

Taxing LLPs at entity level a dampener for PE, VC companies

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Private Equity (PE) and Venture Capital (VC) firms which have been using the trust route as vehicle for funds to pass through the tax at entity level are divided if they should opt for Limited Liability Partnerships (LLPs).

The government had introduced the LLP mechanism on April 1 this year, giving PEs and VCs hope of an alternative to the trust route. However, yesterday's Budget announcement with regard to taxing LLPs at the entity level has created some disappointment. "It is out of sync with international practices," said Nishith Desai, founder of Mumbai-based corporate law firm Nishith Desai Associates. "In a cross-border scenario, issues relating to application of tax treaties and availability of tax credit to foreign partners will arise. There are also problems on the treatment of losses in the hands of the partners," he said.

Internationally, PE and VC firms work in partnership, where investors are limited partners (LPs) and fund managers general partners (GPs). In this,

the partners are taxed at individual levels. But in India, partnership firms are taxed at the entity level and there is no legal position of LPs and GPs. This gave rise to the trust route, which allowed a pass-through to taxation at the entity level. But taxation at individual levels gave the flexibility to plan an account to set off some taxes.

"The industry would have liked to have an option for taxation at entity or individual levels," said Rajeev Agarwal, chief executive officer, Ambit Pragma Ventures. The industry primarily attracts investments from institutions and high net worth individuals (HNIs) from the US and Europe for PE and VC business. But now since this business is witnessing a growing number of Indian investors, market players are divided over the government's announcement.

"Taxation at the entity level for LLPs definitely makes sense for onshore investors, although it has no meaning for offshore investors," said Shahzad Dalal, vice-chairman and managing director, IL&FS Investment Managers. "Operating at the trust level is amorphous and is a much neater structure," he said.

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