

Tax Hotline

May 15, 2001

FOREIGN INSURANCE COMPANIES NOT LIABLE TO TAX IN INDIA

In a landmark ruling, the Indian Authority for Advance Rulings (**AAR**) has held that the profits earned from the sale of Indian securities by a foreign insurance company (**the Company**) would be regarded as business income and not capital gains.

In holding that the profits arising from the sale of securities would be business profits for the Company and hence taxable under Article 7 of the Double Taxation Avoidance Agreement between India and the jurisdiction of which the Company is a tax resident, the AAR observed that the purpose of the investment by the Company in securities was to generate sufficient funds to enable it to meet the future claims of policy holders. The AAR also reiterated the principle laid down in earlier decisions of the English and Indian courts that the income earned from the buying or selling of shares by an insurance or a banking company in the normal course of its insurance or banking business, would be "business income". This is because the activity of investment and realization of securities is integral to the business of insurance and banking. The AAR also stated that the Company had appointed experts to advise them on the investments and all this goes to prove that the investment in securities was a well-organized business activity for the Company.

The AAR also examined the issue of whether the Company could be deemed to have a Permanent Establishment (**PE**) in India, in which case the business profits of the Company that are attributable to the PE in India will be taxable in India. The AAR clearly held that the mere fact that the Company was purchasing and selling shares in India would not constitute a PE. The AAR also held that when shares are purchased or sold through a stock broker who is not an exclusive agent of the Company, then the stock broker cannot be regarded as constituting a PE of the Company in India.

The AAR also examined whether the Company could be absolved from filing a tax return in India as its income would not be subject to tax in India. The AAR concluded that the Company would be required to file a tax return in India, even though there may be a NIL assessment after all the deductions and allowances including the benefit of the double taxation avoidance agreement.

This ruling comes in the wake of another recent landmark ruling by the AAR in the case of a private equity fund that was based in Mauritius, where the AAR held that the profits and gains realized by a private equity fund from the purchase and sale of Indian securities would assume the character of "business income" as the investment in securities for realization of values is integral to the business of private equity funds.

Advance rulings are private and binding only on the applicant and the tax authorities in respect of the applicant, and only with respect to the transaction as stated in the application. However, advance rulings do have some persuasive value.

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