UPDATE

# Irish Fund Succeeds in Claim for Relief under the Ireland India Double Tax Treaty

## What you Need to Know

- A recent decision by the Indian Income Tax Appellate Tribunal ("ITAT") in the case of Vanguard Emerging Markets Stock Index Fund A Series (the "Fund")[1] v ACIT[1] offers helpful insight into the tax treatment of gains earned by an Irish fund from an investment in India.

- The ITAT ruled in favour of an Irish index fund, Vanguard Emerging Markets Stock Index Fund A Series, holding that short-term capital gains from the sale of rights entitlements were not taxable in India under the Ireland India Double Tax Treaty.

## Background

The decision sets out that the Fund is an Irish domiciled index fund that invests in equity securities of companies in emerging markets. The Fund realised capital gains from the transfer of rights entitlements linked to Indian equity shares. The Fund invoked the Ireland India Double Tax Treaty ("DTT") to claim exemption from Indian tax. Under Article 13(6) of the DTT, gains from the transfer of property that do not fall within another specified category under Article 13 should be taxed only in the State of residence of the treaty claimant, which would be Ireland in this case.

The Fund argued that rights entitlements are distinct from shares and are therefore not subject to Indian capital gains tax under a different category of Article 13. Rights entitlements are instruments issued by companies to existing shareholders, giving them the option to subscribe to additional shares at a discounted price.

This interpretation contrasted with the Indian tax authority's position, which argued that the gains should fall to be classified under Article 13(5) of the DTT, which allows India as a contracting state to tax gains from the transfer of shares in companies that are based in that country, i.e. India in this case.

## Transaction Overview

The decision states that the Fund claimed c. INR 65 million (about USD 750,000) in tax-exempt short-term gains from selling rights entitlement earnings under Article 13(6) of the DTT, treating them as a distinct from shares and therefore eligible for tax exemption in India under the relevant article of the DTT. At the same time, the Fund had carried forward capital losses from previous years but did not offset them against the gains, on the basis that the gains were exempt from tax in India.

The Indian tax authority disagreed on both points. First, they claimed that rights

[1] The Fund is a sub-fund of the Vanguard Investment Series Plc umbrella platform

[1] Vanguard Emerging Markets Stock Index Fund v. ACIT, ITA No.4657/Mum/2023

entitlements were essentially derived from shares and should be taxed in India under Article 13(5) of the DTT. Second, they argued that the gains must be offset against the Funds unabsorbed capital losses under the Indian Income Tax Act 1961 – effectively denying the Fund's claim for exemption.

## Indian Tax Tribunal Ruling

The ITAT ruled in favour of the Fund, finding that rights entitlements cannot be equated with shares. It held that these instruments are legally and functionally distinct, as they merely offer an option to acquire shares and do not represent shareholding in themselves. The ITAT also noted that Indian securities regulators treat rights entitlements as separate securities, often credited into different accounts with unique security codes.

Given this legal and regulatory treatment, the ITAT found that the gains fall under Article 13(6) of the DTT and are therefore not taxable in India. Additionally, because the gains were not subject to Indian tax, the ITAT held that the Fund's carried forward losses could not be used to offset them, applying losses to exempt income would effectively amount to taxing it, which was not permitted under the DTT.

## Our Reaction and Key Takeaways

Ireland is one of the world's leading domiciles for the establishment of investment funds for international investment. The Maples Group is increasingly seeing the use of Irish regulated funds and also other Irish investment vehicles by international investors for investment into India.

There is limited international tax caselaw generally on claims by Irish investment funds under Ireland's large network of double tax treaties so this case and the analysis by the ITAT is helpful.

Of course, international tax law is complex and advice should always be taken in respect of the local 'source country' tax position where the investment is located from local tax advisers, both in respect of the domestic charging provisions and the source country position under the tax treaty with Ireland, and also advice on the Irish tax position.

## Further Information

For further information, please liaise with your usual Maples Group contact or any of the persons listed below.

### Dublin

**Andrew Quinn**
+353 1 619 2038
andrew.quinn@maples.com

**John Gallagher**
+353 1 619 2730
john.gallagher@maples.com

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