

LLP to be taxed like general partnerships

Source: *The Economic Times*
July 7, 2009

The door is wide open now for lawyers, chartered accountants and other professionals with entrepreneurial zeal to join hands to run innovative businesses that would also attract venture capital investments.

The Budget has cleared the air of uncertainty over the tax treatment of LLPs, giving a boost to the services sector that accounts for more than half of the country's gross domestic product of \$1 trillion.

An LLP is a hybrid entity with the best features of companies and partnership firms. These entities are proposed to be taxed like general partnership firms. They will have to pay an effective tax of 30.9% — which includes a basic tax of 30%, plus the education cess. They will, however, be spared of the 10% surcharge. Their tax liability will, hence, be lower than that of companies, which pay a 33.99% tax on profits, in addition to dividend distribution tax.

"The tax will be imposed only on 40% of the firm's income, since the firm will be allowed to pay the balance 60% to the partners as remuneration. This means, the partners will have to pay tax on the amount paid to them. So, there will be no double taxation of income. Besides, LLPs will not have to pay a dividend distribution tax or minimum alternate tax (MAT). This will act as a big incentive for their operations," said Sunil Shah, partner, Deloitte Haskins & Sells.

The law on LLPs came into force in January, 2009, and the beneficial tax treatment could be an incentive for many professionals to form LLPs. The liability of a partner in the LLP is restricted to her stake in the entity. Her assets are not at risk, except when she is responsible for the claim.

A Parliamentary panel had recommended that these entities should be given the leeway to choose between taxation at the level of partners or the firm.

Tax experts had, hence, hoped that LLPs would be given the benefit of a pass-through status under the income-tax law just like venture capital funds. A pass-through benefit would have meant exempting the profits of the LLP from tax, and instead levying a tax at the hands of the partners.

"The expectation was that the LLPs will be made fully tax transparent, as is the practice in most other countries. However, this has not happened. The definition of firm now includes a limited liability partnership set up under the LLP Act. The profits of an LLP are proposed to be taxed at the firm level, which is in line with the current practice for general partnerships. The clarity will be useful, as now there is clear understanding of the tax treatment of profits under an LLP structure," said Shefali Goradia, partner, BMR Advisors.

The US, for instance, has a flexible LLP regime, where a taxpayer can determine and decide on how the hybrid entity should be classified for tax purposes. However, in Singapore an LLP is treated as a partnership for tax purposes.