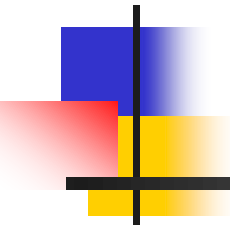


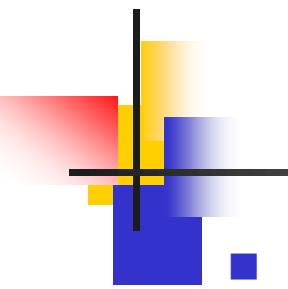
Certificate Course on International Taxation by the Committee on International Taxation of ICAI, Baroda



PARTNERSHIPS UNDER THE LAW OF TAX TREATIES

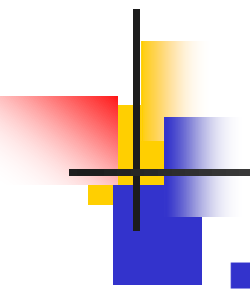
**Presented by:
Mr. Paresh P. Shah**

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Chartered Accountants
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OVERVIEW

- Meaning of Partnership
- Taxation of Partnership Firms under Domestic Laws.
- Partnership under Treaty Laws
 - Application of double Tax Convention – Issues
 - OECD Report
 - Commentary to the OECD model
 - Uses of Partnership – A Hybrid entity.
- India's Tax Treaty & Partnerships
- Legal Position
- LLP Act, 2008
- Partnership Act, 1932



Meaning of Partnership

- Dictionary Meaning: Oxford

- The State of being Partner or Partners
- An association of two or more people as Partners
- The number of runs added by a pair of batsman before one of them is dismissed or the inning ends.

- International Tax Glossary, [IBFD 5th Edition]

An association of two or more persons (individuals or in some cases companies) established for the purpose of making a profit, the profit (or loss) being shared among the partners in predetermined proportion.

- OECD

Entities that qualify as such under civil and commercial law as opposed to tax law.

- Civil & Commercial Law

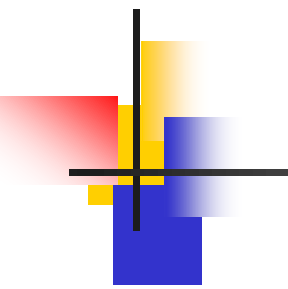
- Partnership Act, 1932
- Companies Act, 1956
- LLP Act, 2006

- These law decides as to Juridical Person or not

- Classification of Entity as Partnership – Characteristic

- Non Tax:
- Is legal Person
 - Perpetual Succession
 - Need of Registration
 - Profit motive
 - Who owns asset & assumes liabilities
 - Who is bound by action of partners
 - Management of

- Classification under general laws
- Under Civil Law jurisdiction Formal Partnership is a Legal Person, Informal is not a Legal Person,
- Types - Three major types are
 - General Partnerships
 - Limited Partnerships
 - Limited by Shares



Meaning of Partnership - Types

- General Partnership

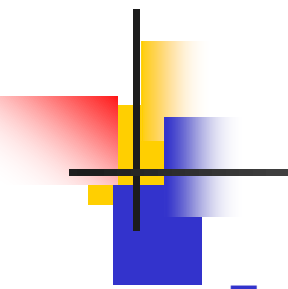
- No Share Capital
- No Separate Management
- Unlimited Liability
- Not a Separate Legal Entity

■ Limited Partnership

- Two types of Partners, General Partners and Limited Partners, atleast one of each type
- General Partner is normally involved in day to day work, Limited Partner is restricted
- General Partner is jointly and severally liable for obligation of the Partnership. Limited Partner make contributions and his/her liability is limited to such contribution
- Limited Partner shares in the profits of the partnership

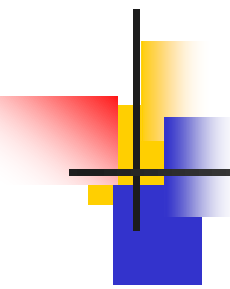
- Partnership - Limited by Shares
 - Generally, it is a company that combines the features of Limited Partnership. Where liability of atleast one member is unlimited
 - Liability of other members limited to their Share Capital

- Silent Partnership
 - Similar to Limited Partnership
 - Identity of silent partner may not be made Public
 - Liability limited to fixed percentage of debts or limited to contribution



Partnership under Taxation Laws - Classification

- Important classification: Two types
 1. Taxable
 2. Fiscally transparent
- Terminology for Entity
- Legal Entity, person and legal person
- Body (Civil & Common Law)
- Unit (OECD commentary)
- Foreign Business Organisation (Inland Revenue UK)



Partnership under Taxation Law - Classification

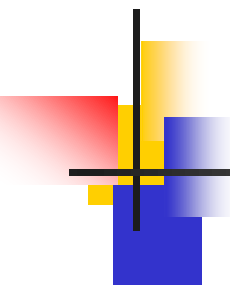
- Terminology

- Non-transparent

- Taxed as Company
 - Legal entity
 - Taxable Unit
 - Separate taxable entity
 - Non Transparent
 - Opaque

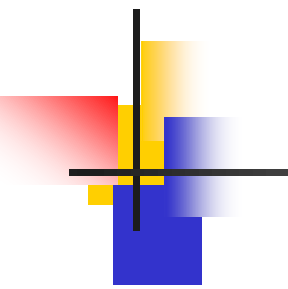
- Transparent

- Taxed as Partnership
 - Pass through
 - Fiscally Transparent
 - Flow through
 - Disregarded
 - Transparent



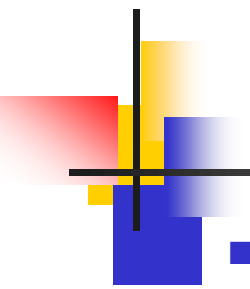
Taxation Law - Country Approach

- Taxed as corporations
- Election to be taxed as corporation
- Taxation of Partners/Members collected from partnership
- Taxation as fiscally transparent entity



Taxation of Partnership Firms - Double Tax Convention (DTC)

- Introduction to issues of International taxation
- Is Partnership entitled to DTC benefits
- If not, are the partners entitle to those treaty benefits
- What treaty Articles are applicable
- Issues when States involved, decides, different classification of the entity
- Conflict of qualification

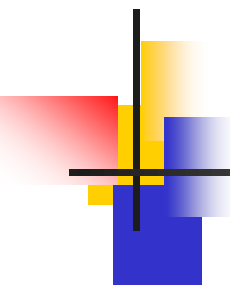


Taxation under DTC-Introduction

- OECD Report

Committee on Fiscal Affairs published a report entitled “Issues in International taxation - The application of the OECD Model Tax Convention to Partnerships” (the Report)

- Partnership according to Civil or commercial laws
- System of taxation where both Residency and Source give rise to taxation, there are risk of Double taxation or non-taxation associated with
 - a) the different classification of a given entity in the State of Residence and the State of Source
 - b) the different tax treatment in these States of a given entity despite common classification



Taxation under DTC - Treaty benefits

- Relevant Articles in OECD/UN models

Art.1

Persons covered

The convention shall apply to Persons who are residents of one or both of the contracting States

Art.3(1)(a)

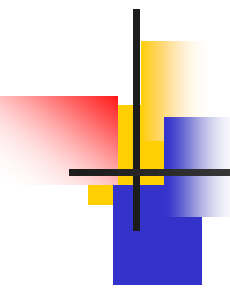
Persons

Art.4

Resident

Art.2

Taxes Covered

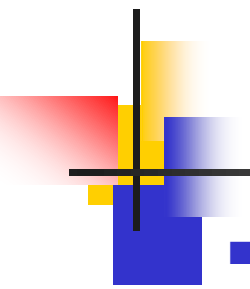


Taxation under DTC - Treaty benefits

- Persons

An Individual, a Company and any other body of persons [Art.3(1)(a)]

A Partnership is a person. A Partnership is either a company or constitutes other body of persons [Commentary to Article 3 at paragraph 2]



Taxation under DTC - Treaty benefits

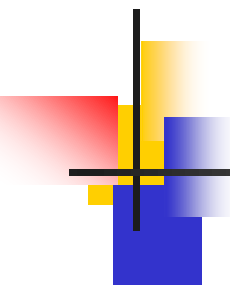
- Resident: [Art.4(1)]

Any person who under the laws of the that State is liable to tax therein by reason of his domicile, residence, place of management, or any other criterion of a similar nature

- Partnership: If treated as a company liable to corporate taxation therefore Resident and therefore may claim treaty benefits

➔ Fiscally transparent → not liable to tax → not a Resident

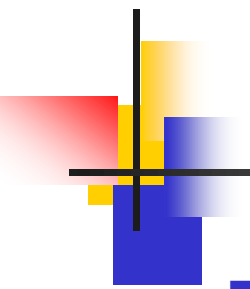
- May not claim tax benefits under DTC
- Members of the Partnership - may claim the treaty benefits
- Mixed character: Benefit is doubtful



Taxation under DTC - Partnership Report

- Paragraph 40 of 1999 report

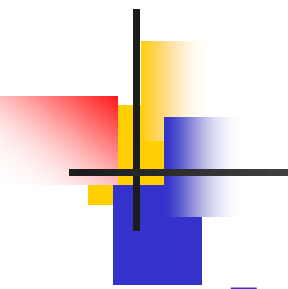
“For the purposes of determining whether the partnership is liable to tax the real question is whether the amount of tax payable on the partnership income is determined in relation to the personal characteristics of the Partner”



Taxation under DTC

OECD Model conventions on Partnership

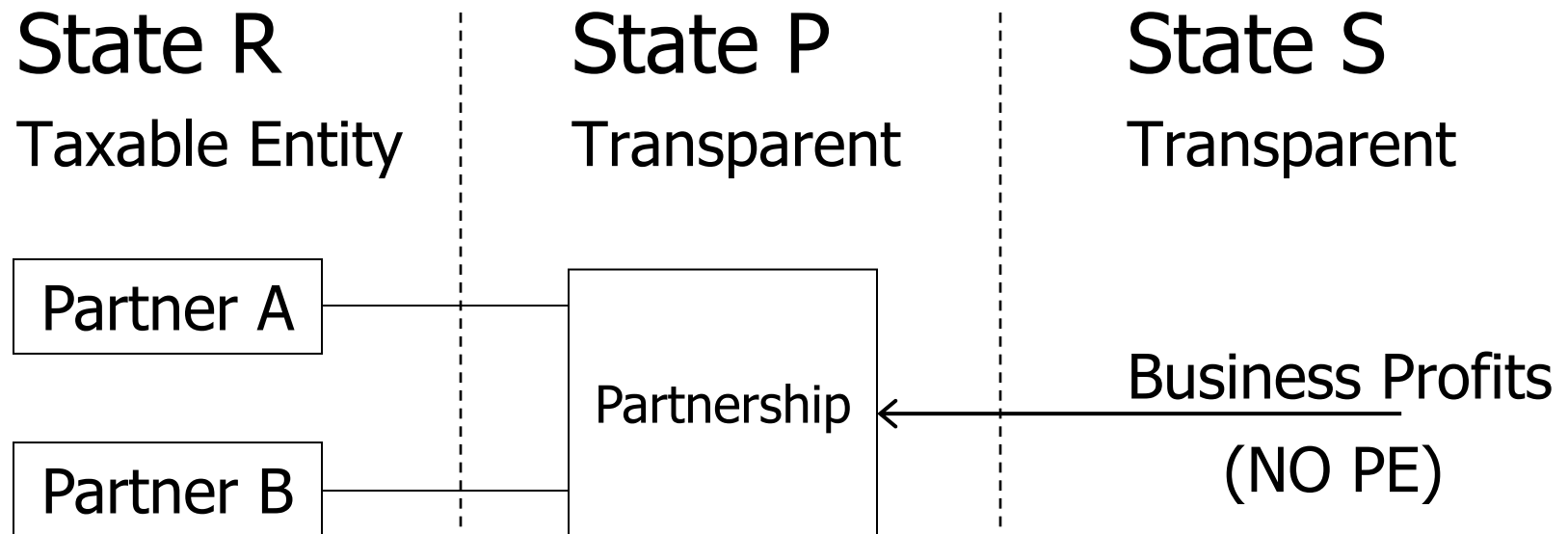
- Article 1: Paragraph (2) to (6.7)
- Article 3: Paragraph (2), (9) to (10.1)
- Article 4: Paragraph (8.8)
- Article 5: Paragraph (19.1)
- Article 10: Paragraph (11) and (27)
- Article 13: Paragraph (26) and (28.5)
- Article 15: Paragraph (6.1) and (6.2)
- Article 23: Paragraph (32.4) to (32.7), (69.1) to (69.2)
- Article 24: Paragraph (7) and (16)
- Article 26: Paragraph (19.3)



Taxation under DTC – Conflict of Attribution (CoA)

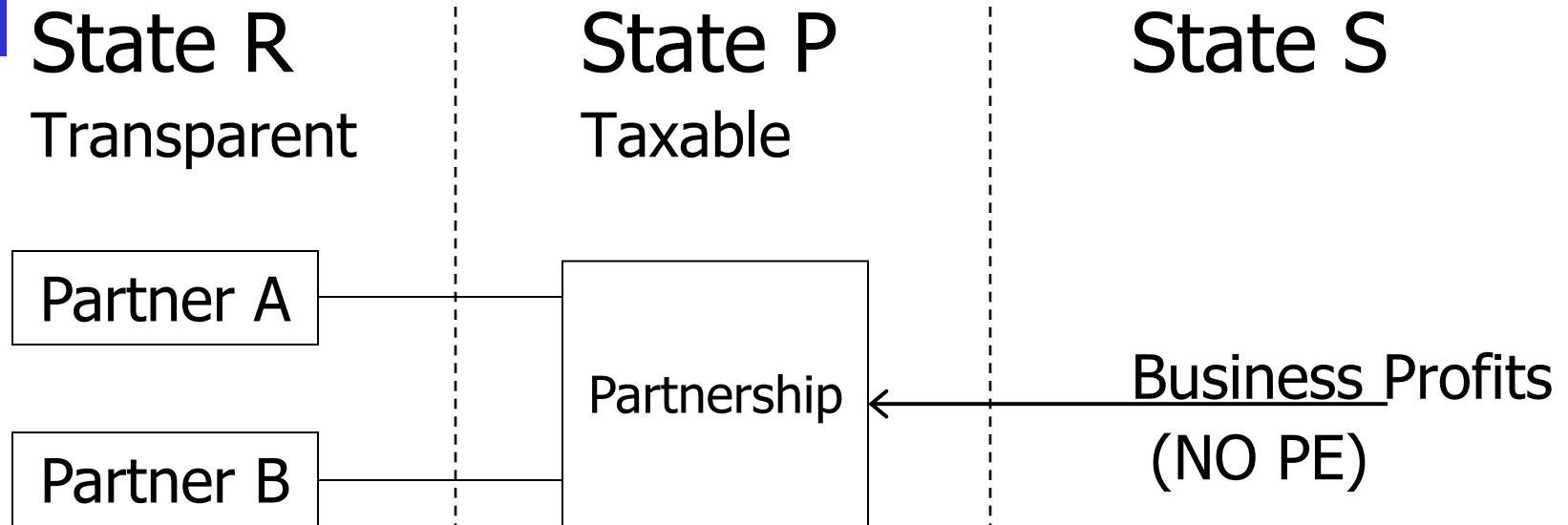
- Different classification of entity in State Source by Partners in R (Resident) State
 - Treating entity as taxable instead of non taxable
 - Non taxable instead of taxable
 - Conflict of qualification
- Income treated differently when paid to partner

Taxation under DTC: CoA-I



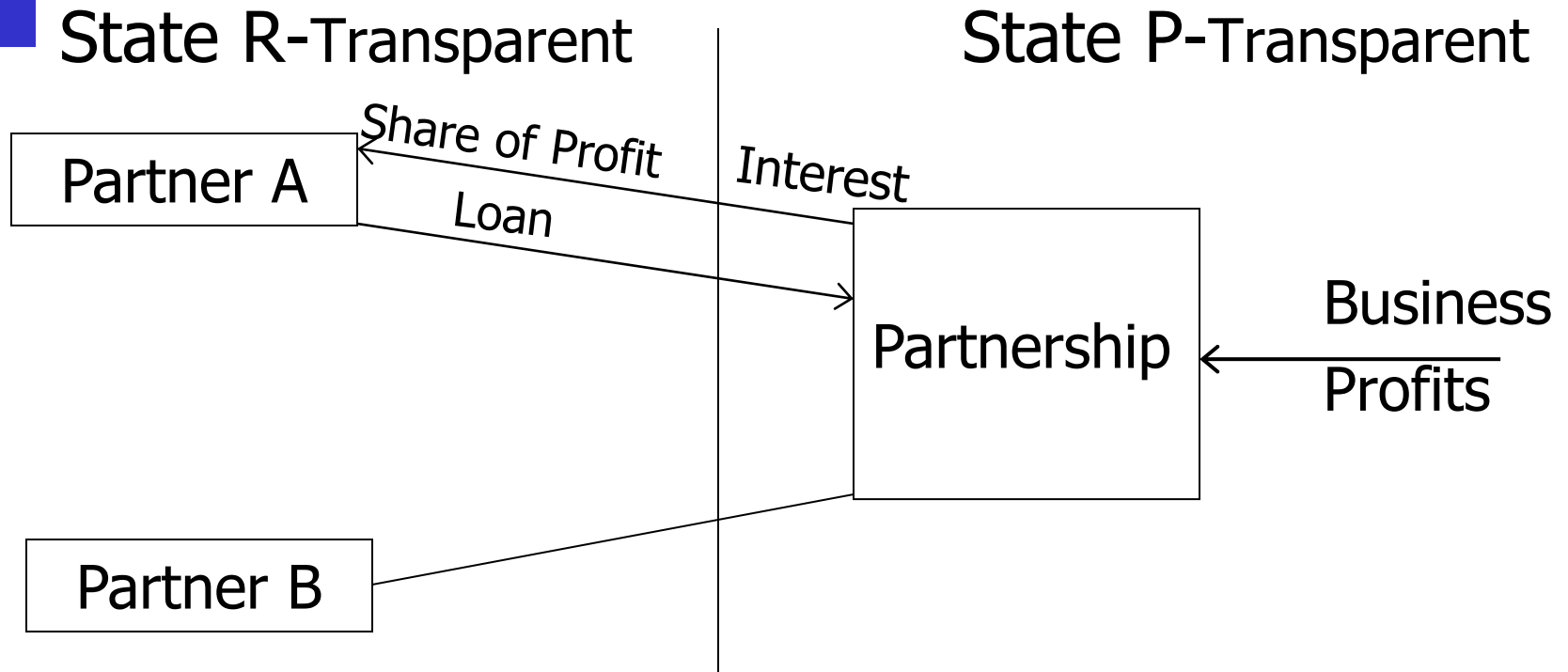
- State P & S treats, P as transparent therefore treats A & B as tax payers, whereas State R allocates income to P as it treats the entity as taxable and therefore income is not liable to tax in State R.

Taxation under DTC: CoA-II



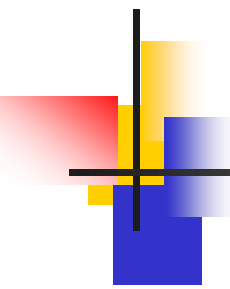
- State S & P treats P as taxable so income is taxed by State P. State R treats it as transparent, tax is paid by A in State R
- Subsequently when dividend is paid by P, withholding tax in State P will also apply

Taxation under DTC – Conflict of Qualification (CoQ)



State R treats receipt as profit

State S treats the payment as Interest



Taxation under DTC (CoQ)

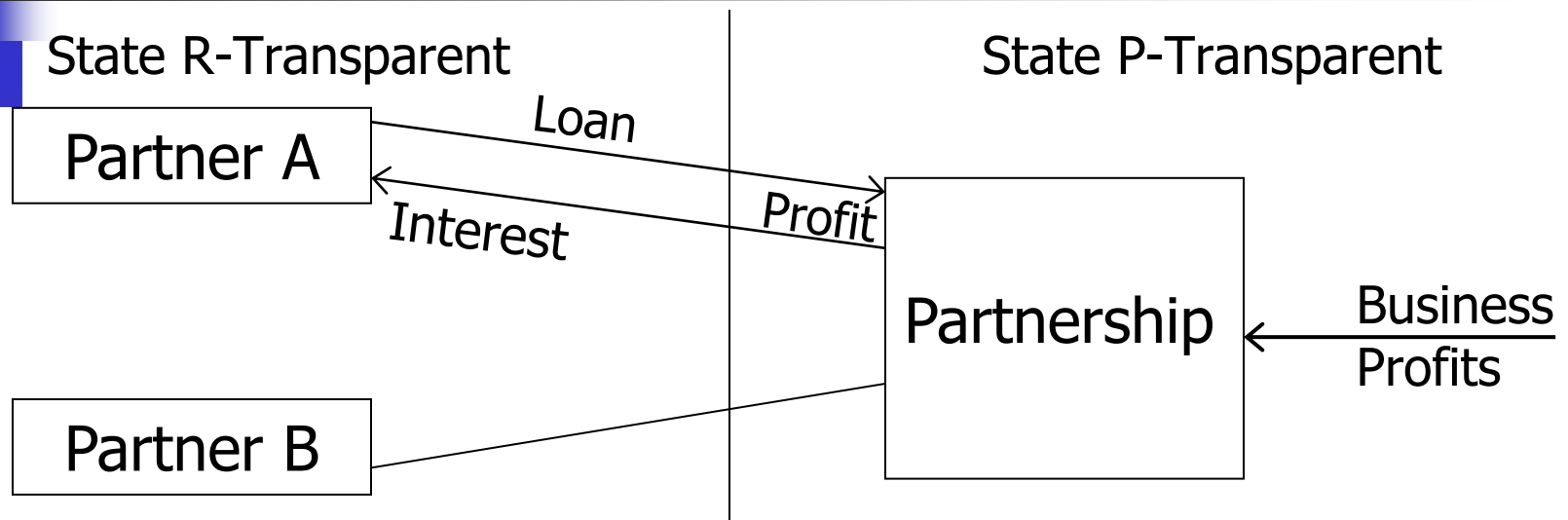
Partner A is entitled to P-R DTC, there is disagreement between State R & State P as to which provisions of the DTC are applicable?

- State P is a Source State applies its DTC and treats the payment as interest from partnership. It also determines that A being a tax payer in State R, Art.11 of DTC will apply to A to restrict withholding @ 10%.

Under DTC of A, it is not an interest but business profits taxable under Art.7

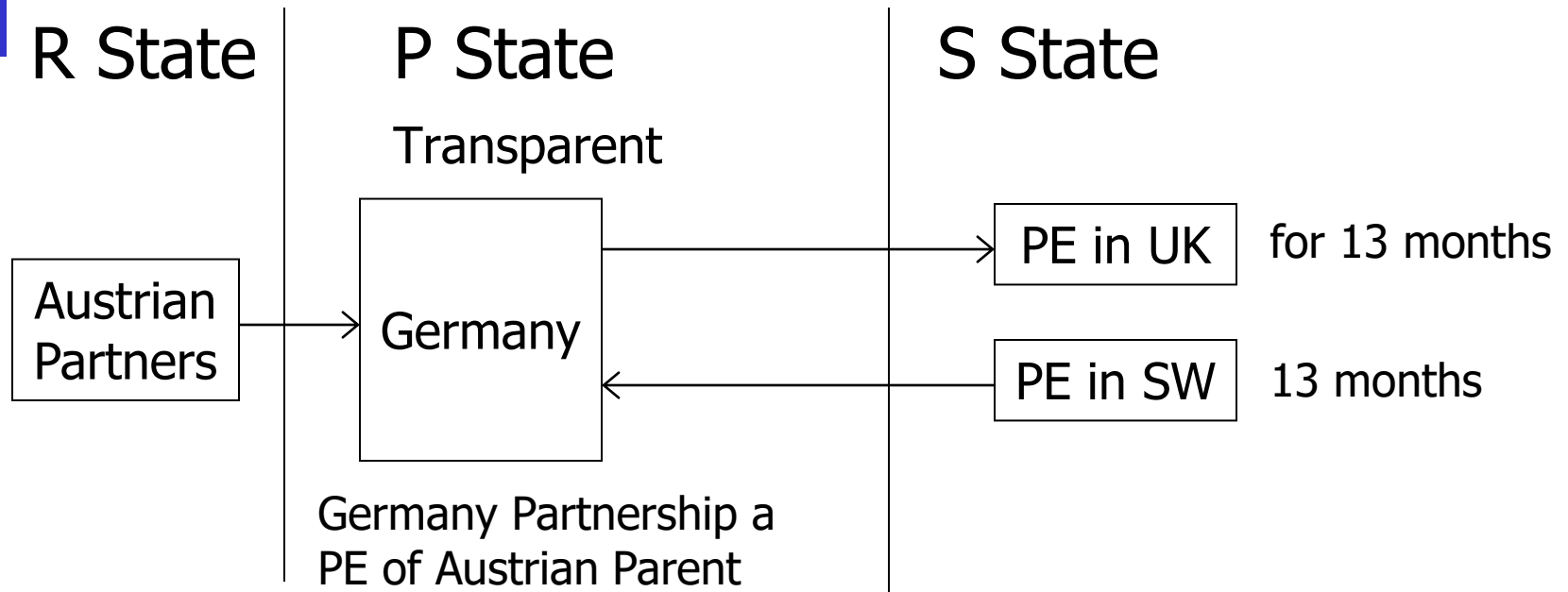
- Consider Exemption method in State R
- Also consider if no withholding on interest income in State P.

Taxation under DTC (CoQ)

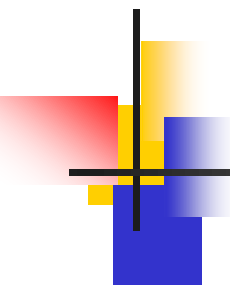


- Here State P considers the payment as distribution of share of Partner A and therefore Art.7 can be applied by State R. State R however considers it as receipt of Interest subject of Art.11 of the DTC.
- Consider application of Art.23A or 23B for credit method applicable to receipt of interest credit of taxes cannot be more than what is permitted under Art.11(2)
- Consider no withholding tax under Art.11(2) of the DTC.

Triangular Situation – Partnership with Sub PE



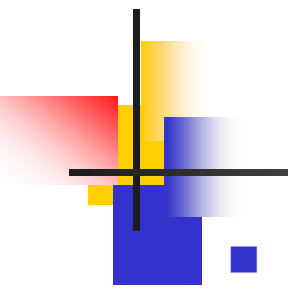
- Austrian Partners have Constituted PE as per the Austria-Germany tax treaty
- Germany can tax only profits allocated to PE in Germany
- How profits of UK PE & SW PE can be allocated, to German PE or to Austrian Resident under Austria-UK or Austria-SW tax treaty?



Taxation under DTC – Advantage of Partnership

- US Co. is profitable, its subsidiary (100%) in France, F Co., is making losses and it is expected to continue making losses for couple of years.

The legal form of F Co. is SA, a corporation under US check the box Rules, US Co. wants to check the box for F Co.?



Income Tax Act, 1961 (ITA) & Partnership

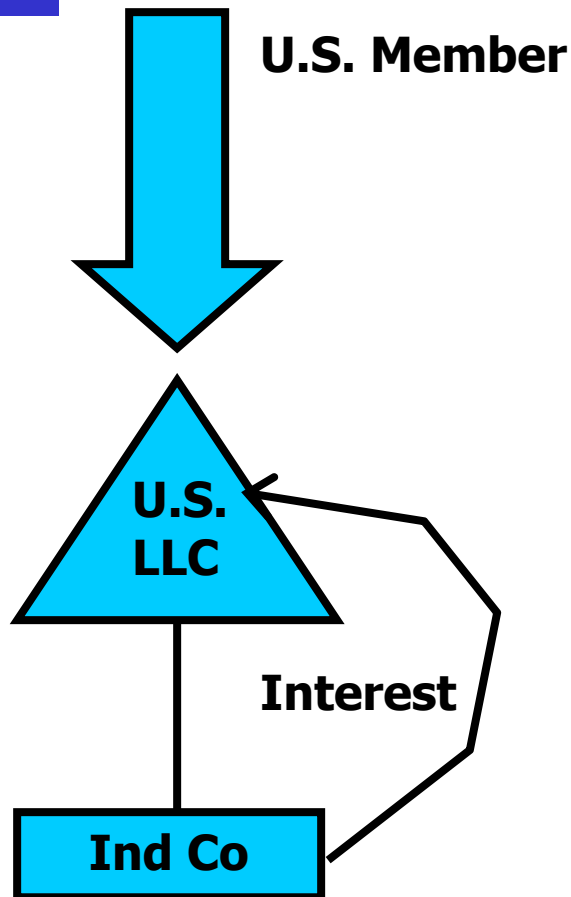
- Tax law recognizes various entities
 - Company (including foreign company), Partnership Firm, AOP
 - No specific rules on circumstances under which an foreign entity would be classified as company/partnership/ AOP (or even disregarded)
 - Determination would have to be based on legal characteristics of the entity based on foreign law
 - Can create practical as well as technical difficulties in determination

- Entity Classification can have bearing on the following:
 - Determination of residency
 - Eligibility for treaty benefits
 - Nature of income derived by entity/ members and tax treatment thereof
 - Application of provisions in the Act which are entity specific

India-U.S. Tax Treaty

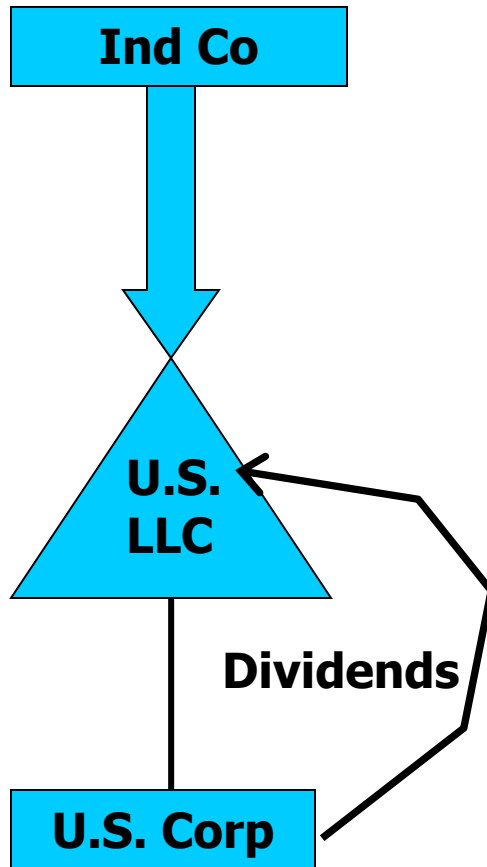
- Article 4(1)(b):
 - The term “resident” means any person who, under the laws of that [residence] state, is liable to tax therein ... provided, however, that in the case of income derived or paid by a partnership... this term applies only to the extent that the income derived by such partnership...is subject to tax in that state as the income of a resident, either in its hands or in the hands of its partners...
- Issues arising from the treaty:
 - Under which state's laws is it determined whether the entity is a partnership?
 - When is income derived by a partnership “subject to tax” in the residence country?
 - To what extent does the treaty apply when the entity is established in a third state?
 - Can a U.S. LLC which has elected to be taxed as a partnership be eligible for treaty benefits?

Application of India-U.S. Tax Treaty – Inbound Case

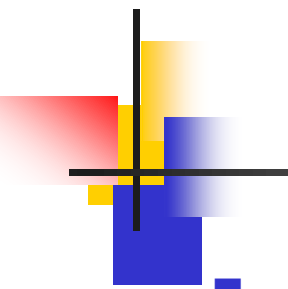


- US LLC “checks-the-box” and taxed as transparent entity in U.S.
 - U.S. Member taxed on interest
- India likely to regard LLC as “foreign company”
 - LLC not liable for U.S. tax by virtue of election
 - LLC may be denied treaty benefit as it is not a “resident”
- 1996 U.S. Model Treaty could prevent this result

Application of India-U.S. Tax Treaty – Outbound Case



- IndCo is member in US LLC which owns US Corp
- US LLC earns dividends from US Corp
- US LLC “checks-the-box” and taxed as transparent entity in US but as a taxable entity for India
- IndCo not liable for residence country tax on LLCs income
- Treaty benefits may be denied
- Similar result likely under 1996 US Model Treaty



India-U.K. Tax Treaty

- Article 3(1)(f):
 - Partnership not considered as a “person” for purpose of treaty, subject to exception in Art. 3(2)
- Article 3(2):
 - A partnership treated as a taxable unit in India shall be treated as a person
- Issues arising from the treaty:
 - Applicability of treaty benefits to U.K. general partnerships?
 - Applicability of treaty benefits to U.K. LLPs?
 - Can a U.K. partnership be treated as a taxable unit in India and qualify for treaty benefits?

Tribunal High Court Rulings on Taxation of Law Firms

- DCIT v Chandbourne & Parke LLP (2005) 93 TTJ 734, Maharashtra State Electricity Board v DCIT (2003) 90 ITD 793 [Freshfields case], Clifford Chance UK v DCIT (2002) 76 TTJ 725, IT Appeal 181 decided by Bombay High Court on 26th Dec'2008, High Court in its decision following the Judgement of Supreme Court in Ishikawama Harima 288 ITR 408 held that if Services are rendered within India and are part of Business or Profession of such Non-Resident Person in India then only such services will be chargeable to tax in India.
 - Taxability to be determined under Article 15 (Independent Personal Services) of the treaty
 - Law Firms taxable if they had a fixed base or if any of its personnel spent more than 90 days in India for providing services
 - Multiple counting of common days to be avoided for measuring 90 day test
 - Residency of partnership and applicability of treaty not discussed in the rulings

Tribunal High Court Rulings on Taxation of Law Firms (con't)

- Linklaters LLP Vs Income Tax Officer – International Taxation [ITA no 4896/Mumbai /03 dt. 16.07.2010]

- Facts:

The assessee, a UK based law firm, rendered services to clients with operations / projects in India. The assessee did not have an office in India and to render the services, its' partners and employees visited India. The assessee took the view that as it did not have a permanent establishment (PE) or fixed base in India, its income was not assessable to tax under Articles 7 or 15 of the India-UK DTAA. The AO took the view that as the assessee had furnished services in India for more than 90 days, it had a PE under Article 5(2)(k) of the DTAA

Tribunal High Court Rulings on Taxation of Law Firms (con't)

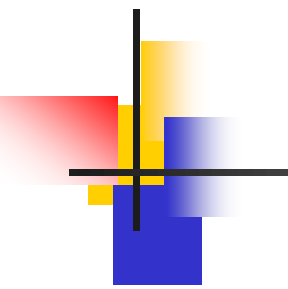
- Linklaters LLP Vs Income Tax Officer – International Taxation [ITA no 4896/Mumbai /03 dt. 16.07.2010]
- On Assessee's entitlement to treaty benefits, Tribunal held: On merits, though a UK partnership is a "person" under Article 3(2), the question is whether it is a "resident of UK". Article 4(1) defines a "resident of a Contracting State" to mean a person "liable to tax in that State by reasons of domicile, residence, place of management or any other criterion of similar nature". According to the OECD Report on Partnerships, mere computation of income at the level of partnership is not sufficient to hold that the partnership firm is 'liable to taxation' in the residence country. However, this view is not correct and has also been rejected by India. A partnership is eligible to the benefits of the DTAA provided the entire profits of the firm are taxed in UK – whether in the hands of the firm (after determining taxable income in relation to the personal characteristics of the partners) or in the hands of the partners directly

India – UK DTAA: Article 15 – Independent Personal Services

1. Income derived by an individual, whether in his own capacity or as a member of a partnership, who is a resident of a Contracting State in respect of professional services or other independent activities of a similar character may be taxed in that State. Such income may also be taxed in the other Contracting State if such services are performed in that other State and if :

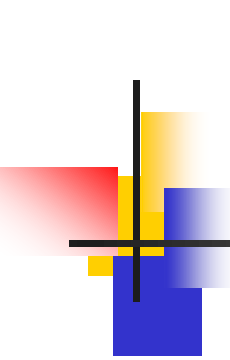
- (a) he is present in that other State for a period or periods aggregating to 90 days in the relevant fiscal year ;
or
- (b) he, or the partnership, has a fixed base regularly available to him, or it, in that other State for the purpose of performing his activities ;

but in each case only so much of the income as is attributable to those services.



India – UK DTAA: Article 15 – Independent Personal Services (con't)

- 2. For the purposes of paragraph 1 of this Article an individual who is a member of a partnership shall be regarded as being present in the other State during days on which, although he is not present, another individual member of the partnership is so present and performs professional services or other independent activities of a similar character in that State.
- 3. The term “professional services” includes independent, scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants



India – UK DTAA and Indian Income-Tax Act: Interplay

- Sec. 9(1)(i) of I.T. Act
-- Business Connection
- Article 7(1) of India – UK DTAA
-- Business Profits
- Article 5 (2)(k) of India – UK DTAA
-- Permanent Establishment

India – UK DTAA and Indian Income-Tax Act: Interplay (con't)

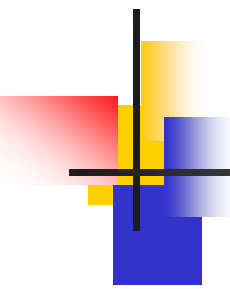
Sec. 9(1)(i) of I.T. Act -- Business Connection

- 9. (1) The following incomes shall be deemed to accrue or arise in India :—

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India or through the transfer of a capital asset situate in India.

[Explanation 1].—For the purposes of this clause—

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;



India – UK DTAA and Indian Income-Tax Act: Interplay (con't)

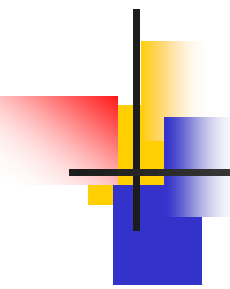
Article 7(1) of India – UK DTAA -- Business Profits

- 1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent, establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment.

India – UK DTAA and Indian Income-Tax Act: Interplay (con't)

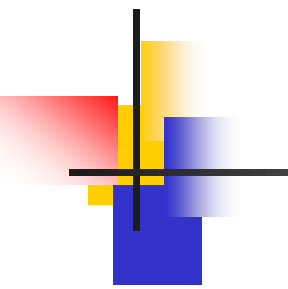
Article 5(2)(k) of India – UK DTAA – Permanent Establishment

- 2. The term “permanent establishment” shall include especially :
 - (k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:
 - (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or
 - (ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period



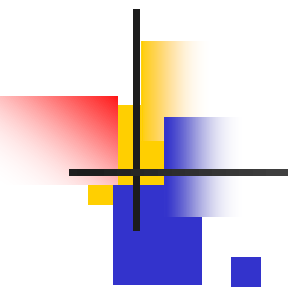
Country practices I

- Partnerships are always regarded as liable to tax
- France does not agree that when treaty application is refused to a partnership, the partners would always be entitled to the treaty benefits.



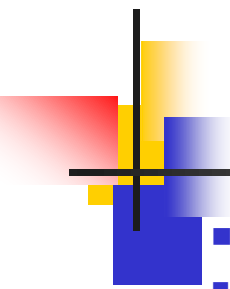
Country practices II

- Canada – Germany Treaty
- Article 29 Miscellaneous rules
 2. It is understood that nothing in the Agreement shall be construed as preventing:
 - (a) Canada from imposing a tax on amounts included in the income of a resident of Canada with respect to a partnership, trust or controlled foreign affiliate, in which that resident has an interest;



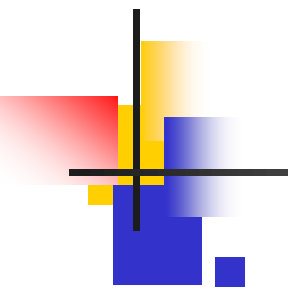
Country practices III

- Art. 7 (6) Germany – Kazakhstan
- This Article shall also apply to income from participation in a partnership. It shall further apply to remuneration received by a partner from the partnership for activities in the service of the partnership and for the granting of loans or the provisions of assets, where such remuneration is attributable under the tax law of the Contracting State in which the permanent establishment is situated to the income derived by a partner from that permanent establishment.



Country practices IV

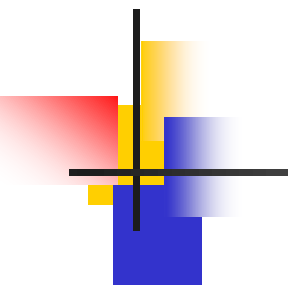
- Protocol Finland – Germany
- (a) With respect to a partnership resident in the Republic of Finland, the following shall apply:
 - (i) Income from sources within the Federal Republic of Germany may be taxed in that State; however, to the extent it can be attributed to the participation in the partnership of a person who is not a resident of the Federal Republic of Germany, Articles 6 through 17 and 21 of the Convention shall apply; this income may be taxed in the Republic of Finland, but a taxcredit is granted in accordance with Article 23, paragraphs 1 and 6 of the Convention.
 - (ii) Income from sources within the Republic of Finland may be taxed in that State; however, if they can be attributed to the participation in a partnership of a person who is not a resident of the Republic of Finland, Articles 6 through 17 and 21 of the Convention shall apply; for the taxation in the Federal Republic of Germany, this income is treated in accordance with Article 23, paragraphs 5 and 6 of the Convention.
 - (iii) Income from sources other than those mentioned under (i) and (ii) which:
 - -- can be attributed to the participation in a partnership of a person who is not a resident of the Federal Republic of Germany may only be taxed in the Republic of Finland;
 - -- can be attributed to the participation in a partnership of a person who is a resident of the Federal Republic of Germany may only be taxed in that State.



Country practices IV

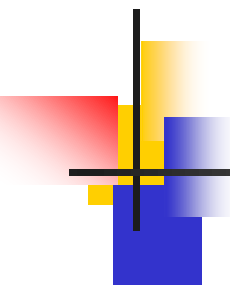
■ Protocol provision I Netherlands – Poland

In case an entity that is treated as a body corporate for tax purposes is liable as such to tax in a Contracting State, but the income of that entity is taxed in the other Contracting State as income of the participants in that entity, the competent authorities shall take such measures that on the one hand no double taxation remains, but on the other hand it is prevented that, merely as a result of application of the Convention, income is (partly) not subject to tax.



Country practices V

- USA
- Check the box rules
- Regulations sections 301.7701-2 and 301.7701-3
- Right for eligible entities to elect to be treated as a company, as a partnership or to have the entity disregarded altogether



Indian Partnership Act, 1932 & LLP Act, 2008

Particulars

Partnership

Limited Liability Partnership

- | | | |
|-------------------------|---|--|
| ■ Liability of Partners | ■ Unlimited Personal liability of each Partner | ■ Limited to the extent of Capital Contributed by each Partner |
| ■ Registration | ■ Can be registered. Registration is not compulsory | ■ No Personal liability except incase of Fraud, Wrongful act, etc. |
| | | ■ LLP is incorporated under LLP Act and incorporation is mandatory |

Indian Partnership Act, 1932 & LLP Act, 2008

■ Particulars

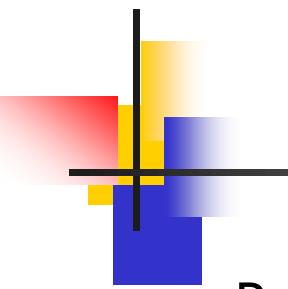
- Agreement
- Legal Status
- Participation

Partnership

- Written agreement is not essential
- Not a legal entity separate from its partners
- Each partner can take part in the business of firm but agreement can provide to the contrary

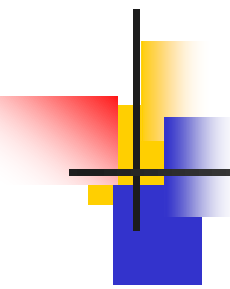
Limited Liability Partnership

- Incorporation document essential
- It is a legal entity separate from its partners, having perpetual succession
- Each partner can take part in business of LLP, but agreement can provide to the contrary



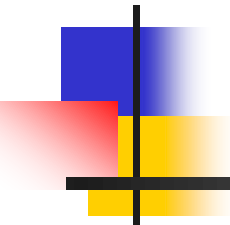
Indian Partnership Act, 1932 & LLP Act, 2008

<u>Particulars</u>	<u>Partnership</u>	<u>Limited Liability Partnership</u>
■ Mutual Agency	■ Every partner of the firm is agent of firm and also of other partners. He can bind partnership firm as well as other partners by his Acts	■ Every partner of LLP is an agent of LLP but not of other partners. Thus he can bind LLP by his acts but not other partners
■ Liability for Statutory Compliance	■ All partners are liable	■ Only designated partners are liable



LLP & ITA

- Whether a person as defined u/s. 2(31)
- A legal person under Civil Law
- A separate taxable unit as it is liable to taxed in India
- Other attributes of taxable entity



Thank You
