



Tax alert: US LLC eligible for India-US tax treaty benefit

17 September 2024

The Delhi Bench of the Income-tax Appellate Tribunal has held that a Limited Liability Company (LLC) formed under US laws, qualifies as a 'resident' under Article 4 of the India-US tax treaty and thus, is eligible for benefit under India-US tax treaty.

In a nutshell



Under the US federal income tax law, an LLC with a single owner is disregarded as separate from its owner unless the LLC elects to be treated as a corporation for US federal income tax purposes. The ability of the LLC to elect its tax classification under US federal income-tax law supported the legal situation or aspect of the LLC being liable to tax.



The taxpayer LLC is liable to tax in the resident state by virtue of US income tax law as an LLC is given an option to either be taxed as a corporation or be taxed as a disregarded entity or partnership (depending on number of members) wherein the income of the LLC is clubbed with its owner who merely discharges the tax that is assessable in the case of the LLC.



The intent of the India-US tax treaty has to be given precedence wherein the concept of a fiscally transparent entity is recognized by way of the phrase 'liable to tax'.



Scroll down to read the detailed alert

Background:

- The taxpayer¹ LLC claiming to be a resident of United States of America (US), offered to tax income by way of Fees for Technical Services / Fees for Included Services (FTS/FIS) at the rate of 15% as per Article 12 of the India-US tax treaty.
- During the course of audit proceedings, the Assessing Officer (AO) observed the following:
 - Taxpayer was a Limited Liability Company (LLC) and a fiscally transparent entity according to the US laws i.e., whose income was not subject to tax in its own hands in the US. The taxpayer did not qualify as resident of the US in terms of Article 4 of the India-US tax treaty.
 - Only persons or entities that are liable to tax in their country under the laws of their country are considered resident for the purpose of tax treaty. In treaty context, the term "laws of that State" meant taxation laws of that State.
 - LLCs did not come under the special clause of partnerships and trusts laid down in Article 4(1)(b) of the India-US tax treaty.
 - In case of an LLC, even if the shareholders were residents of the US, the tax treaty benefits were not available.

Accordingly, the AO proposed to tax the income of the taxpayer at the rate of 25% under section 115A of the Income-tax Act, 1961 (ITA), denying the tax treaty benefit under Article 12 of the India-US tax treaty.

- Aggrieved, the taxpayer filed objections before the Dispute Resolution Panel (DRP) which upheld the view of the AO. Aggrieved, the taxpayer filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

Relevant extract of Article 4 of the India-US tax treaty

“(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 from sources in that State; and

(b) in the case of income derived or paid by a 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 a resident, either in its hands or in the hands of its partners or beneficiaries.”

Decision of the ITAT:

The ITAT noted/ observed the following:

- What was required to be ascertained was the status of the LLC for India-US tax treaty. As per Publication 3402 of the Department of the Treasury, International Revenue Service (IRS) of the Government of US on Taxation of Limited Liability Company, it was noted that:
 - An LLC is a business entity recognized by the US under the state law. It may be classified for federal income-tax purposes as a partnership, corporation or an entity disregarded as separate from its owner.
 - An LLC with at least two members is classified as a partnership for federal income-tax purposes.

¹ General Motors Company USA v. ACIT [2024] 166 taxmann.com 170 (Delhi ITAT)

- An LLC with only one member is treated as an entity i.e., disregarded as separate from its owner for income-tax purposes (but as a separate entity for purposes of employment tax and certain excise taxes). Also, its income, deductions, gains, losses and credits are reported in the owner's Income-tax Return (ITR).
- The Instructions for Form 8802 (application for the Residency Certification) provided that *"In general, under an income tax treaty, an individual or entity is a resident of US if the individual or entity is subject to US tax by reason of residence, citizenship, place of incorporation, or other similar criteria."*

Further, on the aspect of who is not eligible for Form 6166 (certification of US tax residency or US TRC), it is provided that if a fiscally transparent entity is organized in the US (that is, a domestic partnership, domestic grantor trust, or domestic LLC disregarded as an entity separate from its owner) and such entity does not have any US partners, beneficiaries, or owners then such entity is not entitled for Form 6166.

The instruction in Form 8802 also provides that Form 6166 having residency certification is in the form of a letter of US residence certification, and only certifies that for the certification year (the period for which certification is requested), the applicant was a resident of US for purposes of US taxation or, in the case of a fiscally transparent entity, that the entity, when required, filed an information return and its partners/ members/ owners/ beneficiaries filed ITRs as resident of the US.

- Under the US federal income-tax law, an LLC with a single owner is disregarded as separate from its owner unless the LLC elects to be treated as a corporation for US federal income-tax purposes. The ability of the LLC to elect its tax classification under US federal income-tax law supported the legal situation or aspect of the LLC being liable to tax.
- Where an LLC was disregarded as separate from its tax owner for US federal income-tax purposes, the tax owner of the LLC paid tax on the tax owner's share of the taxable income attributed from the LLC. This further supported the legal situation of an LLC being liable to tax, i.e., the LLC was essentially 'liable to tax' but the income was attributed to its tax owner and such tax was imposed and paid by its respective tax owner, like the US consolidated group rules where all affiliated US corporations filed a single US federal ITR.
- The Tax Residency Certificate (TRC) received from the US IRS is in accordance with the requirement of the law as applicable to the taxpayer (being an LLC) which was organized as body corporate as it fulfilled all the requirements of a body corporate in the form of legal recognition of a separate existence of the entity from its member and a perpetual existence distinct from its members. Thus, the taxpayer being a resident under Article 4 of the India-USA tax treaty by virtue of its formation and its recognition as a separate existence from its members qualified as a 'person'.
- Further, the taxpayer was liable to tax in the resident state by virtue of USA income-tax law as an LLC, and was given an option to either be taxed as a corporation or be taxed as a disregarded entity or partnership (depending on number of members) wherein the income of the LLC was clubbed in the hands of its owner who merely discharged the tax that was assessable in the case of the LLC.
- The intent of the India-US tax treaty had to be given precedence wherein the concept of fiscally transparent entity was recognized by way of the phrase 'liable to tax'. Article 4(1)(b) of the India-USA tax treaty recognizes partnership as a resident of the US for the purpose India-US tax treaty to the extent that the income derived by such partnership was subject to tax in the US as the income either in the hands of the partnership or in the hands of its partners or beneficiaries. Reliance was placed on earlier ruling² in this regard.
- Further, the provision imposed a limitation on eligibility of a partnership to avail the benefits of India-US tax treaty as prescribed, i.e., it sought to exclude from the eligibility of provisions of India-US tax treaty such

² Linklaters LLP v. ITO [2011] 9 ITR(T) 217 (Mumbai ITAT)

income of the partnership which was not 'subject to tax' in the USA (either in the hands of partnership or partners). Reliance was placed on an earlier ruling³ in this regard.

- Thus, it could be concluded that an exclusion provision could 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 India-US tax treaty and this provision determined the scope of eligibility of such fiscally transparent partnership by excluding income which was not ultimately 'subject to tax' in the US.

In view of the above, the ITAT held that the taxpayer (i.e., US LLC) was eligible for benefit under India-US tax treaty.

Comments:

The residential status of a US LLC under the India-US tax treaty and thereby, its eligibility for treaty benefit has been a subject matter of litigation. This ruling, while holding that the taxpayer a US LLC qualified as resident in terms of Article 4 of the India-US tax treaty, has held the following:

- The ability of the LLC to elect its tax classification under US federal income-tax law supported the legal situation or aspect of the LLC being liable to tax.
- The taxpayer is liable to tax in the resident state by virtue of US income tax law as an LLC is given an option to either be taxed as a corporation or be taxed as a disregarded entity or partnership (depending on number of members) wherein 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 the LLC.
- The intent of the India-US tax treaty has to be given precedence wherein the concept of fiscally transparent entity is recognized by way of the phrase 'liable to tax'. An exclusion provision can only exclude something if it is included at the outset. Hence, a fiscally transparent partnership is already regarded as 'liable to tax' for the purposes of India-US tax treaty and this provision determined the scope of eligibility of such fiscally transparent partnership by excluding income which is not ultimately 'subject to tax' in the US.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

³ General Electric Pension Trust v. DIT [2006] 150 Taxman 545 (AAR)

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