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Tax Flash News

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Fiscally transparent limited liability corporation qualifies as being 'liable to tax' and a tax resident for the treaty eligibility

Executive summary

The Revenue has been denying the treaty benefit to the fiscally transparent entities such as foreign partnership firms on the ground that such entities are not liable to tax in their home country and do not qualify as tax resident of that country.

The taxpayers claim the treaty benefit on the ground that the members of such firm who are the tax resident of the same country pay taxes (in that country) on the income earned by the firm.

In the case of *General Motors Company USA*[1], this issue arose in the context of a US-based limited liability corporation (LLC).

The Delhi bench of the Tribunal held that as the income of the LLC is clubbed in the hands of its owner who merely discharges the tax that is assessable in the case of LLC, an LLC is essentially 'liable to tax'. The tax residency certificate (TRC) supports this fact and also confirms the status of the taxpayer as a body corporate.

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[1] *General Motors Company USA* v. *ACIT* (ITA No. 2359/Del/2022) – Source: Taxsutra

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Facts of the case

The taxpayer, a US-based LLC, received fees for technical services (FTS) from an Indian company.

During the relevant assessment year, the tax rate under the Income-tax Act, 1961 on FTS was 25 per cent, while the India-USA tax treaty (the treaty) provided for a concessional rate of 15 per cent.

The issue arose whether the taxpayer (an LLC) is liable to tax in the USA and eligible for the treaty benefit.

Relevant provisions of the treaty

To claim the treaty benefit, the taxpayer should qualify as a 'resident' of one of the treaty countries, which, in turn, has two cumulative conditions – the taxpayer should qualify as a 'person' and be 'liable to tax' in that country.

- The term 'person' is defined to include an individual, an estate, a trust, a partnership, a company, any other body of persons, or other taxable entity. The term 'company' is defined to mean a body corporate or any entity which is treated as a company or body corporate for tax purposes.
- Such person should be 'liable to tax' in the USA by reason of domicile, residence, citizenship, place of effective management, place of incorporation or any other criterion of similar nature.
- However, in case the income is derived by a partnership, estate, or trust, such entities qualify as resident only to the extent that such income is subject to tax in the USA as the income of a resident either in their hands or in the hands of their members [**Article 4(1)(b)**].

Revenue's contentions

The taxpayer is a fiscally transparent entity, and its income is not subject to tax in its own hands in the USA according to US tax laws. Thus, the taxpayer is not liable to tax in the USA and does not qualify as a 'resident' of the USA.

An LLC is not covered by Article 4(1)(b) of the treaty and thus, is not entitled to the treaty benefit even if its shareholders are the tax residents of the USA.

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Tribunal's decision

An LLC is a business entity recognised by the USA law[2].

An LLC may opt to be classified as a corporation, partnership[3], or a disregarded entity[4] separate from its owner for the US federal income tax purposes. The ability of an LLC to elect its tax classification supports the legal aspect of an LLC being liable to tax.

Where an LLC is classified as a disregarded entity separate from its owner, its income, deductions, gains, losses and credits are reported in the owner's income tax return. The tax owner of the LLC pays tax on its share of the taxable income attributable from the LLC.

Thus, the income of the LLC is clubbed in the hands of its owner who merely discharges the tax that is assessable in the case of LLC and an LLC is essentially 'liable to tax'.

A fiscally transparent entity is not entitled to the tax residency certification if such entity does not have any US partners, beneficiaries, or owners.[5]

The TRC issued by the US tax authorities confirms that the applicant was a resident of the USA for the purposes of US taxation. In the case of a fiscally transparent entity like the taxpayer, it confirms that the entity has filed an information return and its members filed income tax returns as the residents of the USA.

Thus, the taxpayer was liable to tax in the USA by virtue of the USA domestic tax law.

The TRC also confirms that the taxpayer fulfills all the requirements of a body corporate in the form of legal recognition of its existence – separate, perpetual and distinct from its members. This supports that the taxpayer qualifies as a 'person'.

Scope of Article 4(1)(b)

The intent of the India-USA treaty is to recognise a fiscally transparent entity as 'liable to tax'. This is also evident from Article 4(1)(b) of the treaty.

That article merely imposes a limitation on the eligibility of a partnership firm to avail the treaty benefit and intends to exclude from the treaty eligibility such income which is not subject to tax in the USA (either in the hands of the partnership or its partners).

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[2] Publication 3402 of the Department of the Treasury, Internal Revenue Service, USA on Taxation of Limited Liability Company

[3] If it has at least two members

[4] If it has only one member

[5] Instruction for Form 8802 for applying for TRC in Form 6166

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An exclusion provision can only exclude something if it was included at the outset. Hence, a fiscally transparent partnership was already regarded as 'liable to tax' for the purposes of the treaty and Article 4(1)(b) determines the scope of eligibility of such fiscally transparent partnership by excluding income which is not ultimately 'subject to tax' in the USA.

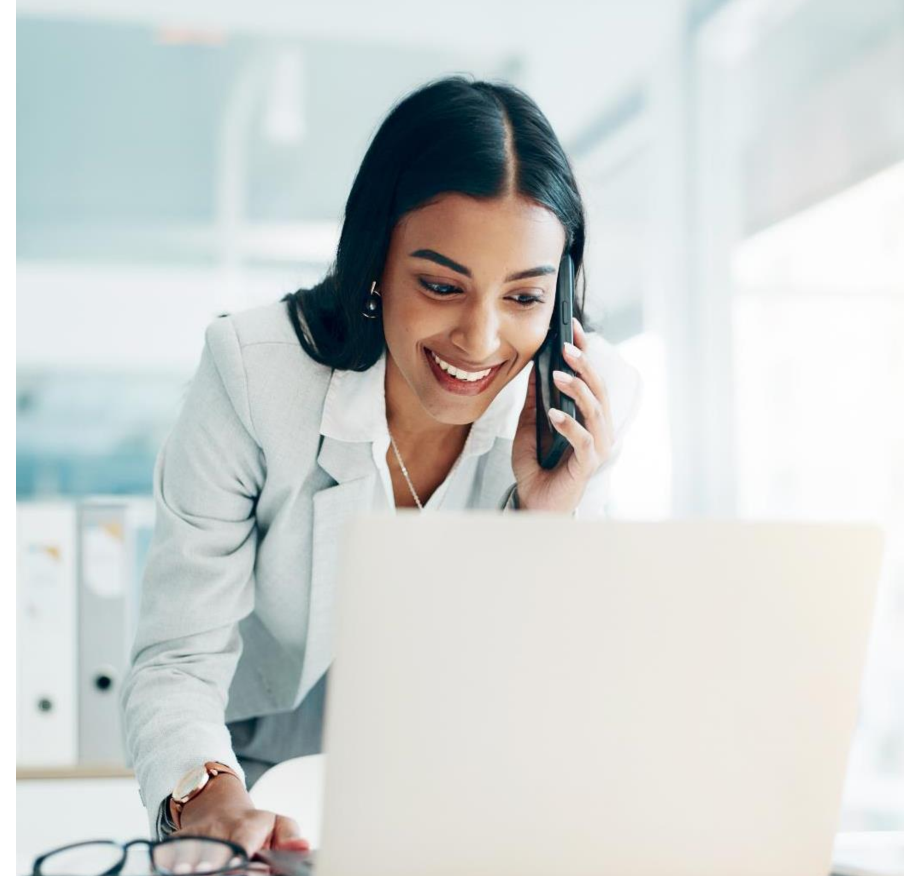
Our comments

In the case of *Linklaters LLP*[5], the Mumbai bench of the Tribunal allowed the benefit of India-UK treaty to a fiscally transparent partnership firm. That decision was rendered prior to the amendment of the India-UK treaty when that treaty did not contain Article 4(1)(b).

In this decision also, the Delhi bench held that the intention of the treaty is to give benefit to fiscally transparent entities. A fiscally transparent entity does not require Article 4(1)(b) to be eligible to treaty benefit. Rather, that article excludes from the treaty eligibility such income which is not ultimately 'subject to tax' in the USA.

It would be interesting to see how the courts will apply this decision to other treaties where there is no provision corresponding to Article 4(1)(b) of the India-USA and the India-UK treaties.

India has chosen not to adopt Article 3 of the MLI[7] which grants treaty benefit to the fiscally transparent entities similar to Article 4(1)(b) of the India-USA treaty.



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[6] [2011] 9 ITR(T) 217 (Mumbai)

[7] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

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