Tax Hotline

June 16, 2020

INTERSECTION OF PRIVATE INTERNATIONAL LAW AND TAXATION: BOMBAY HIGH COURT APPLIES LEX DOMICILII RULE IN TAX MATTERS

Recently, in a significant ruling[1] on a unique issue, the Bombay High Court allowed the **taxpayers**, three sub-funds of Aberdeen Institutional Commingled Funds, LLC ("**AICFL**"), a Delaware (USA) based limited liability company, to carry forward losses following a change in the legal identity of AICFL, from a trust to a limited liability company ("**LLC**").

BACKGROUND

AICFL invests in securities across jurisdictions. It sets up various investment schemes in the form of sub-funds or 'series' with different sets of investors for investing in specific strategies. The taxpayers were set up to invest *inter alia* in Indian securities.

AICFL was originally set up as Aberdeen Delaware Business Trust, a trust under the laws of the Delaware, USA, with three sub-trusts were set up, being the taxpayers.

In 2010, AICFL was converted into an LLC, and the taxpayers were converted into sub-funds of the LLC. Such a conversion is permissible under the laws of Delaware and the provisions of the Delaware Statutory Trusts Act ("**Trusts Act**") and the Delaware Limited Liability Company Act ("**LLC Act**") specifically provide that when a statutory trust is converted into LLC, for all legal purposes, the LLC would be deemed to be the same entity as the trust.[2]

At the time of conversion, the taxpayers' each had accumulated several crore rupees in capital losses. Following the conversion, the AICFL sought to carry forward these losses in accordance with section 74 of the Income Tax Act, 1961 ("**ITA**") and filed an application before the Authority for Advance Rulings ("**AAR**") to determine whether such carry forward of losses was permissible in light of the conversion.

RULING OF THE AAR

While the AAR acknowledged that Delaware law, AICFL may be deemed to be the same entity as Aberdeen Delaware Business Trust, the permissibility of carrying forward and setting off of accumulated loss has to be examined under the provisions of Indian tax law, where no such deeming fiction exists. It held that the deeming fiction under Delaware law cannot be invoked in the absence of similar deeming fiction under Indian tax law.

Ruling against AICFL, the AAR held that Section 70 of the ITA limits a claim of carry forward of loss to a taxpayer who incurred the losses, and that since AICFL was never an assessible entity in India, and had never filed any income tax returns in India, it could not be permitted to carry forward and set off the losses incurred by the taxpayers, which were separate taxable entities.

Against the order of the AAR, AICFL and the taxpayers filed a writ petition before the Bombay High Court.

FIRST RULING OF THE BOMBAY HIGH COURT

The Bombay High Court deleted the taxpayers from the writ petition because they were not parties to the proceedings before the AAR. However, on the substantive issue, the Bombay High Court, relying on principles of private international law, held that the status of an entity incorporated abroad has to be determined, even in India, according to the law of the country where the entity was incorporated.

The Bombay High Court held that since, under Delaware law, AICFL, in its earlier avatar as a Trust and post-conversion as LLC, continues to be the same person, this position must need to be accepted in India. Therefore, any gains or losses incurred by it in its earlier avatar would in law not be denied only because of change in status from Trust to LLC.

While the Bombay High Court noted that AAR had ruled against the taxpayer not on the basis of the change in its legal status but on the ground that AICFL was not the taxpayer who had claimed the losses, it did clarify that the ruling of AAR would not impact the case of the three 'series' (funds) i.e., the taxpayers to claim the benefit of the carry forward of losses under section 74 of the ITA.

Despite the ruling of the Bombay High Court, the Indian tax authorities commenced reassessment proceedings against the taxpayers i.e., the sub-funds. The taxpayers, in turn, filed present writ petitions before the Bombay High Court challenging the reassessment proceedings.

SECOND RULING OF THE BOMBAY HIGH COURT

The Bombay High Court rejected the argument of the Indian tax authorities ("**Revenue**") that the taxpayers as 'series' (funds) of AICFL, were distinct from the taxpayers as sub-trusts, and that the losses incurred by the sub-trusts were not losses incurred by the sub-trusts in their sub-fund of AICFL avatar.

The Bombay High Court also referred to the judgment of the Supreme Court in *Technip SA v. SMS Holding Private*

Research Papers

Mergers & Acquisitions
July 11, 2025

New Age of Franchising
June 20, 2025

Life Sciences 2025
June 11, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India
April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?
February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals
January 15, 2025

Audio

CCI's Deal Value Test
February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice
December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Reimagining CSR: From Grant Giving to Blended Finance & Outcome Based Funding
June 16, 2025

Courts vs Bankruptcy code: The

Limited[3], where the Supreme Court held that questions as to the status of a corporation must be decided according to the laws of its domicile or incorporation subject to certain exceptions including the exception of domestic public policy. This is because a corporation is a purely artificial body created by law. It can act only in accordance with the law of its creation. Therefore, if it is a corporation, it can be so only by virtue of the law by which it was incorporated and it is to this law alone that all questions concerning the creation and dissolution of the corporate status are referred unless it is contrary to public policy.

In view of the ruling in *Technip* and its previous ruling on the writ petition filed by AICFL, the Bombay High Court reiterated that the position that in terms of Delaware law, AICFL earlier as the Trust and presently as LLC continues to be the same person, which position must be accepted in India. Therefore, any gain or loss earned by AICFL in its earlier avatar would in law not be denied only because of change in status from Trust to LLC. The Bombay High Court took note that this court had earlier ruled against AICFL on the basis that it was not the entity that incurred the losses sought to be carried forward. However, this Bench also considered that in its earlier ruling, the Bombay High Court had clarified that the decision would not impact the case of the three (series) funds i.e. the taxpayers to claim the benefit of carry forward and set off of losses.

By extension, therefore, any gain or loss earned by the taxpayers in their earlier avatar would not be denied only because of change in status from sub-trust of the Trust to 'series' (funds) of LLC.

The Bombay High Court also highlighted that the Revenue had previously taken the stand that AICFL is not entitled to carry forward losses as it has not incurred such losses and neither is it registered as a taxpayer in India, and that it is the 'series' (funds) which would be entitled to carry forward the losses, if otherwise eligible.

On this basis, the Bombay High Court held that the reasons for reopening issued by the Revenue is precisely on the basis of change of status of the taxpayer. In light of the first ruling of the Bombay High Court, such reason for reopening is erroneous, and accordingly the Bombay High Court quashed the reassessment proceedings.

On the issue of whether an alternate remedy is available to the taxpayers, the Court held that since the Revenue had no jurisdiction to initiate reassessment proceedings, orders on such re-opening also do not survive.

ANALYSIS

This ruling is significant as it is the first ever judgment in the international tax space that explicitly gives effect to private international law principles in tax matters on question of legal status.

To provide some context, under Indian law, conversions or change in legal form typically result in the creation of a fresh assessee under the ITA. Owing to this reason, there are different PANs also issued to entities depending upon their legal form and status (pre and post conversion). For such converted entities to carry forward and set off losses made by its earlier avatar, there are specific deeming provisions under the ITA. For example, in case of conversion of a private limited company to a limited liability partnership, carry forward of losses is available subject to certain conditions.

Of course, the ITA cannot possibly include deeming fictions for foreign conversions of entities not formed or recognized under and unknown to Indian law. However, in so far as the instant conversion is concerned, under Delaware law, the LLC post conversion is deemed to be the same entity as its trust avatar. This is a legal fiction peculiar to conversions governed under Delaware law. Generally, conversions under Indian law do not have the same effect/ deeming fiction under Indian law. Accordingly, the Bombay High Court has correctly applied the lex domicilli principle to hold that the LLC in its trust avatar is the same post conversion into an LLC.

The Court has recognized that, under conflict of law principles, matters relating to status of an entity will be based on the law of the state of incorporation i.e. *lex domicilii* and not under Indian law. For this, the Court has relied on the Supreme Court's decision in *Technip SA*, which dealt with the status of a French company, and the applicability of the Takeover Code to it.

The ruling is especially relevant in today's evolving times where Indian Courts have to grapple with novel issues such as determining the tax treatment or tax status of legal forms which are not recognized under Indian law, be it LLCs in the US or protected cell companies in Mauritius.

This ruling should serve to make interactions between Indian law and foreign law more equitable.

Lastly, the Bombay High Court, relying on the Supreme Court's judgment in *Calcutta Discount*[4] has also recognized and given effect to the right of the petitioner to knock the writ court's door where the Revenue has initiated reassessment proceedings without jurisdiction.

Join us for a Webinar on Friday, June 19, 2020 (India time) for an engaging discussion on

Role of Private International Law in International Tax : Reflections on Aberdeen judgment

– Joachim Saldanha, Shipra Padhi & Rajesh Simhan
You can direct your queries or comments to the authors

[1] *Aberdeen Asia Pacific Including Japan Equity Fund v. DCIT*, WP No. 2796 of 2019 (Bombay High Court). The international tax team at Nishith Desai Associates developed a new approach to international tax using principles of private international law and handled the matter before Bombay High Court, alongside Sr Adv Porus Kaka.

[2] Section 3821 of the Trust Act and Section 214 of the LLC Act

[3] (2005) 5 SCC 464

[4] Calcutta Discount Company Ltd. v. ITO, 41 ITR 191

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

JSW-Bhushan Saga
June 04, 2025

Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX
April 01, 2025