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By Electronic Delivery

July 12, 2019

Smt. Nirmala Sitharaman
Minister of Finance
Government of India
North Block
New Delhi 110 001
India

RE: *Indian Budget Proposal to Increase Tax
on US RICs Organized in Trust Form*

Honorable Minister Sitharaman:

ICI Global¹ urges prompt clarification that the tax surcharge increase proposed by the Finance (No. 2) Bill, 2019 does not apply to US investment funds² that are organized under US State law as trusts. In the United States, these funds are taxed as corporations.³ All US investment funds, like other foreign portfolio investors (FPIs), pay close attention to market-jurisdiction tax considerations when making investment decisions. Taxes are so important because they can have a disproportionate impact on the investment returns received by funds' moderate-income investors.

¹ ICI Global carries out the international work of the [Investment Company Institute](#), the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$29.3 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

² These funds are registered under the US Investment Company Act of 1940 (15 United States Code (U.S.C.) §§ 80a-1 *et seq.*) and regulated by the US Securities and Exchange Commission (SEC).

³ Specifically, these funds are taxed as corporations under Subchapter M of the US Internal Revenue Code (26 U.S.C. §§ 851 *et seq.*) as regulated investment companies (RICs). To qualify as a RIC, a fund must satisfy several qualification and distribution requirements .

The US funds organized as trusts are not, as reported this week in the Indian press:

- “the most tax-efficient structure” for “the super rich;”
- being set up to avoid being subjected to Minimum Alternate Tax (MAT) in India; or
- being used “to circumvent the Sebi’s disclosure norms.”⁴

Instead, they are highly regulated funds that are taxed in the United States as regulated investment companies (RICs) under the same regime that applies to those US funds organized in corporate form. Moreover, the relevant US securities laws apply equally to both forms in which RICs are organized.

We recognize that India taxes entities based on their legal form. Consequently, US funds that are organized as trusts and file US corporate income tax returns understand that they must file their income tax returns in India as Trusts – Associations of Persons (AoPs). The pre-existing impact of the different treatment in India (slightly higher surcharges on funds organized as trusts) was not sufficiently significant to cause concern. The proposed increase, however, is substantial and unexpected; unless withdrawn, the proposed increase can be expected to have a significant, negative impact on investment decisions by FPIs that India otherwise is seeking to attract.⁵

Turning to the proposed tax surcharge increase, your speech before the Indian Parliament (para 127.) discussed mobilizing revenues by enhancing the surcharge on certain “individuals.” Specifically, the targeted individuals have taxable income (1) between INR 2 crores and INR 5 crores or (2) of INR 5 crores or more. The effective tax rates for these two categories will increase by approximately three and seven percentage points, respectively.

Finance (No. 2) Bill, 2019, however, does not limit the tax increase to “individuals.” Instead, the tax also applies to AoPs (although not to “corporations”). As a result, US funds that are organized as trusts and file their income tax returns in India as Trust – AoPs (rather than as corporations) are being erroneously impacted, along with other FPIs, by the increase in surcharge rates intended for “individuals.”

The history of how US funds are organized under State law illustrates why tax is not a relevant structuring consideration. Specifically, US funds initially were organized in trust form because they were formed (beginning in 1924) in a State (Massachusetts) that had a strong history of allowing enterprises to organize as business trusts. As financial institutions located in States other than Massachusetts began offering funds, the form of organization question was presented. Some continued to use the Massachusetts business trust form, as that was familiar to the market, while others organized under their local State’s corporate laws. More recently, some States (such as Maryland) have revised their corporate laws to eliminate certain organizational (non-tax) requirements, relating to matters such as shareholder meeting obligations, that previously had led some fund sponsors to prefer the trust form

⁴ In fact, SEBI’s ultimate beneficial owner disclosure requirements not only apply to all FPIs but actually apply more stringently, with lower disclosure thresholds (15 rather than 25 percent), to FPIs organized as trusts.

⁵ RICs’ investments in Indian securities, as of March 31, 2019, totaled US\$134.31 billion.

of organization. Other States, such as Delaware, have enacted statutory trust regimes that provide the same organizational (non-tax) benefits as provided by States such as Maryland and Massachusetts.

Importantly, as noted above, funds registered under the US Investment Company Act of 1940 are taxed under US tax law as corporations. This identical US tax treatment has been in place since 1936. There is no US tax advantage to one form of organization over another. Moreover, all US funds that invest in India as FPIs are taxed at the same rate (other than with respect to the surcharge) under Indian tax law.

Finally, the suggestion reportedly made by an Indian Government official (per the Indian press) that funds easily can choose a form of organization before investing in India, and easily can convert from a trust to a corporate structure, is incorrect. Most US fund sponsors investing in India have created hundreds of funds for their customers. Typically, each new fund is organized under the same State law (as a trust or corporation) as the sponsor's other funds—as the fund sponsor already has created a compliance regime for complying fully with the relevant State law requirements. Substantial compliance costs (both initial and ongoing) would be incurred were a fund organized under a different regime. Moreover, were a fund investing in India to convert from a trust to a corporate structure, substantial negative consequences (including tax and transaction costs) would be imposed on the fund's moderate-income investors. A purely tax-driven restructuring also would raise “business purpose” considerations, and possible adverse tax consequences, in both the United States and India.

We strongly urge the Indian Government to address this potentially significant market disruptor by amending the Finance (No. 2) Bill, 2019. The simplest approach would be to provide an exception for FPIs. The effect of this change would be to restore the surcharge rate on income tax to the same level that applied to FPIs for the fiscal year 2018-2019. This approach would resolve the market impact issues for US RICs and for funds organized as trusts in other jurisdictions. Alternatively, some or all FPIs that are organized as trusts could be notified as companies under section 2(17) of the Indian Income-tax Act, 1961.⁶ At a minimum, relief should be provided for all funds, such as US RICs, that are taxed as corporations in their home countries but that register as AoPs in India. The action we request will impact positively funds' investing decisions, restore market confidence, and enhance the Indian economy's growth.

Please contact me at lawson@ici.org or 1-202-326-5832 if you would like additional information.

With kind regards,

/s/ Keith Lawson

Keith Lawson
Deputy General Counsel, Tax Law

⁶ Section 2(17) of the Indian Income-tax Act, 1961 empowers the Central Board of Direct Taxes to declare by general or special order any institution, association, or body whether incorporated or not, and whether Indian or non-Indian, to be a company.