Have Changes in Tax Rates for Indian Companies taken the Shine off LLPs?

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If an MNC wants to Invest in India, the Company structure seems attractive. For Indian promoters, LLPs still appear to be a better option.

Limited Liability Partnership (LLP) is the preferred legal vehicle for a lot of Indian promoters and Multinational Companies for setting up their business in the Country. Among many advantages that LLP offered was the better Income-Tax regime for it.

However, with sweeping changes to the Tax rates applicable to Indian Companies in the recent past and the Amendments Proposed in the recent Budget, the debate taking place among Tax professionals and businesses is whether LLP has lost its charm and has it become inferior to the Company structure. While there is no straight answer to this as the decision for setting up an LLP or a Company needs to be looked into from Business, Legal, Regulatory, and Tax Perspective, the Company form of structure appears to have an edge over LLP in certain scenarios from an Income - Tax Perspective.

The Income - Tax rate for Companies and LLPs on their Income were almost similar, i.e. 34.94 % per cent (**including maximum surcharge and cess**) until September 20, 2019, when the Tax rates for Companies were reduced to 17.16 % per cent and 25.17 % per cent (including maximum surcharge and cess), and even minimum alternate Tax **(MAT)** was abolished. With such reductions, the Company structure gained some ground. However, DDT (Dividend Distribution Tax) at 20.56 % per cent (Including maximum surcharge and cess) applied by Companies while distributing profits in the form of Dividend to their Shareholders continued to give LLPs an edge over the Company structure. This is because there was no Tax on the Distribution of Profits by LLPs.

As far as Multinational Companies - (MNCs) were concerned, Dividend from their Indian Subsidiary was Exempt from Tax in India. For Indian promoters, Dividend above Rs.10 lakh was subject to Dividend Tax at the rate of 10 % per cent **(exclusive of maximum surcharge and cess**). The share of profit from an LLP is exempt for the partners of the LLP from the Indian Income -Tax perspective.

While the recent Budget has proposed to do away with DDT for Companies in India, it has announced to Tax such Dividend Income in the hands of shareholders at the applicable rate. With these Dividend-related Tax proposals, while super-rich Indian shareholders might suffer Tax up to 42.74 % per cent on their Dividend Income, foreign shareholders, including MNCs, may be able to avail the rate of Tax under respective treaties and reduce Tax on Dividend Income to a large extent.

Applying the Tax treaty rate, if the foreign shareholder is based in the Netherlands or Mauritius, Dividend Tax in India could be as low as 5 % per cent, and for jurisdictions like Singapore, the United Kingdom and the United States, and Dividend Tax in India could vary from 10 % per cent to 15 % per cent. Of course, these rates are subject to fulfilment of certain conditions.

In nutshell, in a scenario where an MNC wants to invest in India from certain overseas Jurisdictions, the Company structure seems relatively attractive than the LLP structure with the effective Tax rate for an Indian subsidiary as low as 28.91 % per cent (Lower Corporate Tax plus Dividend Tax). The effective Tax rate applicable to LLP could be 34.94 % per cent. However, an MNC based out of a Jurisdiction like the US may still prefer the Indian LLP structure as for it the effective Tax rate for setting up an Indian Company will be 36.39 % per cent.

As far as Indian Promoters are concerned, LLPs still appear to be better than the Company Structure. The effective Tax rate in the hands of Indian promoters in the LLP structure could be approximately 34.94 % per cent, while in a Company structure it could go up to 57.16 % per cent.

One needs to do a specific analysis based on the facts of each case, and the effective Tax rate could vary depending on the Jurisdiction of foreign shareholders, Tax profile of promoter, and Tax regime applicable to such Indian entity. But the recent Budget proposal, if accepted, will certainly make investors think twice before selecting a legal structure for doing business in India.

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