majority of the directors of the trustee company present and voting at a meeting. However, counsel by their letter dated June 27, 1996, have intimated that they have since amended the draft deed by substituting the following Sub-clause (d) in place of the earlier one : " 17. (d) The trustee shall only delegate its powers by a majority vote of its directors voting at a meeting of the board of directors of the trustee." 64. This amendment deletes the clause objected to by the DR and nothing more needs to be said about it.

65. An important point made by the DR, however, deserves serious notice. He said that a good deal of uncertainty is cast regarding the shares of the members by the provisions in the trust deed (Clause 7) authorising the addition of further contributors to the trust at different points of time (in addition to the initial contributors who are parties to the trust deed and whose names find a place in the Third Schedule to it and the provision enabling contributions to be called up from time to time (paragraph 2.04 of the CA) as well as by the provision in the CA regarding the rights of members who default in payment of the contributions demanded from them in compliance with their commitment (paragraph 2.06). This objection calls for detailed consideration.

66. The scheme under which the income distributions are to take place under the TD is somewhat complicated but the basic principle is quite clear. The fund is

initially set up with minimum commitment of Rs. 750 million as on the date of the trust deed but the IM can stage closings for subsequent commitments up to a period of 12 months thereafter (paragraphs 2.04 and 4.04 of CA). Naturally later commitments will be received only after the date of the trust deed. The trust deed will contain only the names of those who have agreed to contribute up to the date of the TD, However, on the terms of the trust deed, income distributions will have to be made to the persons who have agreed to contribute to the trust much later. But this creates no difficulty as the contributors are known, A difficulty may arise here since a contributor will not be called upon to pay up the entire amount of his commitment at one time. It is left to the IM to call for such amounts from the contributors as may be necessary to meet the amounts needed for the investments necessary at any particular point of time. There could be difficulty if different contributors are asked to contribute different amounts but this is obviated by making clear that the contributions called up from the contributors cannot be haphazard but should be in proportion to the amount of commitment undertaken by him so that the inter se proportions are maintained. Two further difficulties that can arise would be by reason of the facts ; (a) that the contributors come in at different points of time, and (b) that some of the contributors may default in the payments they are called upon to make. These situations are covered by paragraphs 2.01 and 2.06 of the CA. These clauses have been set out earlier and need not be discussed in detail except to say that these difficulties are overcome by procedures respectively calling for interest and the writing down of their capital contributions. In essence, the distribution rule is that distribution should be in the proportion of the capital contributions of the respective members. We may add that, in view of the criticism made by the DR on these aspects, we called upon learned counsel for the applicant to explain by means of clear illustrations how the income distributions will take place in cases where default occurs. In compliance with the instructions of the Authority, the applicant has filed detailed workings of the mode of distribution in such cases. It is not necessary to go into these meticulously ; it is sufficient just to say that, complicated as the scheme is, it is not possible to say that the share income of the beneficiaries cannot be determined or known from the TD.67. The next argument of the DR is that Section 164 will be applicable unless the individual shares of the persons who are the beneficiaries

are determinate and known and that these two expressions have to be understood in the light of the Explanation. It can hardly be said that the shares of the beneficiaries here are expressly stated in the trust deed or are ascer-tainable as such on the date of the TD. He points out that the Explanation lays down two conditions and that they should be both fulfilled.

68. The construction of the section and its Explanation is indeed a matter of some difficulty. It may appear also that there is a slight redundancy in the language of the Explanation which, having required that the shares should be expressly stated in the TD, proceeds to say that they should also be ascertainable from it. It may, therefore, be useful to study the history of this provision and examine the object of the introduction of the Explanation. Section 164(1) was in the Act when it was enacted in 1961 but its wording underwent a change, introducing a concept of taxation at marginal rate in 1970 by the Finance Act of 1970 with effect from 1st April, 1971. The object and scope of this amendment were elaborated in a circular of the Central Board of Direct Taxes (CBDT) (Circular No. 45 dated 2nd September, 1970 (see [1971] 79 ITR (St.) 33)) as under (at page 46) : " Private discretionary trusts.--Under the provisions of Section 164 of the Income-tax Act before the amendment made by the Finance Act, 1970, income of a trust in which the shares of the beneficiaries are indeterminate or unknown, is chargeable to tax as a single unit treating it as the total income of an association of persons. This provision affords scope for reduction of tax liability by transferring property to trustees and vesting discretion in them to accumulate the income or apply it for the benefit of any one or more of the beneficiaries, at their choice. By creating a multiplicity of such trusts, each one of which derives a comparatively low income, the incidence of tax on the income from property transferred to the several trusts is maintained at a low level. In such arrangements, it is often found that one or more of the beneficiaries of the trust are persons having high personal incomes, but no part of the trust income being specifically allocable to such beneficiaries under the terms of the trust, such income cannot be subjected to tax at the high personal rate which would have been applicable if their shares had been determinate.

In order to put an effective curb on the proliferation of such trusts, and to reduce the scope for tax avoidance through such means, the Finance Act, 1970, has

replaced Section 164 of the Income-tax Act by a new section. Under Section 164 as so replaced, a 'representative assessee', who receives income for the benefit of more than one person whose shares in such income are indeterminate or unknown, will be chargeable to income-tax on such income at the flat rate of 65 per cent. or the rate which would be applicable if such income were the total income of an association of persons, whichever course would be more beneficial to the Revenue." 69. When the Explanation was added in 1980, the Central Board of Revenue issued the following circular (see [1980] 123 ITR (St.) 159) : " 49. (iv) Under the existing provisions, the flat rate of 65 per cent. is not applicable where the beneficiaries and their shares are known in the previous year, although such beneficiaries or their shares have not been specified in the relevant instrument of trust, order of the court or wakf deed. This provision has been misused in some cases by giving discretion to the trustees to decide the allocation of the income every year and in other ways. In such a situation, the trustees and beneficiaries are able to manipulate the arrangements in such a manner that a discretionary trust is converted into a specific trust whenever it suits them tax-wise. In order to prevent such manipulation, it is proposed to provide that unless the beneficiaries and their shares are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed, the trust will be regarded as a discretionary trust and assessed accordingly." 70. From these extracts it would seem that the object of the amendments to the provision was only that the distribution of the income should not be entirely at the discretion of the trustees and that the trust deed should regulate the shares.

71. The DR contends that the beneficiaries under the TD here are neither known nor are their shares determinable as on the date of the trust deed. The AR, on the other hand, contends that the section does not require the names of the beneficiaries or the extent of their shares to be mentioned in the TD. It is sufficient if it provides a formula for their ascertainment. To construe the section as requiring more would defeat the object of the provision and render it impracticable and unworkable. Such an interpretation, he urges, should be avoided. In support of this contention, he relied on certain decisions of the Supreme Court. Interpreting the scope of Section 2(15) of the Act, the Supreme Court in CIT (Addl.) v. Surat Art

Silk Cloth Manufacturers Association [1980] 121 ITR 1, observed that "if the language of a statutory provision is ambiguous and capable of two constructions, that construction must be adopted which will give meaning and effect to the other provisions of the enactment rather than that which will give none". This principle has been further extended in later cases. In K.P. Varghese v. ITO [1981] 131 ITR 597 (SC), the court was concerned with the interpretation of Section 52(2) of the Income-tax Act, 1961. This sub-section provided that where the consideration for a transfer of property stated in the instrument of transfer falls short of its market value by more than a particular percentage, the property should be deemed to have been transferred at the market value (and not the stated consideration) and the capital gains computed accordingly. Literally, this provision would apply even to cases where the transferor received no more than the actually stated consideration although the market value was higher. But the court construed the provision in a restricted manner and held that it could be invoked only in cases where the consideration has been understated by the assessee ; or, in other words, the full value of the consideration in respect of the transfer is shown at a lesser figure than that actually received by the assessee and has no application where the consideration received by the assessee has been correctly declared or disclosed by him. The court observed (headnote) : " A statutory provision must be so construed, if possible, that absurdity and mischief may be avoided. Where the plain literal interpretation of a statutory provision produces a manifestly absurd and unjust result which could never have been intended by the Legislature, the court may modify the language used by the Legislature or even do some violence to it, so as to achieve the obvious intention of the Legislature and produce a rational construction." 72. In CIT v. Gotla [1985] 156 ITR 323, the Supreme Court was concerned with the question whether the assessee was entitled to set off the losses incurred by him in his individual business in earlier years and carried forward by him against the share income of his wife and minor children in a firm of which he was not a partner but which was included in his total income for the year under consideration by applying the provisions of Section 16(3) of the Indian Income-tax Act, 1922. Section 24 of the said Act permitted a set off only against the profits and gains of any business carried on by the assessee in the subsequent year. The literal meaning of the section was extended by the court

which observed (headnote) : " If a strict and literal construction of the statute leads to an absurd result, i.e., a result not intended to be subserved by the object of the legislation ascertained from the scheme of the legislation, then, if another construction is possible apart from the strict literal construction, then, that construction should be preferred to the strict literal construction and, again, where the plain literal interpretation of a statutory provision produces a manifestly unjust result which could never have been intended by the Legislature, the court might modify the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational result." 73. The AR contends that a similar situation prevails here and should be dealt with in like manner.

74. There is force in his contention. The whole object and intent of the section, as amended, is to prevent the shares of beneficiaries being manipulated at the discretion of the trustees. If it is read as requiring the specification of the beneficiaries and their shares in the deed itself, it may lead to absurdities. A trust is very often created to benefit a class of beneficiaries who may exist on the date of the trust or who may come into being later and the shares of the individual beneficiaries may also vary depending upon the numerical strength of the class to which they belong or the conditions attached to the receipt of the benefit. Several instances of trusts, particularly family trusts, can be thought of in which reversionary interests in favour of the author's descendants are created. They would all be caught by the mischief of Section 164 if this interpretation were adopted even though the class of beneficiaries is clearly ascertainable from the deed as also the share which every beneficiary is entitled to receive. It could hardly have been the intention of the Legislature to bring the income of such trusts to charge at the maximum marginal rate though it is very clear that the income of a particular previous year is held by the trustees specifically in defined shares on behalf of known beneficiaries and they have absolutely no discretion to distribute the income otherwise than to such persons or in accordance with such shares. As explained by the Supreme Court in the cases cited, the proper way in which to understand a section is to avoid absurd and inequitable and unintended results even if it means some strain on the language.

75. In the opinion of the Authority, however, it is not even necessary to invoke these principles of extended construction in the present case. Literally also, what the section requires is that the shares of the several beneficiaries should be stated and be ascertainable, not from an extraneous source at a later point of time but from the trust deed on the date on which it is executed. There is no redundancy in the language of the Explanation either. If the shares are expressly stated in the deed they must necessarily be ascertainable from it; what the second phrase means is that they should be so ascertainable on the date of the trust deed. It should be noticed that the section does not require that the names of the beneficiaries should be mentioned in the trust deed. Indeed, it would be impossible to do this where future settlements are involved. It no doubt requires that the individual shares of the beneficiaries should be expressly stated in the trust deed. But this requirement can also be said to be satisfied where the proportion of sharing is clearly specified in the instrument although some computation may be needed to find out the individual shares. For e.g., if a deed were to say that four beneficiaries should share the income equally or in the ratio of 1 : 2 : 3 : 4, it must be considered to have expressly stated the individual shares though a process of arithmetical computation is necessary to arrive at the individual shares. This rule can be said to be satisfied even in a more complicated example. For instance, if the deed were to say that the settlor's five grandchildren will get the income each male adult being entitled to four times the share of a minor and twice the share of a female included in the class, there is no difficulty in saying even in such a case that the individual shares are expressly stated in the trust deed. The words "and are ascertainable at the date of the instrument" will in any event apply in such cases, though they are actually intended to cover a slightly different type of case where the number of beneficiaries are not known at the date of the deed but the shares are ascertainable by reference to the specifications and directions given in the deed itself. Thus, to take the examples given above, a trust deed providing that the sons of the settlor should receive the income would fulfil the requirements of the Explanation as, on the date of the deed, it is possible to say who will share the income and in what proportion although the number of shares may not be known on such date. So also, in the second example, if the deed were to say that all descendants of the author will get the income in the proportion 1:2:3:4 calculated

as stated earlier, the specification would be sufficient to satisfy the terms of the Explanation. This would be so even where the ascertainment of the class and the actual share may depend on certain conditions precedent or subsequent which may or may not be fulfilled in the previous year the distributable income of which is under consideration at any point of time. It would be a fair construction of the provision to say that Section 164(4) will not come into operation if the trust deed sets out expressly the manner in which the beneficiaries are to be ascertained and also the share to which each of them would be entitled without ambiguity. The persons as well as the shares must be capable of being definitely pin-pointed and ascertained on the date of the trust deed itself without leaving these to be decided upon at a future date by a person other than the author either at his discretion or in a manner not envisaged in the trust deed. In any event, such a practical interpretation, in the light of the objects of the amendment Acts, would clearly be warranted and justified by the Supreme Court decisions cited by the AR. The Supreme Court, in CWT v. Trustees of H. E. H. Nizam's Family (Remainder Wealth) Trust [1977] 108 ITR 555, was concerned with the interpretation of the words, "when the shares of the persons on whose behalf or whose benefit any such assets are held are indeterminate or unknown" employed in Section 21(4) of the Wealth-tax Act, 1957. The court observed (headnote) : " The question in regard to the applicability of Sub-section (1) or (4) of Section 21 has to be determined with reference to the relevant valuation date. The Wealth-tax Officer has to determine who are the beneficiaries in respect of the remainder on the relevant valuation date and whether their shares are indeterminate or unknown. It is not at all relevant whether the beneficiaries may change in subsequent years before the date of distribution, depending upon contingencies which may come to pass in future. So long as it is possible to say on the relevant valuation date that the beneficiaries are known and their shares are determinate, the possibility that the beneficiaries may change by reason of subsequent events such as birth or death would not take the case out of the ambit of Sub-section (1) of Section 21. The position has to be seen on the relevant valuation date as if the preceding life interest had come to an end on that date and if, on that hypothesis, it is possible to determine who precisely would be the beneficiaries and on what determinate shares, Sub-section (1) of Section 21 must apply and it would be a matter of no

consequence that the number of beneficiaries may vary in the future either by reason of some beneficiaries ceasing to exist or some new beneficiaries coming into being.

If, on the relevant valuation date, it is not possible to say with certainty and definiteness as to who would be the beneficiaries and whether their shares would be determinate and specific, if the event on the happening of which the distribution is to take place occurred on that date, the case will be governed by Sub-section (4) of Section 21." 76. The Authority is of opinion that the question : "Has the Explanation superseded this interpretation ?" has to be answered in the affirmative only in respect of cases where the instrument of trust leaves the determination of the shares of the beneficiaries in a particular previous year dependent on a person other than the author of the trust or events and conditions not specified in the instrument of trust. If there be any ambiguity in the matter it should be resolved by resort to the principles stated by the Supreme Court in the cases referred to earlier.

77. Judged by these considerations, the TD and the CA (which is a part thereof) in the present case leave no doubt as to who would be the beneficiaries and what their individual shares would be. The beneficiaries are the persons whose names are set out in the Third Schedule to the trust deed as well as other persons who are permitted to make, contributions to the trust fund according to the terms and conditions set out in the CA. The share of the beneficiaries in the distributable fund will inter se be in the same proportion as the amounts actually contributed by them to the fund as on the date of the distribution, irrespective of the date on which the contribution was actually made by them. There is no uncertainty regarding the beneficiaries and there is no uncertainty regarding the share of income to which he is entitled. The class of persons who become contributories subsequent to the date of the trust deed are also expressly defined in the instrument and the manner in which the share of each of them should be ascertained is also mentioned in the instrument. Ultimately despite the very complicated structure the position is very simple. All persons who contribute to the trust are entitled to receive the benefits of income distribution. The total distributable income is distributed among these beneficiaries in proportion to the respective contribution made by each of them to

the fund. There is no discretion left in anybody to manipulate the beneficiaries or their shares. The Authority is, therefore, of the opinion that the present case does not fall within the vice of Section 164 and that the provisions of Section 161(1) will be applicable to the income of the trust, otherwise than from business.

78. The next point for discussion relates to the nature of the income received from the CT by the IC, in the latter's hands. As will be presently seen, this question assumes great importance in the light of the provisions contained in the Agreement for Avoidance of Double Taxation between India and Mauritius (DTAA). The point arises this way.

The income earned by the CT from the investments made in India may be in the nature of dividends, interest, capital gains, and perhaps also, business income. Will the aliquot part of this income, when distributed to the IC partake of the same character The answer prima facie may appear to be that it cannot. For example, the CT may receive dividends in respect of the investments made by it in various companies. But so far the IC is concerned they cannot be dividends since this company has made no investments in shares of companies but is just receiving a share of the income of the trust in which receipts of various kinds are mingled. This answer, however, does not take into account the effect of the application of Section 161. This section treats the trustee as having a representative character. The assessment on the trustee is to be in like manner and to the same extent as if it were made on the beneficiary himself directly. The practical effect of this provision is to render the assessment of the trustee and beneficiary identical in every respect. Thus if the trustee receives income by way of dividend or interest or capital gains it cannot but be treated as dividend, interest or capital gains respectively in the representative assessment which is to be made on the trustee. Any plausibility of an argument to the contrary is ruled out by the decisions of the Supreme Court in the cases of CIT v. H. E. H. Mir Osman Ali Bahadur [1966] 59 ITR 666 (SC) and in CIT v. P. Krishna Warrier's case [1970] 75 ITR 154. In CIT v. H.E. H. Mir Osman Ali Bahadur [1966] 59 ITR 666 (SC),the Nizam had delivered certain tax-free State securities on trust with directions that the interest income therefrom be paid to certain beneficiaries, including himself, for life. As such a beneficiary, the Nizam claimed that he was exempt from tax on the distribution

made to him. The Revenue took the view (which the High Court approved) that (at page 681) : "... after the execution of the trust deed, the assessee was divested of his ownership of the securities and the trustees became their owners. On that basis . . . though the income was interest on securities in the hands of the trustees, it was in the hands of the assessee only the income which he got from the trustees . . . the character of the income, namely, interest on securities, had changed when it reached the hands of the assessee." 79. The Supreme Court did not agree. It explained the scope of Section 41 of the Indian Income-tax Act, 1922 (to which Section 161 of the Act corresponds) thus (at page 682) : " Under this section the Revenue has the option to levy or collect tax from the trustee or the beneficiary ; the tax can be levied upon and recoverable from the trustee in the like manner and to the same amount as it would be leviable upon and recoverable from the person, on whose behalf such income, profits or gains are receivable. In short, it imposes a vicarious liability on the trustee. The expression 'all the provisions of this Act shall apply accordingly' indicates that there is no distinction in the matter of assessability of the income in the hands of a trustee or the beneficiary, as the case may be. Indeed, Section 41 of the Act comes into play only after the income is computed in accordance with Chapter III of the Act. In the case of income from securities Section 8 applies and under the second proviso thereto, the income-tax payable on the interest receivable on any security of the State Government issued income-tax free shall be payable by the State Government. No tax on interest on such securities is payable by the assessee. After ascertaining the income and after giving the exemptions, the income-tax authority has the option to assess the beneficiary directly or, in respect of the same income, the trustee on behalf of the beneficiary. This construction finds support in the decision of the Bombay High Court in CIT v. Balwantrai Jethalal Vaidya [1958] 34 ITR 187. If that be the scope of the assessment under Section 41 of the Act, we find it difficult to appreciate the contention that the interest on securities in the hands of the trustee becomes an income other than such interest in the hands of the beneficiary. The interest retains its character whether the assessment is made on the trustee or the beneficiary. We cannot, therefore, accept the construction put upon Section 41 of the Act by the High Court. " 80. In P. Krishna Warrier's case [1970] 75 ITR 154 (SC), the assessee had settled his

business in Ayurvedic drugs on trust. He directed the trustees to maintain a school and hospital that had been set up by him out of 60 per cent. of the income from the business and apply the balance of 40 per cent. on two tavazhies. The Income-tax Officer sought to levy a special surcharge on the latter treating it as "unearned" income under the Finance Act (No. 2) of 1957 and the Finance Acts of 1958 to 1961. "Earned income" was defined in the Finance Acts as meaning, "in the case of income chargeable under the head 'Profits and gains of business', 'profession or vocation', where the business, etc., is carried on by the assessee". The Income-tax Officer held that since the business was carried on by the trustees and not the tavazhies it could not be treated as earned income. By a short order, the Supreme Court upset that conclusion. It observed (at page 157) : " Under the will of P. S. Warrier the trustees were directed to carry on the business of 'Arya Vaidya Shala'. In the income of the business the trustees had no beneficial interest, but it was still income chargeable under the head 'profits and gains of business, profession or vocation' carried on by the trustees. Being income chargeable under the head 'Profits and gains of business, profession or vocation' carried on by the trustees, it was earned income in their hands, and to the earned income the special surcharge under the Finance Acts of 1957, 1958, 1959, 1960 and 1961 had no application. The High Court was right in answering the third question referred by the Tribunal in favour of the trustees." 81. The AR also referred to the decision of the Madras High Court in CIT v. Trustees, T. Stanes and Co. [1995] 200 ITR 396. In this case the assessees were the trustees of the company's staff pension fund. Under the terms of a trust, the balance of income remaining after payment of pension to the four beneficiaries was to be paid to the company. The beneficiaries having died, the entire income became payable to the company itself. The income of the assessee was from dividends and the Income-tax Officer was of opinion that since the recipients of the dividends were the trustees (an association of persons) no relief could be given under Section 80M relating to inter-corporate dividends. The High Court held, applying the ratio of the Nizam's case that the assessment of the trustee would have to be made in the same status as the beneficiary, i.e., as a company, and hence relief under Section 80M would be available. This decision also illustrates the same principle, viz., that, in making an assessment on an assessee in respect of a beneficiary, the assessment should be made as if the

income in question had been directly earned by the beneficiary and not the trustee. The Supreme Court has thus read the effect of Section 41 of the 1922 Act (section 161 here) as obliterating, except for the facility of making an assessment on it, the personality of the trust and of assessing the trust (for the beneficiary) as he would have been assessed had he been earning the income himself directly, instead of through the trust. The argument of learned counsel for the applicants that the character of the income for purposes of the assessments in so far as they relate to the investor company cannot be different from its character in the hands of the trust has, therefore, to be accepted. Dividends, interest and capital gains included in the distributable income would be dividends, interest and capital gains in the hands of the investor company to an aliquot extent.

82. The consequence of the above conclusion results in benefits to the IC under the DTAA. This agreement confers certain benefits on a resident in Mauritius within the meaning of the DTAA in respect of various categories of income earned by him in India. Relevant portions of articles 10, 11, 13 and 22 of the DTAA which deal with the benefits relevant for the purposes of the case need to be set out (see [1984] 146 ITR (St.) 214, 221) : (1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

(2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed : (a) 5 per cent. of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 10 per cent. of the capital of the company paying the dividends ; (b) 15 per cent. of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid . . .

(4) The term 'dividends' as used in this Article means income from shares or other rights, not being debt-claims participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from

shares by the laws of the Contracting State of which the company making the distribution is a resident . . .

(1) Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

(2) However, subject to the provisions of paragraphs 3 and 4 of this article, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State.

(3) Interest arising in a Contracting State shall be exempt from tax in that State provided it is derived and beneficially owned by : (a) the Government or a local authority of the other Contracting State ; (b) any agency or entity created or organised by the Government of the other Contracting State ; or (c) any bank carrying on a bona fide banking business which is a resident of the other Contracting State . . .

(5) The term 'interest' as used in this Article means income from debt-claims of every kind whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and, in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article ...

(1) Gains from the alienation of immovable property, as defined in paragraph 2 of Article 6, may be taxed in the Contracting State in which such property is situated.

(2) Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base may be taxed in that other State.

(3) Notwithstanding the provisions of paragraph 2 of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

(4) Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of this Article shall be taxable only in that State . . .

(1) Subject to the provisions of paragraph 2 of this article, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing articles of this Convention, shall be taxable only in that Contracting State.

(2) The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply." 83. Starting from the position earlier explained that the dividends, interest and capital gains earned by the CT and distributed to the investor company should be treated as dividend, interest and capital gains in the hands of the latter as well, the distributed income would be liable to tax in India at five per cent. or 15 per cent. (in the case of dividend income) and at the normal rates of tax in India (in the case of interest) and to no tax in the case of capital gains.

Learned counsel for the IC sought to wriggle out even from this liability on dividends and interest by taking advantage of the language of articles 10 and 11. The point made by him was that Article 10 would be attracted only where an Indian company pays a dividend to a resident of Mauritius ; likewise, Article 11 would be applicable only where interest is paid by a person in a Contracting State to a

resident of Mauritius. Here, however, the AR argues, the dividends and interest are paid by the companies and other investees to the CT and not to the IC.Hence, he argues, these receipts will not attract articles 10 and 11 and would fall within the purview of Article 22 with the consequence that they can be charged to tax only in Mauritius and not in India. The advantage to the IC is that at Mauritius it is not liable to tax unless it elects to pay tax at specified rates not less than 15 per cent. and not exceeding 35 per cent. (vide page 41 of the placement memorandum).

(In paranthesis, it may be observed that when it was pointed out at the hearing that this seemed to be a rather unusual type of provision that gives the assessee an option of choosing his tax rate, it was stated by counsel that a provision of such nature can be found even under the Indian law : for, e.g., see Section 44AD of the Act. But that is really a different kind of provision giving an option to the Revenue to estimate the income at a prescribed rate or a higher income declared by the assessee). Ingenious as this argument is, the Authority is of the view that it cannot be accepted as it cuts across the principle behind Section 161 on which he has built up his argument, relying on the Supreme Court decisions, that the assessment on the IC should be made as if it were in direct receipt of the income and not through the CT.Though it is the CT that receives the dividend and interest and makes the capital gains, it is the hand of the IC that is deemed to have received the income directly. It is true that the fiction is one created by Section 161 of the Act but the fiction of Section 161 should be extended to its legitimate consequences: in the present context, even to the interpretation of the DTAA. If the IC wishes to seek the benefit of the provision for the purpose of an assessment on it, it cannot turn around and deny the logical follow up of the fiction for purposes of the DTAA. The Authority is, therefore, of opinion that interest will be assessable to income-tax in India, that dividends will be liable to be charged to tax at five per cent. or 15 per cent. (as the case may be) and that capital gains will not be chargeable to tax.

84. The AR next contends that, if dividends and capital gains must be taxed in the hands of the investor company, they should be taxed at five per cent. in the case of dividends and at 20 per cent. in the case of capital gains. He further says that

even if an assessment is to be made on the CT under Section 164, the amount of CG included in its income can only be taxed at 20 per cent. and not at the maximum marginal rate. To take up the first contention, the rate of five per cent. will be available only where the recipient of the dividends is the beneficial owner of the dividends and that, too, when it holds directly at least 10 per cent. of the capital of the company paying the dividend. In the present case, the Indian companies pay dividends to the CT as trustee and not as beneficial owner. It may seem that the logic of treating the investor company as the direct recipient of the dividends by reason of the application of Section 161 should be extended here also but such a view would run counter to the explicit language used in Article 10(2)(a) of the treaty (see words in italics) and also to its manifest intent that no concessional tax treatment will be available if the person holding the shares in the company is not its beneficial owner. In any event, even if such interpretation be acceptable, the relief asked for can be available only if the holding of the Mauritian company (through the CT) exceeds 10 per cent. of the share capital of the company paying the dividend. The dividends, therefore, will be taxable at the rate of 15 per cent.

85. The other point raised by the AR also raises certain difficulties.

He bases his claim for having the CG assessed at 20 per cent. on the language of Section 112 of the Act. This provision may now be extracted, to the extent relevant, for facility of easy reference : " 112. Tax on long-term capital gains.--(1) Where the total income of an assessee includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head 'Capital gains' the tax payable by the assessee on the total income shall be the aggregate of,-- (a) in the case of an individual or a Hindu undivided family, being a resident,-- (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been his total income ; and (ii) the amount of income-tax calculated on such long-term capital gains at the rate of twenty per cent. : Provided that where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax, then, such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the

balance of such long-term capital gains shall be computed at the rate of twenty per cent. ; (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been its total income ; and (ii) the amount of income-tax calculated on such long-term capital gains at the rate of thirty per cent. : Provided that in relation to long-term capital gains arising to a venture capital company from the transfer of equity shares of venture capital undertakings, the provisions of Sub-clause (ii) shall have effect as if for the words 'thirty per cent.', the words 'twenty per cent' had been substituted ; (c) in the case of a non-resident (not being a company) or a foreign company,-- (i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been its total income ; and (ii) the amount of income-tax calculated on such long-term capital gains at the rate of twenty per cent. ; (i) the amount of income-tax payable on the total income as reduced by the amount of long-term capital gains, had the total income as so reduced been its total income ; and (ii) the amount of income-tax calculated on such long-term capital gains at the rate of thirty per cent." 86. He says, therefore, that a tax rate of only 20 per cent. can be applied to the CG whether an assessment is made on the trustee under Section 164 directly or under Section 161 as representative of the individual beneficiaries qua their shares. There is no difficulty in accepting the argument if the assessment is made under Section 161. In that case, the trustee, being assessable in the same status as the beneficiary, will be assessable as a "foreign company" attracting the provisions of Section 112(c) or Section 115A read with Section 2(3) of the relevant Finance Act (set out later). Section 112 and Section 115A will then apply as if the investor company were the direct recipient of the CG from the investee and the tax will be chargeable at 20 per cent.

87. The legal position where the assessment is made under Section 164, however, bristles with difficulties. The first question is regarding the status in which the CT should be assessed to tax. Should it be treated as an "individual", "domestic company" or "association of persons" The second is : what are the rates at which the CG part of its total income should be assessed ; at the maximum rates as directed by Section 164 or at the appropriate rate applicable under Section 112(1)(a), (b) or (d), as the case may be The AR contends that the assessment

should be made in the status of "individual" and that the rate of 20 per cent. prescribed by Section 112(1)(a) will apply.

88. The first question thus is whether the AR is right in claiming that whereas, if an assessment is made on the CT as trustee qua investor company, the status should be taken as that of the beneficiary, viz., as a "company", assessment under Section 164 on it will have to be in the status of an "individual". He prefers this status because of the rate of 20 per cent. prescribed under Section 112(1)(a), in contradistinction to the rate of 30 per cent. under Section 112(1)(b) or (d). In support of his contention, Sri Dastur relies on the decisions of the Supreme Court in Trustees of Gordhandas Govindram Family Charity Trust's case [1973] 88 ITR 47 and in Nizam's case [1977] 108 ITR 555. The decisions referred to by him were rendered under the Wealth-tax Act, 1957, on the question as to whether, where there is more than one trustee, the body of trustees could be treated as an "individual" and brought to tax even though "association of persons" was not a category of assessee under that Act as under the Income-tax Act. They are not helpful to decide that even where there is a sole trustee and it is a company and the assessment is made on it under Section 164, the assessment should be made on it in the status of an "individual". Having considered the pros and cons carefully, the Authority is of the view that the assessment on the CT will have to be made in its status as a company. The Authority cannot see how a direct assessment on the CT, without recourse to Section 161, can be made in a status different from what the assessee in fact possesses. Once Section 161 is out of the way and the assessment on the trustee is a direct one under Section 164, the idea that it is a representative assessment of the income of the beneficiary should be eschewed, except possibly for the fact that tax levied on the trustee may eventually be recoverable from the beneficiary as well. (But there will be difficulties in this course as well as no one beneficiary can be made liable for the tax liability of another beneficiary and the postulate of Section 164 is that the extent of share income of the beneficiary or beneficiaries in question is indeterminate or unknown). The assessee is a company and an assessment on it must be made in that status.

89. Turning now to the second question, should the CT be taxed at the maximum rate (40 per cent.) as stipulated in Section 164 or at the rates of 20 per cent. or 30

per cent. mentioned in Section 112 In the case of any assessee who is directly assessed under Section 4 of the Act read with the provisions of the relevant Finance Act, the rates mentioned in Section 112 in respect of capital gains will prevail over the rates prescribed under the Finance Act. This is so because Chapter XII contains provisions for certain special cases and will prevail over the general rates. This is also made clear by Section 2(3) of the relevant Finance Act (the Act of 1995 is considered here but there is a similar provision in other Finance Acts as well) : " Section 2(3). In cases to which the provisions of Chapter XII or Chapter XIIA or Sub-section (1A) of Section 161 or Section 164 or Section 164A or Section 167B of the Income-tax Act, 1961 (43 of 1961) (hereinafter referred to as Income-tax Act), apply, the tax chargeable shall be determined as provided in that Chapter or that section, and with reference to the rates imposed by Sub-section (1) or the rates as specified in that Chapter or section, as the case may be : Provided that the amount of income-tax computed in accordance with the provisions of Section 112 shall be increased in the case of a domestic company by a surcharge as provided in Paragraph E of Part I of the First Schedule : Provided further that in respect of any income chargeable to tax under Section 115B, or in the case of a domestic company having a total income exceeding seventy-five thousand rupees, under Section 115BB of the Income-tax Act, the income-tax computed shall be increased by a surcharge calculated at the rate of fifteen per cent.

of such income-tax." 90. This not only makes Section 112 applicable in such a case and provides for a surcharge in addition, where the assessee is a domestic company, to the rate of 30 per cent. Where, however, the assessment is one made under Section 164, the choice has to be between the maximum rate prescribed under that section and the lower rates specified in Section 112. Section 2(3) of the Finance Act does not meet this situation. It does not solve the issue of priority as between a provision contained in Chapter XII (section 112) and Section 164 both of which are specifically mentioned in it. Perhaps the correct solution would be to give weightage to Section 164 which is designed to meet the issue of liability in special cases and to counter a strategy of tax avoidance as mentioned earlier.

91. Fortunately, the Authority is not constrained to express a concluded opinion on the two questions discussed above in paragraphs 59 to 61 in view of its conclusion that Section 161 applies to the present case and that the capital gains received by the investor company will not be chargeable to tax in India by reason of Article 13 of the DTAA.92. The DR, however, raised the contention that neither the investment company nor the investment manager is entitled to avail of the benefits of the DTAA. It is common ground that these companies cannot claim relief under the DTAA unless they can be said to be resident in Mauritius within the meaning of the DTAA. That definition is contained in Article 4 of the DTAA which reads as follows (see [1984] 146 ITR (St) 214, 216) : (1) For the purposes of this Convention, the term "resident of a Contracting State" means any person who under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature. The terms "resident of India" and "resident of Mauritius' shall be construed accordingly.

(2) Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his residential status for the purposes of this Convention shall be determined in accordance with the following rules : (a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him ; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (hereinafter referred to as his 'centre of vital interests') ; (b) if the Contracting State in which he has his centre of vital interest cannot be determined, or if he does not have a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode ; (c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national ; (d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

(3) Where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both the Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management

is situated." 93. Clause (2) of this definition is not relevant for the present purposes. The residential criterion has to be decided only with reference to clauses (1) and (3). Taking up Clause (1), it is argued by the AR that the companies are liable to tax in Mauritius. They are incorporated there--the certificates of incorporation as well as tax residency certificates to the effect that the companies are resident in Mauritius under the Income-tax Act, 1995, of that country have been filed and they are, therefore, resident in Mauritius. They are not liable to tax in India. The mere fact that they are liable, even as non-residents, on the income accruing or arising or deemed to accrue or arise in India is not sufficient, according to counsel, to make them residents in India under Clause (1). Hence, they are entitled to claim benefits under the DTAA.94. On the other hand, the DR urges that the companies cannot be said to be residents of Mauritius as they are not liable to income-tax in Mauritius unless they choose to submit themselves to assessment and pay tax there. On the other hand, they are certainly liable to tax on their Indian income. Even if'they can be said to be resident in Mauritius, they are also resident in India and so the tie-breaker provision in Clause (3) has to be invoked. But this clause refers not to the place of incorporation but to the place of effective management and the DR says that there is nothing to show that the effective management of the companies is exercised from Mauritius. The companies are subsidiaries of the American company and their shareholders are other companies (also the subsidiaries of the same company) with registered offices in different countries (except to the extent of 27 per cent. in the case of the investment manager which is with the Indian financial service company and an Asian Bank). They have no doubt some Mauritians as directors but the real and effective management may well come from the location of the American company or the other shareholding companies : say USA or Hongkong or the like.

95. Interesting as these contentions are, they are concluded, so far as this authority is concerned, by its own earlier decisions. In Mohsinally Alimohammed Rafik's case [1995] 213 ITR 317 (AAR) this Authority has held that an individual living in Dubai would be a 'resident' of Dubai within the meaning of Article 4(1) of the DTAA between India and the United Arab Emirates though actually no tax is collected from individuals there. The applicants in the present case are in a better position. There is an Income-tax Act in Mauritius and it is said that a minimum tax

at 15 per cent. is payable by them, though earlier they had an option to pay tax or not. Hence, the IC and the IM should both be treated as resident in Mauritius. It was also held by the Authority in Mohsinally Alimohammed Rafik's case [19951 213 ITR 317 (AAR) that the individual in that case was a 'resident' of India within the meaning of Article 4(1) (in that case, identified with the one here) as he was liable to tax on his Indian income. There was a liability on him to Indian income-tax based on the criterion of residence, etc., and this was sufficient for purposes of the article.

The AR contests the correctness of this part of that ruling as, according to him, if that principle is applied, all persons (individuals, companies or other associations, wherever living) would be resident of India for purposes of the DTAA. This authority has pointed out in Mohsinally Alimohammed Rafik's case [1995] 213 ITR 317 (AAR), that there is no substance in this objection because : (i) a person seeks relief under the DTAA in India only when he is subjected to tax here and so there would be no error in saying that he is liable to tax in India within the meaning of Article 4(1) ; and (ii) the Article itself provides for the eventuality of a person being resident in both countries and prescribes tie-breaker tests to meet the situation. Hence, his contention that the IC and the IM are not resident in India cannot be accepted. Nor can the interpretation by the DR of Article 4(3) be accepted. In the case of the investor company, its registered office is in Mauritius and its only transaction is the investment in India. In an application made in January, 1996, to the Mauritius Offshore Business Activities Authority (MOBAA) for a residency certificate--there is also a like letter on behalf of the investment manager--certain features of the investor company which show that its place of management will be in Mauritius have been set out.

This letter can be usefully quoted here ; " The following steps are to be taken to ensure Mauritian place of management, in particular : 1. The company has two resident directors of appropriate calibre to exercise independence of mind and judgment.

4. Banking transactions will be channelled through the Hongkong and Shanghai Banking Corporations ; 5. Accounting records will be maintained in Mauritius in

accordance with the Companies Act, 1984 ; 7. All statutory records, such as minutes and members' register, will be kept at the registered office ; 96. Firstly, it is difficult to say that the effective management of the affairs of the company is not in Mauritius in the above situation unless there are facts to at least prima facie indicate that such control emanates elsewhere than from Mauritius. (The factual position in the case of IM is separately dealt with in its application).

Secondly, in its ruling reported as Advance Ruling No. P. 9 of 1995, In re, [1996] 220 ITR 377 (AAR) the Authority has pointed out that Article 4(3) is intended to break the tie on the issue of residence as between the two Contracting States. The companies are, on Article 4(1), resident both in India and Mauritius and under Article 4(3), the seat of effective management as between these two Contracting States, should be taken to be in Mauritius. Article 4(3) does not authorise the exploration of a possibility that the effective management, despite the company's location and residence in Mauritius, could lie elsewhere, in a third country. The Authority would, therefore, hold that the investor company is a resident of Mauritius entitled to claim the benefit of the DTAA.97. The next point for discussion before the Authority is the mode of treatment of the income, if any, of the CT assessable under the head "Profit and gains of business, profession and vocation" in the hands of the investor company when an assessment is made on the CT under Section 161. This situation is dealt with in Article 7 of the DTAA which makes such income taxable only if the investor company has a permanent establishment in India and the income is attributable to such permanent establishment (PE). There are no facts to suggest that, apart from barely investing the funds, the investor company has any office, place of business or other apparatus that would come within the definition of permanent establishment in Article 5 of the DTAA. It is true that Section 161(1A) provides for a tax at the maximum rate on the income from business in the hands of a trust but the beneficiary here being eligible for the benefit of the DTAA, that benefit can be availed of under Section 90(2) of the Act. The Authority, therefore, accepts the plea of counsel for the investor company that in case there are any business profits earned by the CT and an aliquot share thereof is distributed to the investor company, such distribution will not be liable to income-tax in India.

98. The discussion thus far disposes of the issues raised by the IC in its application.

99. To turn to the application filed by the investment manager, the four questions raised by the applicant have already been set out and as mentioned earlier, the principal question sought to be raised is whether that company can be said to have a permanent establishment in India within the meaning of the DTAA. Reference has earlier been made to the argument of the DR that the investment manager cannot seek to avail of the provisions of the DTAA since that company cannot be said to be a resident of Mauritius within the meaning of the DTAA. This argument has already been dealt with in so far as IC is concerned. In the case of the IM, however, there are certain additional facts which need consideration on this issue. These will be dealt with now.

100. The investment manager is a company incorporated in Mauritius. It is proposed that 73 per cent. of the shareholding of this company will be with the American company while Indian financial service company and an Asian Bank will have shareholdings of 22 per cent. and five per cent., respectively. It is the responsibility of this company to manage the affairs of the CT. The investment proposals are to be finally approved and decided upon by the board of directors of the company which paragraph 13.01 of the IMA specifically says will be done at its meetings outside of United States and India. But in carrying out its duties, the investment manager will be helped by various other bodies.

Firstly, there is the investment committee which will consist of seven members with the chairman appointed by the Indian financial service co.

Four members of the committee will be from the AIG and the ILFS will nominate three members of the committee. The investment committee will act by majority vote but the American company retains a veto right on any recommendation of the investment committee. It will be seen that though the nominee of the Indian financial service co. will be the chairman of the investment committee, the decisions of the committee will always be dominated by the American company and that organisation has also a right of veto. It is not quite clear from where the investment committee is to function. The second body to assist the investment

manager is the advisory board. This is a body comprised of professional business and financial executives. But the recommendations of the advisory board will not be binding on the investment manager unless otherwise agreed to by the trustee. Thirdly, the investment manager also enters into separate contracts with the Indian financial services company and the American company as investment advisors. The terms and conditions of the draft investment advisory agreement with the Indian financial service company have already been set out. The Indian financial service company and the American company team of advisors provide the investment manager with the advisory services, consulting services and assistance in the identification, analysis and review of the investments of the CT. From the terms of the advisory agreement, it is also seen that the investment advisors may function with the help of service units. But these only appear to be advisory bodies in no way controlling the decision of the board.

101. The provisions of the investment management agreement, however, contain certain provisions which require consideration. Reference may be first made to paragraph 2.01 under which the investment manager agrees to provide and be responsible for day to day management and administrative services to the trust fund in accordance with the provisions of the agreement and any directions and instructions of the trustees. Likewise, paragraph 3.03 makes the responsibility of the IM subject to any directions, instructions and guideliness provided by the trustees. It was pointed out to learned counsel for the applicants that the words in italics might lead to the conclusion that the control and management of the affairs of the management company would rest ultimately in India where the trustee company is located. Shri Dastur thereupon agreed that the applicants would be willing to drop the offending words from paragraph 2.04 and to delete paragraph 3.03 altogether. The position is, therefore, considered on the footing that that these provisions are no longer in the IMA. Apart from these provisions, there is nothing in the IMA which would indicate that the functions of the IM are not completely independent or that its business is subject to any control from India. Reference has already been made to paragraphs 3.04 and 13.01 under which the decisions of the board of directors will be taken at locations outside the United States and India. Though the IM has certain restrictions placed on its functioning by the introduction of other bodies such as the investment committee, the

investment advisor, the advisory board, and the service units, it appears clear that the last word and decision on any of the functions of the investment manager rests with its own board of directors. From paragraph 13.04, it is clear that, regardless of any delegation, the investment manager shall remain responsible for all decisions and acts of any delegate if it would have been liable under the Act for such act or omission if it had been done by itself. It is no doubt true that, in carrying out its functions, the investment manager will rely to a considerable extent on the investment advisors such as the Indian financial service co. But as pointed out, these bodies are not decision-making bodies but are just advisors whose expertise is taken advantage of by the investment manager. The Indian financial service has a great experience in advising on such matters and its credentials in this regard have been set out at page 37 in the placement memorandum. It would, therefore, appear that the effective management of the IM is in Mauritius. This company has, therefore, also to be treated as a resident of Mauritius for the purposes of the DTAA.102. On the question of permanent establishment, the DR referred to a sentence occurring at page 40 of the placement memorandum which has been extracted earlier. Attention was also drawn to paragraph 10.01 of the IMA under which the functions of the investment manager will include the engagement of "professionally skilled and/or experienced personnel to provide the necessary advisory and investment managerial support and/ or guidance to the portfolio and investment and the entrepreneurs and if necessary to assist in the administration of the trust fund". It was contended that the amplitude of this clause was so wide as to enable the investment manager to carry on its work and functions with the aid of its own personnel rendering services in India. The AR replied to this objection by saying that this clause should be read with paragraph 13.04 and that it only envisages the appointment of professionally skilled persons to assist the IM in the discharge of its functions. He also explained that the passage at page 40 of the placement memorandum pertains to the investor company and not the investment manager.

103. He, however, saw the force of the arguments of the DR. Counsel, by their letter dated June 27, 1996, have proceeded to give the following undertaking : "During the hearing of the captioned company (hereinafter referred to as 'the company') certain concerns were raised as to whether the company would

undertake activities that would result in its being construed to have a permanent establishment in India. It is, therefore, submitted that the company does not intend to undertake the following activities : 1. Open a fixed place of business in India as contemplated under Article 5(1) of the India Mauritius Double Taxation Avoidance Agreement (DTAA).

2. Undertake any activity or open any place of business as contemplated under Article 5(2) of the India Mauritius DTAA.

3. Appoint any agent or broker in India who has the authority to conclude contracts in the name of the company and who is not of an independent nature."

104. They have also intimated the change effected in paragraph 10.01(a)(iii) of the IMA by rewording it thus : " 10.01(a)(iii) to engage professionally skilled and/or experienced personnel to provide the necessary advisory support and investment managerial entrepreneurs and if necessary to assist in the administration of the trust fund."

105. Having considered the pros and cons of these arguments, the Authority is of the view that it is not possible to give any ruling on the question whether the investment manager has a permanent establishment in India or not, unless more details are available regarding the actual functioning and the activities performed by or on behalf of the company in India. In the first place, the passage at page 40 of the placement memorandum clearly shows that the memorandum does not exclude the possibility, at least in future, of the IM having to have a permanent establishment in India. It is no doubt true that the word "company" referred to in the said paragraph refers to the IC and its tax advantages. But the reference to "permanent establishment" is clearly related to the investment manager. This is also quite understandable because the investor company has nothing to do in India except to invest funds under the contribution agreement. It is really the investment manager that has to take all action in regard to the selection of investments, the placing of investments, the management of investments and the collection of the proceeds of the investments on behalf of the CT. Secondly, the facts before us do not indicate at all the manner in which the investment manager proposes to set about its business. It could, for example, establish an office in

India to facilitate its functions. It could have agents and other persons of that type to help it in discharging its functions. Or again if the activities became too numerous it can also make use of paragraph 10.01 to appoint its own employees or personnel to carry on its activities in India. The AR placed considerable reliance on clause 5 of Article 5 of the DTAA. He pointed out that the mere presence of professional agents or independent parties dealt with at arm's length for carrying out its activities in India would not amount to the setting up of a permanent establishment in India. That is no doubt true. But one cannot anticipate in what manner the investment manager will organise its activities. The language of paragraph 10.01 is sufficiently wide to enable it to carry on its activities, if not through an office in India, at least through its own employees and other personnel functioning in India and looking after some or all of its operations.

It is true that some changes in paragraph 10.01 have been made and counsel have given certain assurances in their letter of 27th June, 1996. These are no doubt of some help but the absence of a clause such as paragraph 10.01 is not sufficient to prohibit the IM from carrying on the business to best advantage in such manner as it considers fit and proper. The undertakings are also not wholly satisfactory as they repeat the clauses of the DTAA and it may have to be decided on actual facts whether a fixed place of business exists for the IM in India and whether persons employed to carry out its activities are independent within the meaning of the DTAA. The Authority cannot be expected to envisage all possible methods or channels through which the investment manager can function and to give an advance ruling as to which of them will amount to a permanent establishment and which not. All that can be stated now is that if the investment manager functions purely outside in India and does not get any assistance from India, except by way of advice from the various bodies envisaged under the agreement, it cannot be said to have a permanent establishment in India. However, if the business of the investment manager is so carried out that it necessitates an office in India or the employment of personnel in India or the carrying out of systematic operations in India in some manner or the other, then it may be necessary to consider, on the facts as they emerge, whether a permanent establishment has been created in India or not.

106. The other three questions raised by the applicant depend for their answer on the first. The Authority has already concluded that, on the facts so far disclosed and on the provisions of the various agreements that have been placed before it, it can be said that the applicant does not have a permanent establishment in India at present. This being so, the applicant will not be liable to tax in respect of the management fees or carried interest received from the CT. Consequently, the CT will not be under an obligation to withhold tax in respect of the payment of the management fees and carried interest to the investment manager. However, as has already been made clear more than once, it will be open to the assessing authorities, should necessity arise, to examine the modus operandi of the investment manager in carrying on its business under the agreement and, if at any time, a conclusion is reached that a permanent establishment has been set up in India, the fees and interest paid to the investment manager by the CT will become liable to tax and the CT will be obliged to deduct tax at source from such payments.

107. Before parting with the case, reference must be made to two matters. The first is this. Reference has been made in the course of the discussions to the consent of counsel to make certain changes in the draft instruments to meet the criticisms raised by the other side.

This may seem to be a somewhat unusual procedure but there is nothing wrong in it. The applicants are seeking a ruling on certain proposed transactions which have not yet materialised. There could be no objection to their revising the proposed drafts so as to be beyond the pale of criticism. The Authority has, however, ensured that there is no ambiguity about the changes made by indicating both the changes and the reasons for them in bold letters in this order. That apart, the changes in the draft have to be made by the Indian financial service company, the IC, the IM and the trust company, as the case may be. The Authority has been informed by counsel's letter dated June 27, 1996 (in each of the cases), of the precise terms of the changes effected in the various documents and presumes that these modifications have been by the persons respectively competent to effect these changes. The ruling given by this order is based on these changes being validly carried out in the various documents.

108. The second matter to which the Authority would like to refer is this. Before the case was heard, the applicants were asked whether they would have any objection to the publication of the rulings given by the authority on these two applications; The answer was in the negative initially but later it was said that there would be no objection if the answers are in favour of the applicants but that, if the rulings are adverse, they would have every objection to such publication. The Authority has considered this objection and is of opinion that the objection has to be overruled. The confidentiality that once attached to proceedings under the Income-tax Act, 1961, has since been abolished. Section 138 no doubt refers to some situations in which details of assessment records could be given to outsiders at their request. But the proceedings of this Authority are not assessment proceedings and there is no statutory rule of confidentiality that prevents publication of the rulings given by it. It is true that, under the statute, the rulings of the Authority are binding only in respect of the transactions on the basis of which the questions have been raised by both the applicants and the income-tax authorities. But this will not be decisive of the present issue. The scheme of advance rulings has been introduced for the benefit of non-residents and to enable them to have an advance ruling on matters of doubt and ambiguity arising under the Act. Though the rulings of the Authority are generally given on the basis of stated facts and background, they also have a general value as guides to the interpretation of the various provisions of the Act, the rules, the Double Tax Avoidance Agreements and so on. Many of these rulings deal with questions of law also.

Hence, irrespective of the binding nature of the ruling given in a particular case vis-a-vis other cases, the Authority is of the opinion that it is in public interest that the rulings be published particularly where they deal with general questions of far-reaching importance. The Authority is aware that, when parties are proposing to enter into transactions in India, the applications may sometimes contain confidential particulars, the disclosure of which they may not desire and may even be harmful to them. In the present case, the applicants are setting out on a course of open business operations to benefit India and its placement memorandum has been circulated to prospective investors. The Indian financial service company is actively interested in securing participation from Indian investors. It would,

therefore, seem that publicity of the setup proposed is actually being solicited by the applicants. The Authority, therefore, does not consider that there is any element of confidentiality involved. The Authority is, therefore, of the opinion, having regard to the importance of the various questions raised by the applicants in the present cases, both on the interpretation of sections 112, 161 and 164 of the Act as also of several important treaty provisions of the DTAA with Mauritius, that it is desirable to publish the rulings. The Commissioner of Income-tax on the Authority is, therefore, directed to have the rulings on these applications also published in due course.

However, in doing so, he may carefully examine the contents of the rulings and consider the possibility of expunc-tion therefrom of references to persons, figures and other like details of a personal nature to the extent it can be done without detracting from a proper comprehension of the principles and reasonings contained in the Ruling.

109. In the light of the foregoing discussions, the Authority hereby makes the following rulings on the two applications before it : Question No. 1 : Based on the facts and circumstances of the case, and in view of the provisions of India-Mauritius double tax avoidance agreement, can it be construed that the applicant does not have a permanent establishment (PE) in India Answer No. 1 : On the basis of the documents placed and undertakings given by the parties, it can be said that no permanent establishment for the applicant is envisaged at present. However, this answer to the question will be subject to the manner in which the applicant company's activities are actually carried on.

Question No. 2 : Based on the facts and circumstances of the case, will the applicant be liable to tax in respect of the management fees received from the CT Question No. 3 : Based on the facts and circumstances of the case, will the applicant be liable to tax in respect of the carried interest received from the CT Question No. 4 : Based on the facts and circumstances of the case, if the answer to above question is yes, will there be a withholding tax liability on the CT, in respect of the payment of management fees and carried interest to the applicant Answer Nos. 2, 3, 4 : The answer to these questions will depend upon the answer

to question No. 1 as it will emerge on a full examination of the facts and circumstances of the carrying on of the business by the applicant. It may, however, be stated that, if on the facts, the conclusion is reached that there is no permanent establishment in India for the applicant, questions Nos. 2, 3 and 4 have to be answered in the negative. In that event, the applicant will not be liable to Indian Income-tax on the management fees and 'carried interest' received from the CT and consequently the CT will not be liable to withhold tax from such payments made to the company. If, however, it is held that there is a permanent establishment of the applicant in India, the profits attributable to the permanent establishment will be taxable in India and questions Nos. 2, 3 and 4 will have to be answered in the affirmative.

Question No. 1 : Based on the facts and circumstances of the case, whether the applicant would be assessed in respect of its proportionate share of income earned by the contributory trust as per the provision of Section 161 of the Income-tax Act, 1961 (the Act) Question No. 2 : Based on the facts and circumstances of the case, whether the contributory trust would be regarded as a 'see through' or 'transparent entity' vis-a-vis the applicant ; i.e., to say, the applicant will be taxed in respect of its proportionate share of income under Section 161 of the Act Answer Nos. 1 and 2 : The applicant company can be assessed and made liable either directly or through the CT only in respect of its proportionate share of income derived from the CT. Question No. 3 : Based on the facts and circumstances of the case, if it is held that the provisions of Section 161 do not apply to the income of the applicant from the contributory trust because of the power vested in the trustees to add to the list of the beneficiaries on the terms laid down in the indenture of trust and the contribution agreement, then if such power is deleted, would the assessment of the applicant in respect of its proportionate share of income of the trust be made in accordance with Section 161 Answer No. 3 : Yes. As the trustees' power to add to the list of beneficiaries has been held not detrimental to the application of Section 161, the question is hypothetical. But, if this power is altogether deleted, the case for an assessment on the CT under Section 161 will become stronger.

Question No. 4 : Based on the facts and circumstances of the case, even if it is held that the shares of the additional beneficiaries are indeterminate whether the capital gains arising to the applicant will be charged to tax at the rate of 20 per cent. as prescribed in Section 112 of the Act Answer No. 4 : The word "additional" appears to be superfluous. The question does not arise in view of the finding that the beneficiaries are not indeterminate and the Authority wishes to express no ruling on the issue.

Question No. 5 : Based on the facts and circumstances of the case, will there be any tax withholding by the investee companies at the time of distribution of income to the CT Answer No. 5 : At the end of the question, the words "and if so to what extent" were requested to be added. So far as the investee companies are concerned, they will be required to withhold tax from the amounts paid to the CT at the rates appropriate in the case of an Indian company on all payments made by them in accordance with the provisions of the relevant Finance Act. It may, however, be open to the CT or to the applicant to apply to the Assessing Officer praying that tax may not be deducted, or should be deducted at a smaller rate on the whole or part of such income held on behalf of the IC in view of Section 161 and the DTAA. Question No. 6 : Whether, on the facts and circumstances of the case, the character of the applicant's proportionate share in the income of the contributory trust will be same as in the hands of the contributory trust Question No. 7 : Based on the facts and circumstances of the case, whether the applicant's share in the dividend earned by the contributory trust will be chargeable to tax and if so at what rate Answer No. 7 : The answer to this question is in the affirmative.

The rate of tax payable under Article 10 of the DTAA will be 15 per cent.

Question No. 8 : Based on the facts and circumstances of the case, will the applicant's share in the interest earned by the contributory trust be chargeable to tax at the rate of 20 per cent.

Answer No. 8 : The applicant's share of the interest earned by the contributory trust will be chargeable to tax at normal rates.

Question No. 9 : Whether, on the facts and in the circumstances of the case, the applicant's share in the capital gains earned by the contributory trust will be chargeable to tax Answer No, 9 : The capital gains embedded in the applicant's share of distributions made by the CT will be exempt from tax under Article 13.

Question No. 10 : Based on the facts and circumstances of the case, whether there would be any withholding tax liability on the CT in respect of the distributions made to the applicant Answer No. 10 : The CT would be liable to withhold tax from the distributions made to the applicant in so far as such distributions are attributable to dividend and interest income earned by the trust.

Question No. 11 : Whether, on the facts and in the circumstances of the case, the applicant's proportionate share in the surplus arising on the realisation of the investments made by the contributory trust would constitute capital gains Answer No. 11 : It is difficult to give a ruling on this question at this stage, The surplus arising on investments pure and simple will be capital gains in the hands of the CT. But circumstances could arise, or the manner of the carrying on of the activities of the CT may be such, as to render such surplus or part of its income, profits and gains from a business. That determination has necessarily to be made by the officer assessing the trust based upon the facts and circumstances placed before him.

Question No. 12 : Whether, in case the answer to question No. 11 is in the negative, the proportionate share of the applicant in such surplus will be chargeable to income-tax in India in the applicant's hands Answer No. 12 : This question, which was added at the time of oral hearing, will arise only if the whole or any part of the income of the trust is held to be the profits and gains of a business. In that eventuality Article 7 of the DTAA would come into operation and, since the applicant has no permanent establishment in India, the distributable income attributable to such profits will be exempt in its hands,

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