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Brief analysis under Income Tax and FEMA of Indian Resident investing in USA LLC or Inc.

In this note we shall discuss briefly about taxability and FEMA regulations in relation to Indian resident's investment in LLC and Inc. in USA

INC.

INTRODUCTION

Inc. is an abbreviation for **Incorporated** when it is used after a company's name. Inc. is a corporate body which issue shares of stock to their owners, who are called shareholders. Inc. **can issue stock certificate**. An issued stock certificate proves that the holder of the certificate has an ownership stake in a corporation.

TAXABILITY OF INC.

There are **two kinds** of Inc. for tax purposes namely C corporation and S corporations. S corps are restricted to maximum 100 shareholders whereas C corporations have no restrictions on number of shareholders. In case of S-Corp, only **US residents** can be the member whereas in case of C-Corp there is no such restriction. **Therefore, Indian residents cannot be a member of S-Corp.**

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S-Corp is a **pass-through entity** or transparent entity i.e., it passes all its income on to the owners or investors of the business whereas C-Corp is not a pass-through entity, it is an opaque entity i.e., shareholders are only taxed in relation to any profits actually distributed by way of dividend.

In case of C-Corp, profits are taxed first at the corporate level and again the recipient of dividends have to pay tax at the individual level which leads to **double taxation** whereas S-Corp are only taxed at individual level because it is a pass-through entity. Income of Inc. Will not be taxable in hands if individuals unless it is distributed in any form.

TAXABILITY OF INDIAN RESIDENT IN CASE OF INC.

In case of Inc, **Indian resident** can earn income from US in the form of salary if he is a director and dividend if he is a shareholder. Since, global income of an Indian resident is taxable in India so income earned from INC by an Indian resident will be taxable in India and any tax withheld in USA will be available as tax credit while filing Indian Income tax return.

LLC

INTRODUCTION

LLC (Limited Liability company) is a legal business entity created by statute and governed by the laws of its operating state. Unlike Inc., LLC **cannot issue share certificate** as it does not have any shareholders. It has members who have share in the profits of the business. An LLC issues **Membership Certificate** that indicates ownership of a member. Each state in USA has its own rules regarding LLC, it can have either have one member or multiple members.

One member LLC is known as Single- Member LLC and multiple no. member LLC is known as General Partnership. A single-member LLC is like a sole proprietorship and a multi-member LLC is like a partnership. LLC will be **disregarded** completely for tax purposes if you are the only member.

TAXABILITY OF LLC

There are **four kinds** of LLC for income tax purposes namely:

- Sole proprietorship,
- Partnership,
- C-corporation and
- S corporations, (**Indian resident cannot be the member of S-Corp**).

LLC is taxed as a pass-through entity **by default** except in case of C-Corp. This means that the profits of the business are “passed through” to the members.

Profits and losses are reported on the individual tax returns for the owners, and not at the business level in case where entity opts to be a pass-through entity **except** in case of C-Corp. Any losses or operating costs of the business can be deducted on personal tax returns, which can help to offset other income. Profits and losses go straight through to the owners. Business income equals personal income, so the owner pays the tax on his or her personal return, and it is taxed at the individual rate. Since only the members pay tax, there is a **single level of taxation**.

TAXABILITY OF INDIAN RESIDENT IN CASE OF LLC

1. If LLC is a pass-through entity, then income will be taxable in the hands of resident in India as per the nature of the income earned by LLC.
2. If LLC opts for C-Corp taxation (i.e., non pass-through entity), Indian resident can earn income from US in the form of salary and profit and same will be taxable as per the local laws of India.

Note: Indian Resident cannot opt for taxation as S-Corp

Differences between INC. and LLC

<u>Basis</u>	<u>INC.</u>	<u>LLC</u>
Types of tax identity	C-Corp & S-Corp	Sole proprietorship, Partnership, S-Corp & C-Corp
Management Level	Shareholders, Directors, Officers etc. Shareholders are owners	Members and managing members. Members are owners
Taxation	Double taxation	Single taxation
Pass through entity	Profit or loss are not passed directly to members except S-Corp.	Profit or loss are passed directly to members except in case of C-Corp
Legal entity	Separate entity than members	Separate entity from partners, but members may be held liable for non-fiscal obligations
Limited Liability	Yes	Yes, but it is disregarded for tax purpose.
Source of income	Salary and dividend	Profit and salary
Share certificate	Inc may issue shares of stock and furnish a share certificate.	LLC cannot issue share.
Documents	Article of Incorporation	Article of Organization

Note- Indian Resident cannot opt for taxation as S-Corp in USA.

FEMA PERSPECTIVE

Where should the investment be made?

Overseas direct investment means direct investment outside India which means investments, either under the Automatic Route or the Approval Route, by way of

1. Contribution to the capital or
2. Subscription to the Memorandum of a foreign entity
3. Purchase of existing shares of a foreign entity either by market purchase or private placement or through a stock exchange, signifying a long-term interest in the foreign entity (Joint Venture JV or Wholly-Owned Subsidiary WOS).

As per the Master Direction on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad, Direct investments by residents in Joint Venture (JV) and Wholly Owned Subsidiary (WOS) abroad are being allowed, in terms of clause (a) of sub-section (3) of section 6 of the **Foreign Exchange Management Act, 1999, (42 of 1999)** read with [Notification No. FEMA.120/RB-2004 dated July 7, 2004](#), (GSR 757 (E) dated November 19, 2004), viz. **Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004**.

As per '**B.20. Overseas Direct Investments by resident individuals**' of the **Master Direction** stated above,

“With effect from August 05, 2013, a resident individual (single or in association with another resident individual or with an ‘Indian Party’ as defined in the Notification) satisfying the criteria as per Schedule V of the Notification, may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. The limit of overseas direct investment by the resident individual shall be within the overall limit prescribed by the Reserve Bank of India under the provisions of Liberalised Remittance Scheme, as prescribed by the Reserve Bank from time to time.”

From the above, it can be inferred that that a resident individual can make overseas direct investment in the **equity shares and compulsorily convertible preference shares** of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. It does not mention anything about investing in entities that offer participation rights/profit share etc. in place of securities.

Further an inference can be made from **Point 4 of FEMA 120/RB. Point 4 of FEMA 120/RB** allows overseas direct investment by stating that,

‘A person resident in India

a. may purchase a foreign security out of funds held in Resident Foreign Currency (RFC) account maintained in accordance with the Foreign Exchange Management (Foreign Currency Accounts) Regulations, 2000;

b. may acquire bonus shares on the foreign securities held in accordance with the provisions of the Act or rules or regulations made thereunder;

c. when not permanently resident in India, may purchase a foreign security from out of his foreign currency resources outside India;

d. may sell the foreign security purchased or acquired under clauses (a), (b) or (c).”

From the above it can be concluded that an Indian Resident can make overseas direct investment in foreign securities only like in equity shares, preference shares, debentures etc. FEMA 120 does not specify anything about investment in entities that offer participation rights/profit share etc. in place of securities.

Hence, it is advisable to invest in a **C-Corp INC** which can issue shares rather than investing in a **C-Corp LLC** as they do not issue shares and issue partnership rights.

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Thank you

