



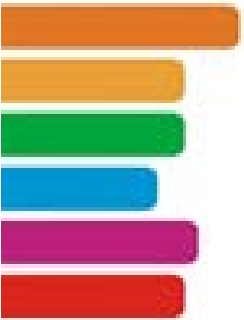
# Partnership

under the Law of Tax Treaties

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# Introduction

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# Taxation of Partnership in India

- Partnership governed by Partnership Act, 1932
  - Taxed as separate entity
  - Distributions by Partnership not taxed in the hands of Partners
- Limited Liability Partnerships under LLP Act 2008
  - Formed as Body Corporate
  - However, for tax purposes, it is considered in lines with Partnerships



# Taxation of Partnership in India

- Taxation of Foreign LLPs in India?
  - Need to consider their characteristics to determine Indian taxation
- Section 2(17)
  - Any body corporate incorporated by or under laws of country outside India to be taxed as 'Company'
- Foreign LLPs would be considered 'Company' if under the respective statute it is considered body corporate
- If it is not body corporate and it meets the general tests of Partnerships, it would be treated as 'Partnership'



# Conflict of Classification

- Partnership is, generally, not a separate legal entity
- However, for tax purposes certain countries treat them as separate entities
  - E.g. India
- However, other countries continue to treat them as 'Transparent' or 'Pass-through' entities
  - i.e. Partnerships are not taxed but its partners are taxed on income derived by them through Partnerships



# Partnership and Tax Treaties

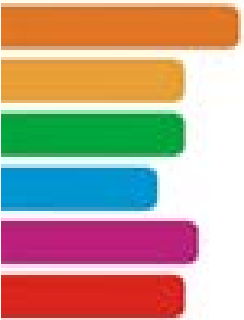
- Is a partnership entitled to the benefits of tax convention?
- Is it a “person”?
  - **Article 3(1)(a) of OECD Model Tax Convention**
    - a person is an individual, a company and any other body of persons
- Is it a “resident of a contracting state”?
  - **Article 4(1) of OECD Model Tax Convention**
    - any person who, under the laws of that state, is liable to taxation by reason of his domicile, residence, place of management or any other criterion of a similar nature...



# Issues due to Conflict

- Where Partnerships are not taxed, they are not liable to pay tax
- Consequently, they would not be considered as 'Resident'
- In absence of qualifying as 'Resident', access to Tax Treaty is not available
- In absence of access to Tax Treaty, relief from Double Taxation may not be achieved





# OECD Approach

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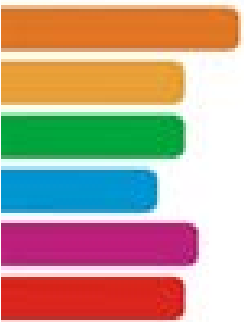
# OCED – Commentary on Article 1

- OECD suggests purposive interpretation
- Para 5
  - In case of transparent partnership, it is not 'liable to pay tax' and hence not 'resident' for Tax Treaty
  - In such case, access to Tax Treaty would be refused unless special provisions are made
  - **In such a case, Partners should be entitled to the benefits with respect to their share of income in the partnership**
- Para 6.4
  - In case of countries transparent partnership, income should be viewed as 'paid to the partners' and not to the partnership and accordingly benefits should be granted under Tax Treaty



# OCED – Commentary on Article 1

- Para 6.5
  - If the State of establishing partnership considers it as transparent, no benefit could be granted to it as no income / profit is allocated to it
    - There is no income of partnership (in Residence country) and hence no treaty benefit
  - No benefits will be available under Treaty between Source and Residence of partners if the income of partnership is not allocated to the partner under the taxation law of Residence State
    - There is no income of partner and hence no treaty benefit
- Departure from General Rule that in case of Conflict, meaning to be assigned based on source country interpretation



# India's Approach

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# OCED – Commentary on Article 1

- Does not agree with OECD interpretation
- Benefit to partners can be granted only if special provision to that effect are included in the Tax Treaties
- Other countries following India's position
  - OECD Countries – Netherlands, France, Portugal, Chile
  - Other Observer Countries - Gabon, Ivory Coast, Morocco, Tunisia
- Landmark Ruling
  - Decision in case of Linklaters LLP, 40 SOT 51 (Bom)



# Linklaters LLP *Ruling*

*One must, therefore, apply the test of fiscal domicile in such a manner so as to lead to a reasonable result. As long as de facto entire income of the enterprise or the person is subjected to tax in that tax jurisdiction, whether directly or indirectly, the taxability test must be held to have been satisfied. Of course, the other possible approach to such a situation is that as long as the tax jurisdiction has the right to tax the entire income of the person resident there, whether or not such a right is exercised, the test of fiscal domicile should be satisfied. Viewed thus, all that matters is whether that tax jurisdiction has a right to tax or not; the actual levy of tax by the tax jurisdiction cannot govern whether a person has fiscal domicile in that jurisdiction or not. Having said that, one is alive to the fact that this line of reasoning is diametrically opposed to the stand taken by the OECD in the matter, but, having carefully considered the stand of the OECD on this issue, one cannot be persuaded by the OECD stand on the matter, nor the Indian judicial precedents support that position. As a matter of fact, even the Government of India's approach to the tax treaties does not entirely approve that school of thought either. [Para 75]*



# Linklaters LLP *Ruling*

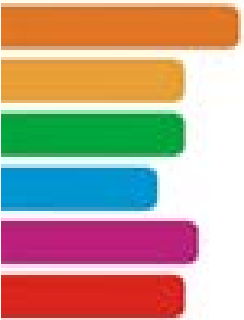
*As it has been observed that the partnership firm is eligible for treaty benefits in the source country even as it is not taxable in its own right in the residence country, the Bench is alive to the fact that the OECD report on partnership does not approve that proposition. As evident from paragraph 40 of the said report even when partnership firm is not taxable in the residence in its own right, the treaty entitlements to the firm are to be denied. However, in the same report, at paragraph 56, the OECD report recommends that, in such a situation, the treaty benefits should accrue to the partners in the partnership firm. However, that is a solution rejected by India. [Para 77]*

*In this situation, i.e., when the Government of India has rejected the stand taken in the OECD partnership report and the changes made in the OECD Model Convention Commentary as a result of the same, it cannot be open to hold that in the light of the OECD report, the partnership firm must be declined treaty entitlement benefits. The remedy to unintended consequence of a treaty provision in the said report has been rejected, and, therefore, the treatment accorded to the said provision, in the same report, cannot be accepted either. Any other view of the matter will lead to absurd consequences rather than avoiding the absurd consequences. [Para 78]*



# Linklaters LLP *Ruling*

*In view of above, it was to be held that the assessee was indeed eligible to the benefits of India-UK tax treaty, as long as entire profits of the partnership firm were taxed in UK - whether in the hands of the partnership firm though the taxable income was determined in relation to the personal characteristics of the partners, or in the hands of the partners directly. To that extent, objection taken by the revenue on the question of admissibility of India-UK tax treaty benefits was to be held as maintainable but to be rejected on merits. [Para 79]*



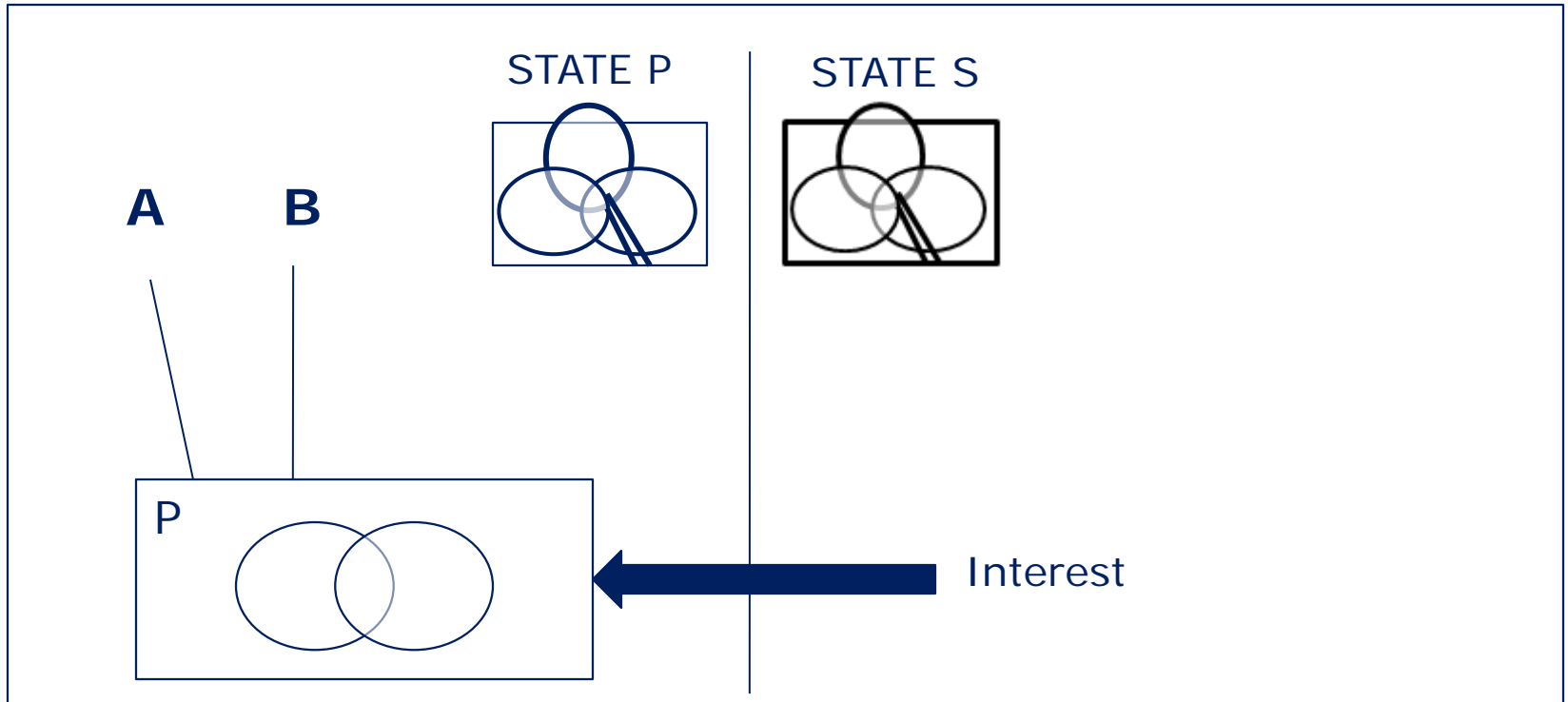
# Case Studies

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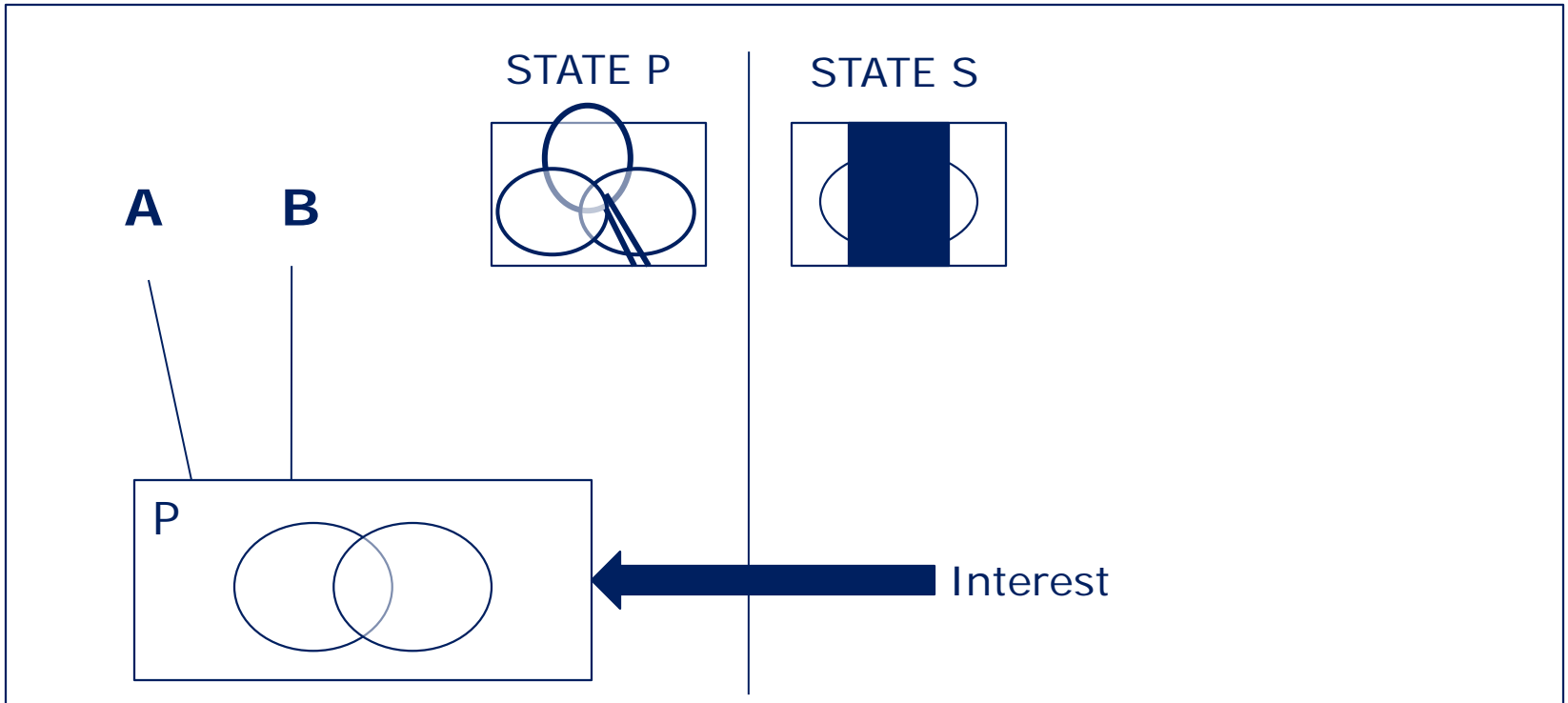
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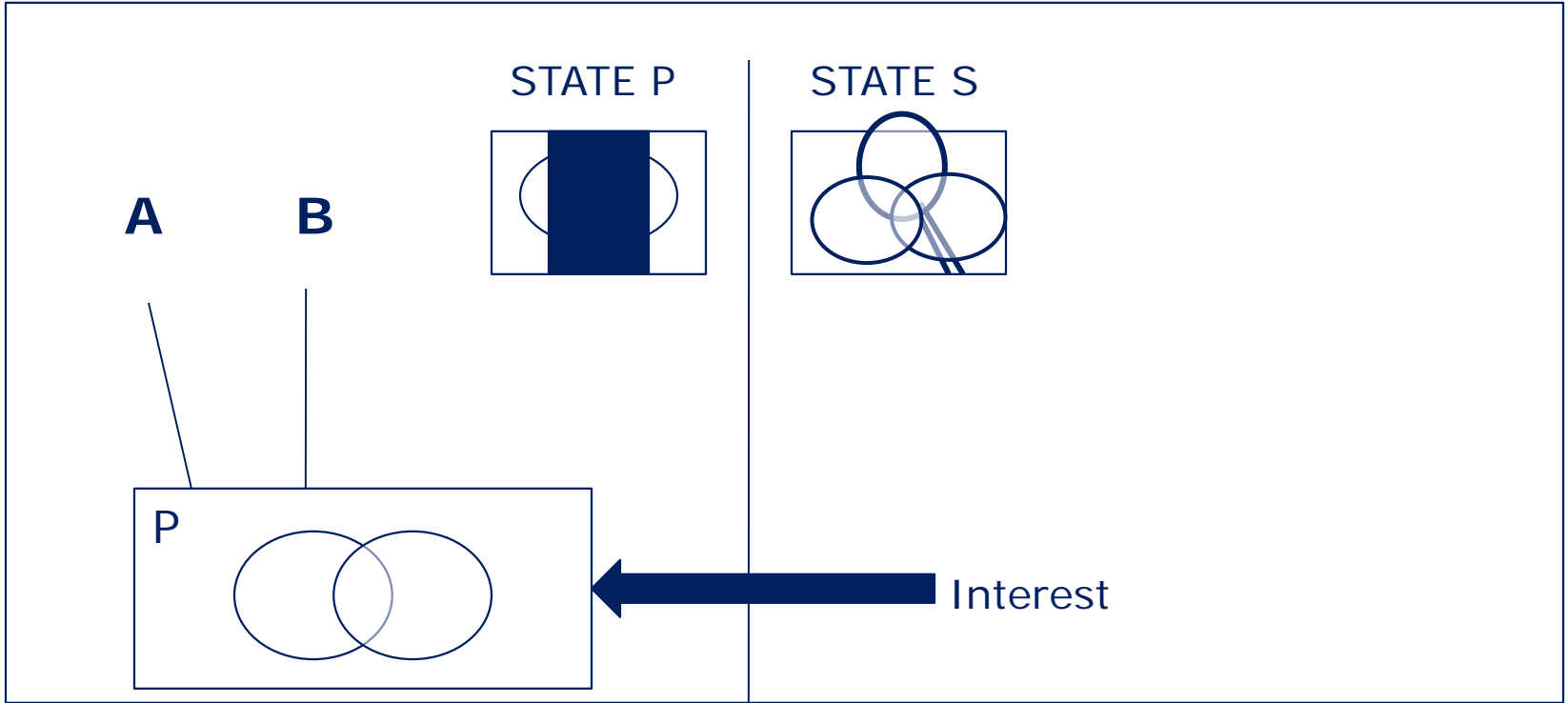
# Case Study 1



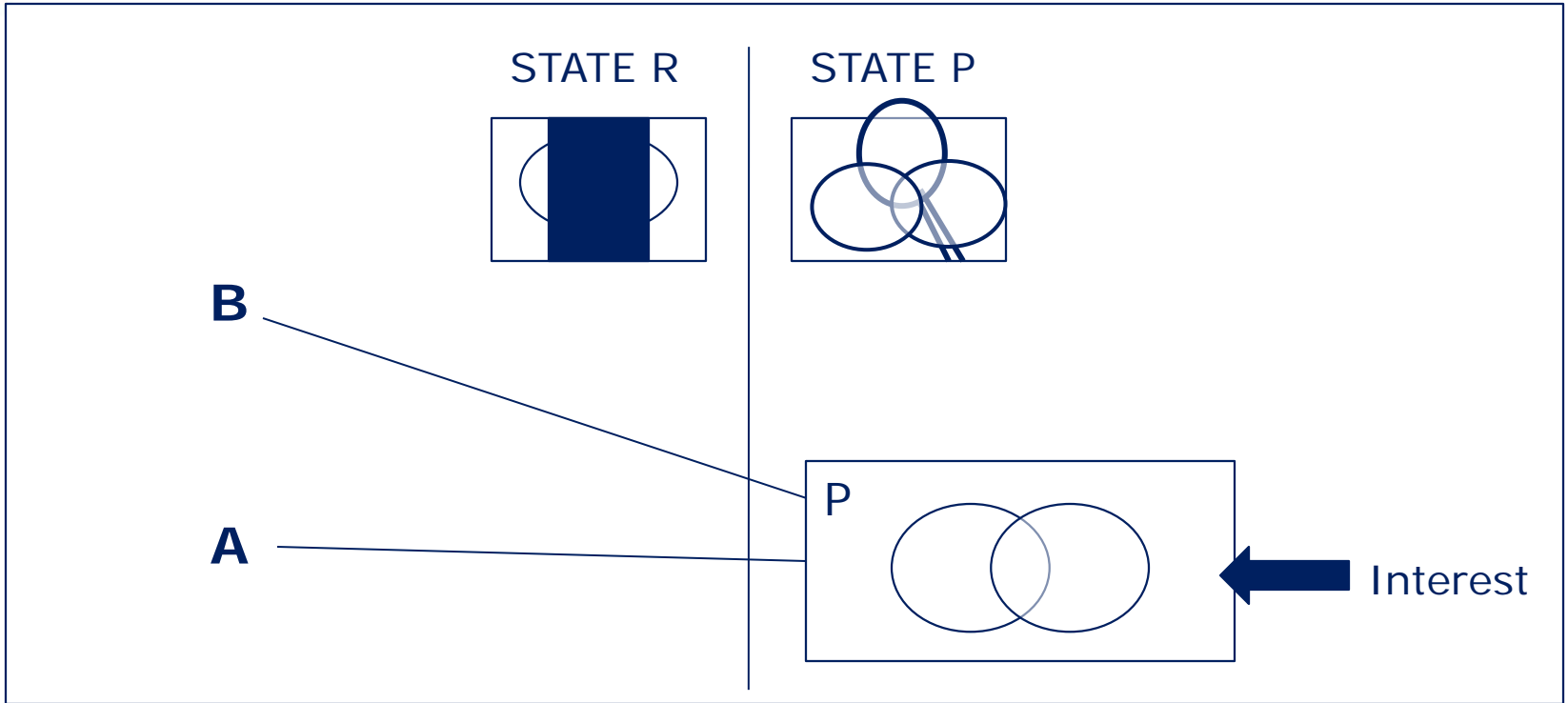
# Case Study 2



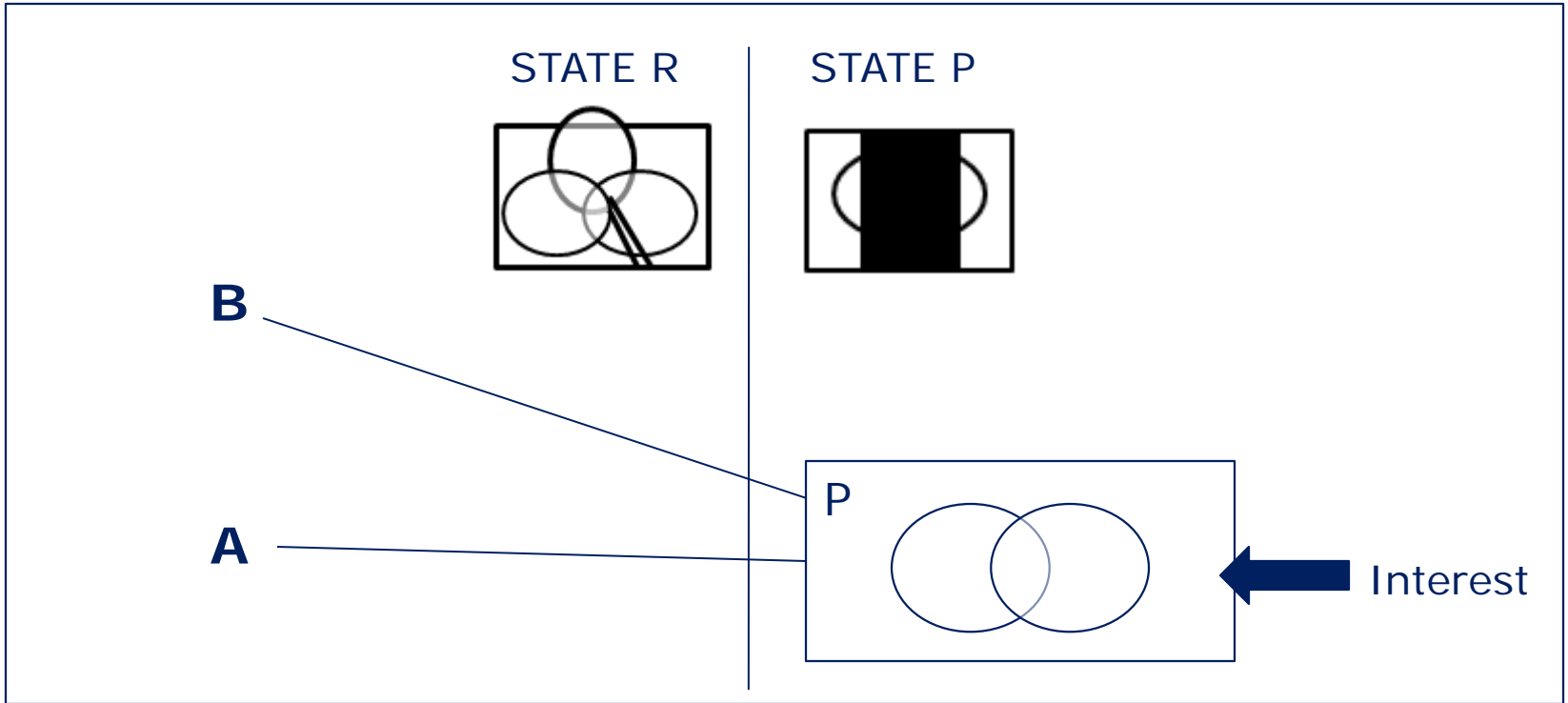
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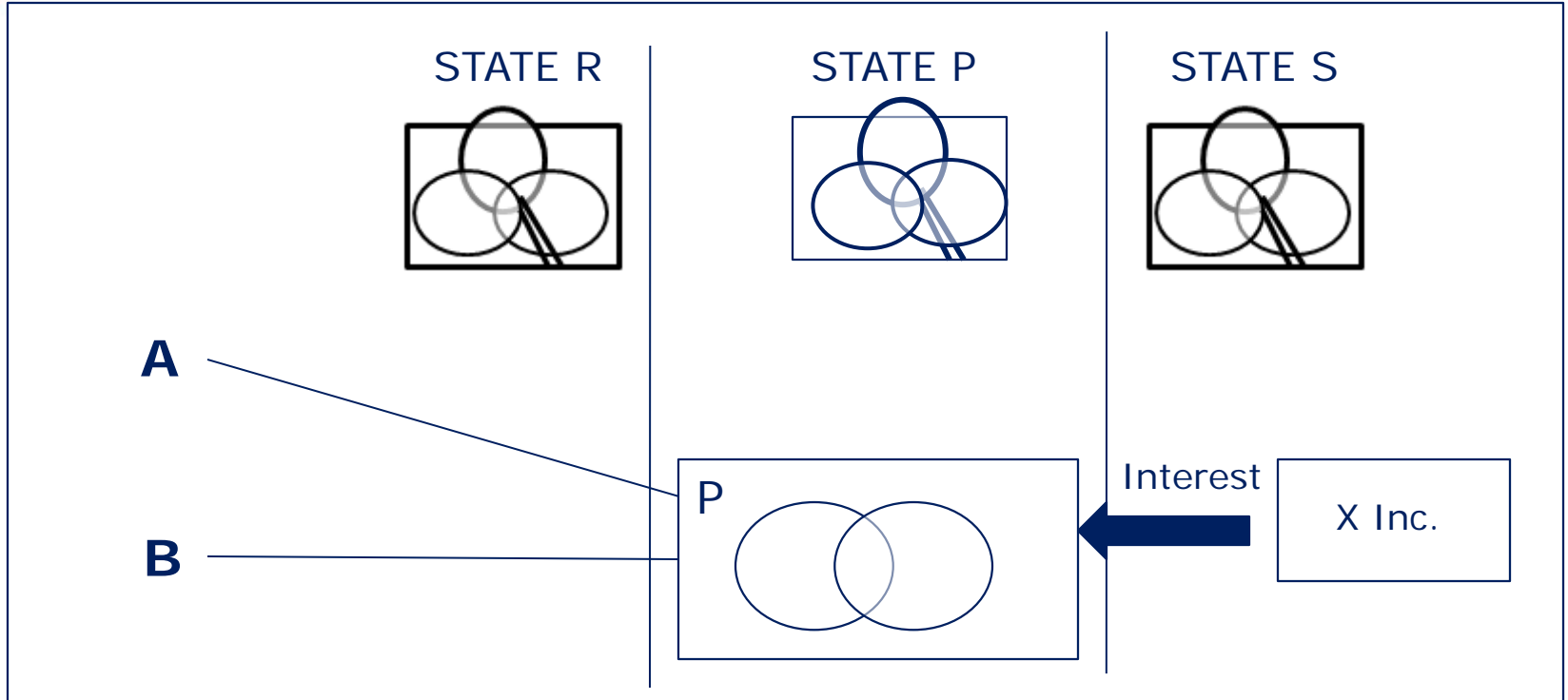
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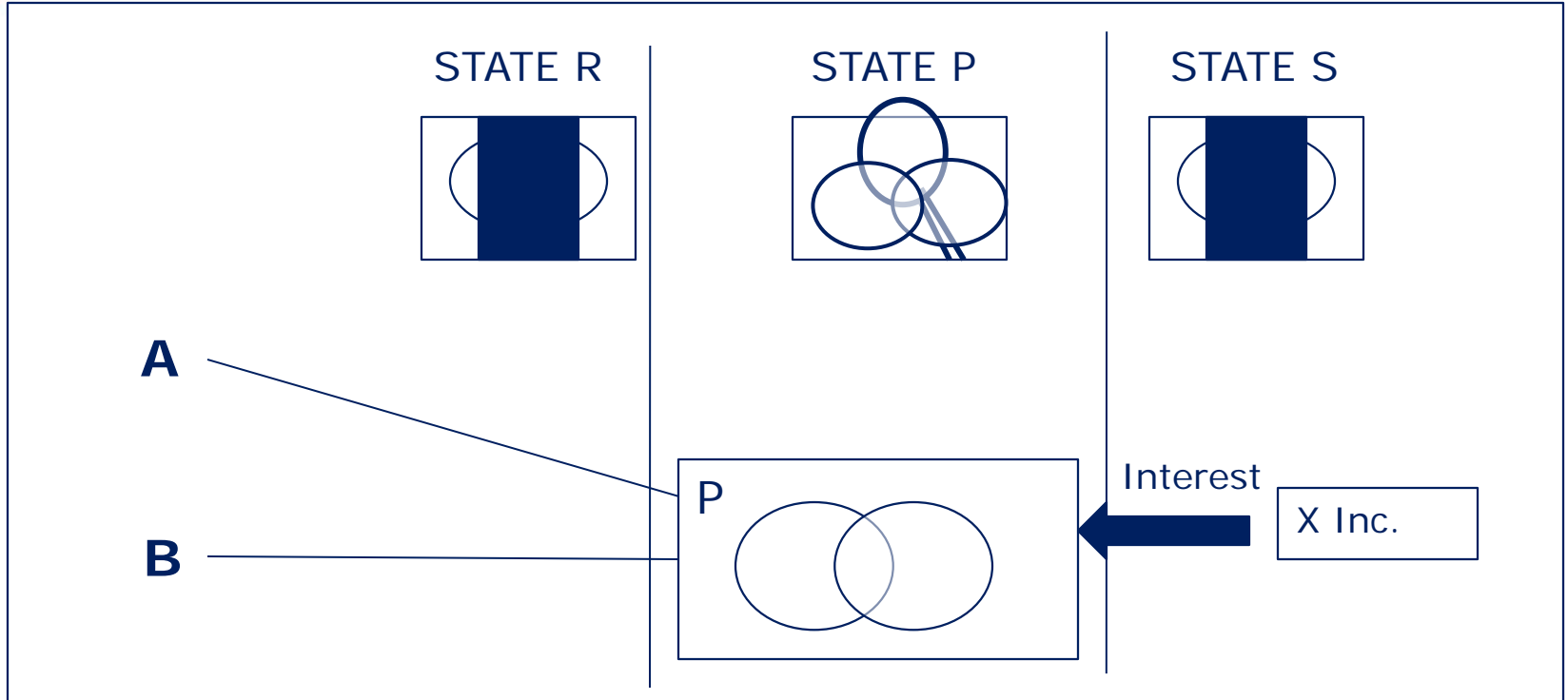
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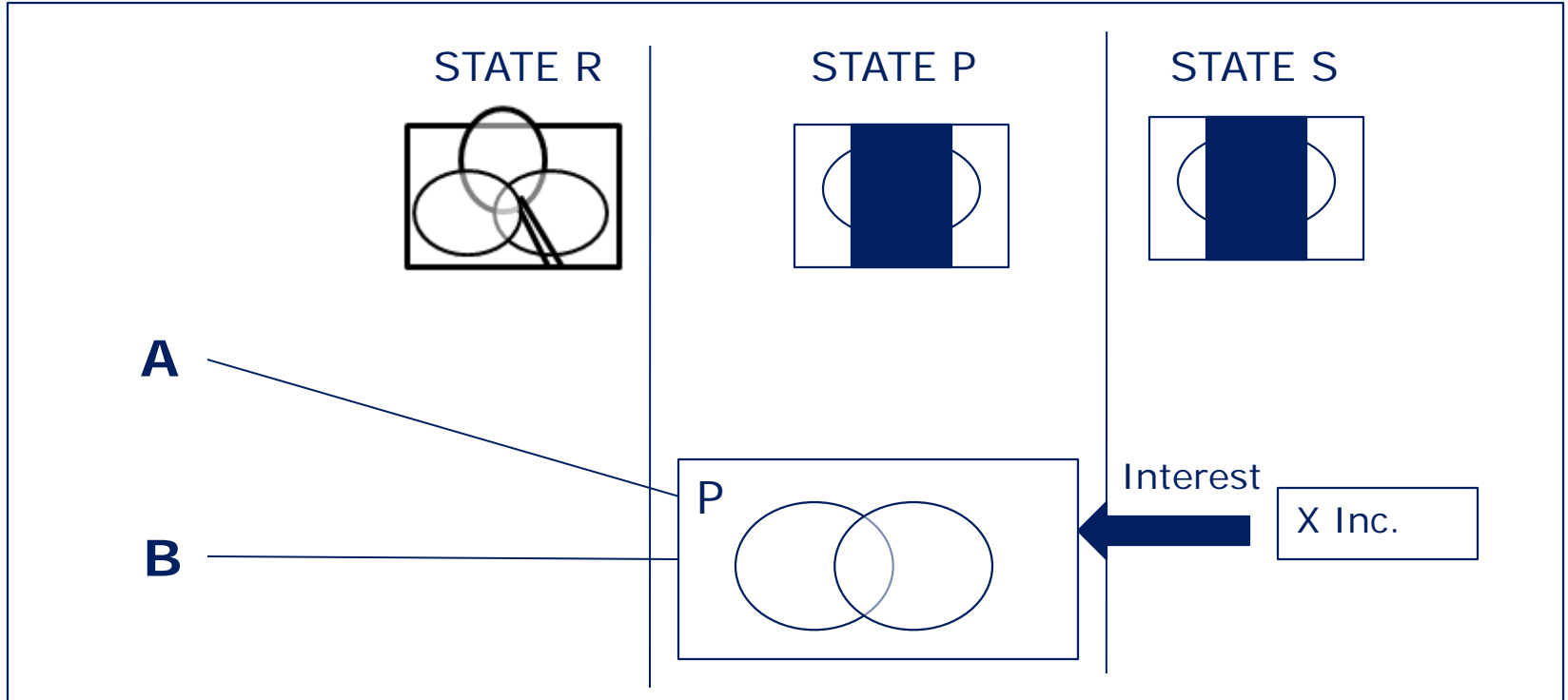
# Case Study 6



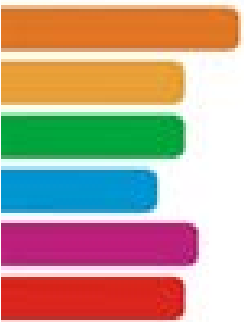
# Case Study 7



# Case Study 8







# Indian Experiences

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# India – US DTAA

- ❑ Article 3(1)(e): the term “person” includes an individual, an estate, a trust, a partnership, a company, any other body or person, or other taxable entity.
  
- ❑ Article 4: *Residence* – 1. For the purposes of this convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that
  - a) This term does not include any person who is liable to tax in that State in respect only of income of sources in that State; and
  - b) In the case of income derived or paid by partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of that resident, either in its hands or in the hands of its partners or beneficiaries.



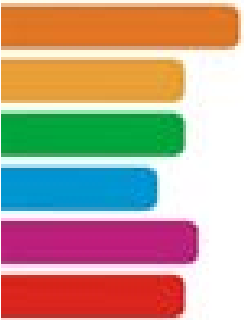
# India – UK DTAA

- Article 3 – General Definitions
  - 1 (f): the term “person” includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States, but, subject to paragraph 2 of this Article, does not include a partnership
  - 2. A partnership which is treated as a taxable unit under the Income-tax Act, 1961 (43 of 1961) of India shall be treated as a person for the purposes of this Convention.



# India – UK DTAA

- ARTICLE 25 - *Partnerships* –
  - 1. Where, under any provision of this Convention, a partnership is entitled, as resident of India, to exemption from tax in the United Kingdom on any income or capital gains, that provision shall not be construed as restricting the right of the United Kingdom to tax any member of the partnership who is a resident of the United Kingdom on his share of the income and capital gains of the partnership; but any such income or gains shall be treated for the purposes of Article 24 of this Convention as income or gains from sources in India.
  - 2. Nothing in Article 11 of this Convention shall entitle a partnership which is a resident of India to a tax credit in respect of dividends paid to the partnership by a company which is a resident of the United Kingdom; but any member of the partnership who is a resident of India shall be regarded as entitled to the tax credit to which he would have entitled under that Article, if his share of those dividends has been paid to him by the company which is a resident of the United Kingdom.



# Practical Case Studies

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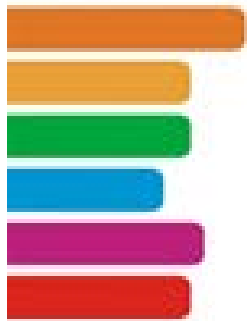
# Case Study 9

- US company wishes to set up manufacturing facility in India
- It is contemplating two options
  - Subsidiary
  - Limited Liability Partnership
- Can you list the items that is relevant for decision-making?



# Case Study 10

- Indian company has made payment of shrink-wrap software to LLC in US.
- Is Indian company required to withhold tax on such payment?



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