

In Re: Fidelity Advisor Series

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Court : Authority for Advance Rulings

Decided On : Sep-27-2004

Reported in : (2004)192CTRAAR201

Judge : S S Quadri, K Singh

Appellant : In Re: Fidelity Advisor Series

Judgement :

For Respondents/Defendant: Salil Gupta, Addl. CIT and D.K. Gupta, Joint CIT Income Tax Act, 1961 - Sections 14, 245N and 245Q; Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 - Regulation 16(1) Dalhousie Investment Trust Co. Ltd. v. CIT, (1968) 68 ITR 486 (SC); CIT v. Sutlej Cotton Mills Supply Agency Ltd., (1975) 100 ITR 706 (SC); In Re: XYZ/ABC Equity Fund, (2001) 250 ITR 194; A.V. Thomas and Co. Ltd. v. CIT, (1963) 48 ITR (SC) 67; CIT v. P.K.N. Co. Ltd., (1966) 60 ITR 65; CIT v. Associated Industrial Development Co. (P.) Ltd., (1971) 82 ITR 586 1. In this application Under Section 245Q(1) of the Income-tax Act, 1961 (for short "the Act"), the applicant (Fidelity Advisor Series VIII) is a non-resident company in India. It is a tax resident of the United States of America, It is registered under the provisions of the Investment Company Act, 1940 of the USA. It is a trust, set up to provide investors a continuous source of managed investments in securities. The investment of the applicant is mainly in equity security with a view to provide long-term capital appreciation to its investors under a scheme of an investment fund organised as a Massachusetts Business Trust governed by the laws of the Commonwealth of

Massachusetts, USA. The applicant is registered with the Securities and Exchange Board of India (SEBI) as a sub-account of "Fidelity Management and Research Company" and a "Foreign Institutional Investor" under the SEBI (Foreign Institutional Investors) Regulations, 1995. It has invested in equity shares of various companies in India and in other countries like Hong Kong, Indonesia, Korea, Singapore and United Kingdom. Under the FII regime the applicant has invested in the listed Indian companies. As per regulation 16(1) of the SEBI FII Regulations, 1995, all registered FIIs are required to appoint a domestic custodian in India. Accordingly, an FII or a global custodian acting on behalf of the FII is required to enter into an agreement with a domestic custodian of securities for the FII. The applicant appointed M/s. Brown Brothers Harriman (Luxembourg) S. A. as its global custodian for its investments. The global custodian, in turn, appointed M/s. Standard Chartered Bank (SCB) as its correspondent to act as domestic custodian.

It is stated that the global custodian and the domestic custodian are acting in the ordinary course of business. The SCB performs services for the applicant as well as other FIIs in India. From the investments made by the applicant in several companies in India it receives dividends, interest and capital gains. The applicant does not have any branch office or a place of business in India nor does it have any employee of its own in India. It does not have any advisor or agent in India. The business operations of purchase and sale of securities in India are carried on through brokers in India and the Indian securities are held by the SCB. The Government of Republic of India and the Government of the United States of America concluded a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income Under Section 90 of the Act 1961 which was notified on December 20, 1990 (referred to in this ruling as "the Treaty").

2. On these facts the applicant sought an advance ruling of the Authority Under Section 245R(1) of the Act on the following questions : (i) Whether, on the facts and in the circumstances of the case, the income from portfolio companies and the gains arising from the sale of portfolio investments in India will be treated as part of the Fidelity g Advisor Series VIII; Fidelity Advisor Emerging Asia Funds'

(hereinafter referred to as "the applicant") business income and hence be covered within the provisions of article 7 of the Convention dated December 20, 1990, regarding the Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital gains entered into between the Government of the Republic of India and the Government of the United States of America (hereinafter referred to as "the Treaty") and thus not be taxable in India (ii) Whether, on the facts and circumstances of the case, the applicant will be absolved from filing a tax return in India, under the provisions of section 139 of the Indian Income-tax Act, 1961 (hereinafter referred as the "HA"), if its entire income is subject to tax only in the United States of America (iii) Whether, on the facts and the circumstances of the case, any penal provisions of the ITA would be invoked due to non-filing of tax returns by the applicant Under Section 139 of the ITA 3. After the Authority passed order Under Section 245R(2) of the Act, the Commissioner forwarded his comments stating that the applicant has not provided the facts in any detail, therefore, it cannot be determined as to whether it would be having any permanent establishment in India under article 5 of the Treaty. Going by the nature of the operations proposed to be carried out by the applicant in India, it would be required to maintain a branch office or a place of management for entering into transactions in securities, it must be availing of the advice of some investment advisors but no details are given. It is only on examining the role of the investment advisor that one can say whether the domestic guardian is a dependent agent of the applicant in India. It is pointed out that para. 6 of article 7 of the Treaty made specific distinction among various heads of income which have to be dealt with separately under other articles even if such items of income form part of the business income of the applicant. The taxability or otherwise of such income would be governed by the specific provisions postulated for that purpose and not by article 7 of the Treaty. The taxability of dividend income is dealt with in article 10, interest income in article 11 and capital gains in article 13 of the Treaty. As the applicant is carrying out business in India it has to file a return of income Under Section 139 of the Act even if it is entitled to exemption and deductions under the Act as also for claiming benefits of the Treaty between India and USA.⁴ The applicant filed its rejoinder to the comments of the Commissioner. It is reiterated that the income arising on the

sale of Indian investments (shares, etc.) is in the nature of business income and that the applicant does not have a permanent establishment in India.

5. On August 18, 2004, at the time of hearing Mr. Nishith Desai, appearing for the applicant, has submitted that as the dividend income is exempted from payment of income-tax in the hands of the shareholders and there is no significant interest income, these items are proposed to be deleted from the questions, therefore, the applicant may be permitted to reframe the questions for seeking advance ruling.

6. Mr. Salil Gupta, Additional Commissioner of Income-tax appearing for the Commissioner, objected to the applicant giving up parts of questions in regard to the dividend and interest and reframing the same.

7. In our view, it is hard to appreciate the objection of Mr. Gupta.

The applicant has a right to seek an advance ruling on a question of its choice permissible under the Act. However, after stating questions for seeking an advance ruling, the applicant cannot at the time of hearing so modify the questions as to change the very complexion of the application. But if the applicant wants to confine a question to only some of the items/aspects mentioned therein and/or give-up some parts of the question, there can be no valid objection to such a course.

After all, it cannot be lost sight of that the scheme and the provisions b of the Act, dealing with advance rulings, are intended to provide a facility to all those who fall within the sweep of the term "applicant" and by a narrow interpretation, the object and the purpose of the Act cannot be thwarted. We, therefore, permit the applicant to reframe the questions, given hereunder, for purposes of pronouncement of the ruling.

1. Whether, on the facts and the circumstances of the case, the gains arising from the sale of portfolio investments in India will be treated as part of the applicant's business income and hence be covered within the provisions of article 7 of the Convention dated December 20, 1990, regarding the Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to taxes on income

and capital gains entered into between the Government of the Republic of India and the Government of the United States of America (hereinafter referred to as the "Treaty") 2. Whether, on the facts and circumstances of the case, the applicant has a permanent establishment in India in terms of article 5 of the Treaty 8. Mr. Nishith Desai argued that the applicant was carrying on business as an investment trust; the income arising to the trust could only be characterised as a business income and in view of the provisions of the Treaty between India and the USA, the profits of business could be taxed in India only if the applicant had a permanent establishment in India ; the applicant had no branch office or place of business in India; nor did it have any employee of its own, therefore, it had no permanent establishment in India.

9. Mr. Salil Gupta vehemently contended that no material was produced by the applicant to show that shares were held by it as stock-in-trade ; the documents relating to the trust were only enabling documents from which it could not be inferred that the shares were held by the trust as investment; as the period between the purchases and sales of shares was generally more than a year, the profits of the applicant can be taxed only as capital gains under article 13 of the Treaty without the necessity of going into the question as to whether the applicant was having any permanent establishment. He also argued that the applicant did not furnish material facts as to who was operating the applicant's bank account in India and who was placing the orders for purchases and sales of shares with the brokers and the facts given by the applicant were not enough to determine whether the applicant was having a permanent establishment in India.

10. In the light of these contentions, the main question that arises for consideration is, whether article 7 or article 13 of the Treaty would apply to the income of the applicant from purchases and sales of shares in various companies in India.

11. It is a common ground that by virtue of article 1(1), the applicant, being a tax resident of the USA, is entitled to avail, of the benefit of the Treaty. Articles 7 and 13 of the Treaty are relevant for the present discussion and in so far as they are pertinent, they read as under (see [1991] 187 ITR (St.) 102) : (1) The profits of an enterprise of a Contracting State shall be taxable only in that State unless the

enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment . . .

(6) Where profits include items of income which are dealt with separately in other articles of the convention, then, the provisions of those articles shall not be affected by the provisions of this article.

(7) For the purposes of the Convention the term 'business profits' means income derived from any trade or business including income from the furnishing of services other than included services as defined in article 12 (royalties and fees for included services) and including income from the rental of tangible personal property other than property described in paragraph 3(b) of article 12 (royalties and fees for included services).

Except as provided in article 8 (Shipping and Air Transport) to this convention each Contracting State may tax capital gains in accordance with the provisions of its domestic law." 12. A plain reading of para. 1 of article 7, suggests that the profits of an enterprise (applicant) of a contracting State (USA) shall be taxable only in that State (USA) unless the enterprise (the applicant) carries on business in the other Contracting State (India) through a permanent establishment situate therein. If the enterprise (the applicant) carries on business as aforesaid, the profits of the enterprise (applicant) may be taxed in the other State (India) but only so much of them as is attributable to (a) that permanent establishment; (b) sales in other State (India) of goods merchandise of the same are similar kind as those so sold through the permanent establishment; or (c) other business activities carried on in the other State (India) of the same or similar kind as those effected through the permanent establishment. We are concerned here with clause (a) namely, permanent establishment. The contents of para. 6 thereof which are important,

clarify that where profits include items of income which are dealt with separately in other articles of the Treaty, the provisions of those articles shall not be affected by the other provisions of article 13. It may be appropriate to mention here that for purposes of charge of income-tax and computation of total income, section 14 of the Act classifies all income under five heads (A, C, D, E and F). The Treaty deals with income falling under the aforementioned heads differently in distinct articles thereof. "Business profits", i.e., profits and gains of business or profession (income falling under the head "D") is dealt with in article 7 of the Treaty, and income falling under other heads is excluded from it, which is dealt with in other articles thereof. In passing we may mention that income by way of "capital gains" is covered by head "E" of section 14 of the Act and is the subject matter of article 13 of the Treaty.

14. The expression "business profits" is defined in para. 7 of article 7, quoted above, to mean income derived from any trade or business including income from the furnishing of services other than included services as defined in article 12 (royalties and fees of the included services) and including income from the rental of tangible personal property other than property described in paragraph 3(b) of article 12 (royalties and fees for included services).

15. In regard to capital gains, article 13 provides that with the exception of the gains dealt within article 8 (Shipping and Air Transport) each Contracting State, i.e., India, as well as the USA, may tax "capital gains" in accordance with the provisions of its domestic law, i.e., under the Indian Income-tax Act or under the Investment Company Act, 1940, or any other law of the United States of America as the case may be.

16. From a combined reading of article 7 and article 13, it follows that business profits of the applicant, dealt with in article 7 of the Treaty, may be taxed in India if business activities or operations are carried on through its permanent establishment in India and income falling under other heads will be treated as postulated under other articles of the treaty ; capital gains will be taxed as provided in article 13 of the Treaty. The expression "permanent establishment" is defined in article 5 of the Treaty. It is not necessary to delve into it here.

17. Whether a company is an investment company or trading company or whether any amount received by a person is a revenue receipt or a capital receipt is a mixed question of law and fact which has to be decided on the facts and in the circumstances of each case. Before advertng to the facts of this case on this question, it will be useful to refer to the decisions cited by the parties.

18. In *Raja Bahadur Visheshwar Singh v. CIT* [1961] 41 ITR 685 (SC), the assessee purchased shares during a period of 10 years from his own funds. He then borrowed substantial amounts for making further purchases of shares and securities. He made profits on selling some shares in the subsequent years. The Income-tax Appellate Tribunal, taking note of the magnitude and frequency of the transactions and the ratio of sales to purchases and total holdings, held that the appellant must be regarded as a dealer in shares and securities and that the profits of those years were assessable to income-tax. On a reference, the Patna High Court held that there was sufficient material to support the findings of the Appellate Tribunal. On further appeal to the Supreme Court, it was, inter alia, held (headnote) : "(i) that if on the evidence which was before the Tribunal, i.e., the substantial nature of the transactions, the manner in which the books had been maintained, the magnitude of the shares purchased and sold and the ratio between the purchases and sales and the holdings, the Tribunal came to the conclusion that there was material to support the finding that the appellant was dealing in shares as a business, it could not be interfered with by the High Court; (ii) that the High Court was right in holding that there was sufficient material to support the finding of the Appellate Tribunal." 19. It may be noticed that in one of the earlier years of assessment the appellant was not treated as a dealer in shares and this fact was not considered by the High Court but the hon'ble Supreme Court rejected the contention observing that when an owner of an ordinary investment chooses to realise it and obtain a higher price for it than he originally acquired it at, the enhanced price is not a profit assessable to income-tax but where what is done is not merely a realisation or a change of investment but an act done in what is truly the carrying on of a business the amount recovered as appreciation will be assessable. In *Dalhousie Investment Trust Co. Ltd. v. CIT* [1968] 68 ITR 486 (SC), the appellant was investing its capital in shares and stocks of Mcleod and Co., and companies managed by that company. It was changing its investment by sale of

its shares from time to time. The appellant purchased the bulk of shares of those companies by taking a loan at a time when the market price was continuously falling and the rate of dividends was very low. Those shares were sold subsequently at a considerable profit. The question was whether the profit derived by the appellant from the sale of those shares was in the nature of a revenue receipt or a capital gain. It was held by the hon'ble Supreme Court that the appellant purchased and sold the shares of the company and the allied companies as stock in trade and that they were in fact purchased even initially not as investments but for the purpose of sale at a profit, and therefore, the transactions amounted to an adventure in the nature of trade and the profit derived by the appellant from the sale of shares was a revenue receipt and as such liable to income-tax. The fact that the Department in the earlier years treated the transactions in the nature of investments was not binding in the proceedings for assessment during the subsequent years.

21. In CIT v. Sulej Cotton Mills Supply Agency Ltd. [1975] 100 ITR 706 (SC), the respondent-assessee subscribed for 3,49,000 shares of a new issue of Gwalior Rayon and paid the application and call moneys.

Subsequently, it sold 1,58,200 shares with a profit. The Income-tax Appellate Tribunal found that the transaction constituted business being an adventure in the nature of trade and that the profit was liable to income-tax. On reference the High Court of Madhya Pradesh held that the transaction was not an adventure in the nature of trade.

On appeal to the hon'ble Supreme Court, the decision of the High Court was reversed holding that the Tribunal had considered the evidence on record and applied the correct test in law, and there was no scope for interference with the finding of the Tribunal.

22. We may notice here a recent judgment of the Authority in the case of XYZ/ABC Equity Fund, In re [2001] 250 ITR 194. In that case the applicant-company was a resident of Mauritius which mobilized investment from different investors and collected a large pool of money and after identifying investment opportunities invested in three Indian companies and one USA company. It utilised the services

of an advisor who was also advising other companies. The investment in India was through the custodian which was rendering services in the ordinary course of business to about twenty companies. The Authority ruled, inter alia, that the applicant-company had been formed with the object of carrying on the business of acquiring and investing in and holding securities of all kinds and ultimately selling at a profit. It is with that purpose it had raised capital and acquired money from other sources with which it acquired a large block of shares in Indian companies and that indicated a large systematic activity for making profits. Transactions of this magnitude in furtherance of the object stated in its memorandum could be nothing other than business and the proceeds of sale of shares in India would amount to business receipts and not capital gains.

23. Mr. Gupta stressed on the point that the applicant's reliance on the trust deed is of no consequence and that it has placed no material to support the contention that the shares and securities were held as stock in trade and that the burden of showing that the shares were so held was on the applicant. He relied on the decisions of the Supreme Court in *A.V. Thomas and Co. Ltd. v. CIT* [1963] 48 ITR (SC) 67; *CIT v. P. K. N. Co. Ltd.* [1966] 60 ITR 65 and *CIT v. Associated Industrial Development Co. (P.)* 24. In *A. V. Thomas and Co. Ltd. v. CIT* [1963] 48 ITR (SC) 67, the assessee referred to the memorandum of association to show that it was one of the objects of the assessee to include the promotion of companies and accordingly the amount in question was paid to promote the Rodier Textile Mills Ltd. Repelling that contention the hon'ble Supreme Court observed that a memorandum of association is not conclusive as to the real nature of a transaction which has to be deduced from the circumstances in which the transaction took place and not from the memorandum. As a fact it was found that different versions given in the books of accounts of the assessee-company, belied the assertion. What this decision lays down is that mere recital in the memorandum of association is not conclusive of the nature of transaction, there must be some material to show that in furtherance of the objects clause in the memorandum steps are taken and it is given effect to.

25. In *CIT v. P. K. N. Co. Ltd.* [1966] 60 ITR 65 (SC), the question for consideration before the hon'ble Supreme Court was whether the profits realised

by the assessee-company from the sale of properties could be brought to tax. It is observed that the question whether in purchasing and selling land, the assessee-company enters upon a business activity has to be determined in the light of the facts and circumstances ; the purpose or the object for which it is incorporated may have some bearing, but is not decisive, nor is the profit motive in entering into a transaction decisive. In that case, the respondent-company was formed primarily to take over the assets of a firm. The memorandum of association, inter alia, specified in the objects clause, purchase or acquisition, sale, development and disposal of land. It was held that the profits arising from the sale of the land in plots were not taxable income ; the primary object of the company was to take over the assets of the firm to carry on the business of planters and to earn profits by the sale of rubber and that the acquisition of the estates was not for the purposes of carrying on business in real estate. The incidental sale of uneconomical or inconvenient plots of land could not convert what was essentially an investment into a business transaction in real estate. Existence of powers in the memorandum of association to sell or turn into account, dispose of or deal with the properties and rights of all kinds had no decisive bearing on the question whether the profits arising therefrom were capital accretion or revenue. CIT v. Associated Industrial Development Co. (P.) Ltd. [1971] 82 ITR 586 (SC), was a case of the assessee-company being managing agents of various companies. It sold shares held by it in three of its companies and derived substantial profits. The claim of the assessee was that the profits were in the nature of capital gain and not income.

The Tribunal found that in view of the multiplicity of transactions over the years the assessee-company had ceased to be an investor and had become a dealer and the profits were liable to be taxed as income.

The High Court, on a reference, did not interfere with the finding of the Tribunal but held that the shares were held by the assessee as part of its investment and, therefore, profit on the sale of the shares did not arise to it in the course of its business as a dealer in shares, which was a capital receipt. On appeal, the hon'ble Supreme Court reversed the decision of the High Court holding that the question whether the shares had been held by way of investment, was essentially a question of fact and the Tribunal was not called upon to decide it.

The assessee did not place any material from which it could be established whether a particular holding of shares was by way of investment or formed part of the stock in trade. It was a matter which was within the knowledge of the assessee who held the shares and he should, in normal circumstances, be in a position to produce evidence from his records to show that the shares were held as stock-in-trade.

(i) where a company purchases and sells shares, it must be shown that they were held as stock-in-trade and the existence of the power to purchase and sell shares in the memorandum of association is not decisive of the nature of transaction; (ii) the substantial nature of transactions, the manner of maintaining books of account, the magnitude of purchases and sales and the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions ; (iii) ordinarily the purchase and sale of shares with the motive of earning a profit, would result in the transaction being in the nature of trade/ adventure in the nature of trade ; but where the object of the investment in shares of a company is to derive income by way of dividend, etc., then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt.

28. Keeping in view the above principle, we shall examine the facts of the case to determine the aforementioned question. In the instant case, the applicant was registered as an investment company under the Investment Company Act, 1940 of the USA. The purpose of setting up of the company as mentioned in article II of the Amended and Related Declaration of Trust dated April 18, 2001, is : "The purpose of this trust is to provide investors a continuous source of managed investments in securities". It invested in equity shares and also sought to provide long-term capital appreciation to its investors. The applicant is being managed by a board of trustees, which has discretion and authority to invest. This is reflected in clauses (a), (i), (v) and (x) of article V (powers of the trustees) of the amended and restated declaration of trust dated April 18, 2001. Accordingly, the applicant got registered with the SEBI in India and obtained a FII licence. It invested in listed Indian companies under the FII regime. The global custodian as well as the domestic custodian of the applicant have been appointed to comply with the requirements of regulation 16(1) of the SEBI, FII Regulations, 1995.

29. We have carefully gone through the custodian agreement dated July 1, 2001, entered into between each of the investment companies and the global custodian Brown Brothers Harriman and Company. Various clauses of article II (which includes powers and duties of custodian) embody copious scheme of investment dealing with security purchases (section 2.03); exchange of securities (section 2.04); sales of securities (section 2.05); purchase of interest bearing, deposits etc. proceeds from shares sold, etc., (section 2.12). For the assessment year 2003-04 for which the previous year ended on March 31, 2003, the statement of purchases and sales of shares in various companies is placed in the compilation which discloses enormous sale of transactions. Except in a few instances in respect of shares of Bharat Petroleum, Tata Iron and Steel Ltd., Bharat Heavy Electrical Ltd. and Bajaj Autos, the sales of shares have been made well after over a year from the date of the purchases. This is the material in furtherance of the object clause in the declaration of trust, referred to above. Having regard to the objects of the company, its investment of the amounts in India, the registration with the SEBI, obtaining FII licence and the enormity and frequency of purchases and sales, we are persuaded to conclude that the applicant held the shares and securities as business assets and the profits from the purchases and sales of shares are in the nature of business income. In view of this finding, the business profits of the applicant could be taxed in India under article 7 of the Treaty but only if the applicant has a permanent establishment in India.

30. The expression permanent establishment is defined in article 5(5) of the Treaty which reads as under (see [1991] 187 ITR (St.) 102, 108) : "An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's-length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph."

31. It is stated in the application that the applicant does not have any branch or office in India, nor does it have any place of business in India that would lead to an

inference that the applicant has a permanent establishment in India. It is also mentioned that the applicant does not have any dependent agent or otherwise any employee in India that could be considered as the applicant's permanent establishment in India. The only connection the applicant has in India is an independent domestic custodian appointed by the global custodian.

The appointment of a global custodian and domestic custodian is in compliance with the requirement of regulation 16(1) of the SEBI, FII referred to above.

32. The domestic custodian of the applicant is SCB which has to discharge, inter alia, the following duties : (a) The custodian has to act in accordance with the instructions of the applicant in relation to its properties in India ; and (b) It has to open, operate and maintain a bank account on behalf of the applicant.

33. There cannot be any dispute that the domestic custodian would be the agent of the applicant in India.

34. What is contended by Mr. Gupta is that the SCB is not an agent of independent status within the meaning of clause 5 of article 5 of the treaty and that the activities of the domestic custodian are almost exclusively to the applicant. We are unable to accept this submission.

It would be necessary to note here that the SCB-the domestic custodian of the applicant in India-provides custodial services to a number of other local and international companies on a routine basis and, therefore, it cannot but be an independent agent of the applicant both legally and economically. It will be useful to refer to attachment No.8 (in the compilation of documents) which is a letter addressed by the domestic custodian on November 19, 2001, and reads thus : This is to confirm that Standard Chartered Bank is registered with the Securities and Exchange Board of India as a custodian under the SEBI (Custodian of Securities) Regulations, 1996 (SEBI Registration Number IN/CUS/006).

As custodians, we only provide settlement services to FIIs/domestic mutual funds and do not take any investment decisions on behalf of FIIs/mutual funds.

We currently provide custodial services to many FII's and domestic mutual funds. Our contractual relationship is with the Global Custodian and not directly with the FII. We attach a copy of the custody agreement between Brown Brothers Harriman and Standard Chartered Bank and also a letter from the Department of the Treasury, Internal Revenue Services in relation to Fidelity Advisor Emerging Asia Fund Inc.

35. It is evident that the domestic custodian is registered with the Securities and Exchange Board of India (SEBI) as a custodian under the SEBI (Custodian of Securities) Regulations, 1996, and it is currently providing custodial services to many FII's, domestic mutual funds and having contractual relationship with global custodian and not directly with the FII. These aspects are not denied by the Revenue. Indeed the grievance of the Revenue has been that no details have been given by the applicant which, we are afraid, is unsustainable. In our view there is enough material to determine whether the applicant has a permanent establishment in India.

36. On a perusal of the agreement of the global custodian and the domestic custodian and the letter of the domestic custodian, we are satisfied that the SCB is an independent agent and satisfies the requirement of clause 5 of article 5. We are, therefore, of the view that the applicant has no permanent establishment in India. Having regard to the provisions of article 7 of the treaty, we conclude that the applicant would not be taxable in India under the treaty.

37. For the above mentioned reasons, we rule on question No. (2) that, on the facts and circumstances of the case, the applicant has no permanent establishment in India in terms of article 5 of the treaty and on question No. (1) we rule that, on the facts and in the circumstances of the case, the gains arising from the sales of portfolio investments in India are the applicant's business profits, covered under article 7 of the Convention dated December 20, 1990, regarding the Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion (Treaty) with respect to taxes on income and capital gains entered into between the Government of the Republic of India and the Government of the United States of America.

38. Pronounced by the Authority in the presence of the parties on this September 27, 2004.

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