

**LIMITED LIABILITY PARTNERSHIP**

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**I. INTRODUCTION**

Despite rapid growth of the service sector in the last few years, service based organizations such as doctors, lawyers and accountants have not been able to grow to their full potential. The 'general partnership' has traditionally been the entity of choice for professional bodies and small enterprises. The partnerships in India which was till now, governed exclusively by the Indian Partnership Act, 1932, had some **apparent limitations and posed following hindrances:**

**Sole Proprietorship and Partnerships:**

- Largely unregulated and are being used by entities from small kirana stores to large international professional outfits
- Unlimited liability poses a significant hindrance to growth
- Traditional form of partnership does not permit expansion beyond 20 partners

**Companies:**

- Regulated entity with various compliance procedures
- Besides corporate tax, companies are also liable to dividend distribution tax

Due to the innate restraining characteristics of the existing forms, a need was felt to evolve a structure which would aid the growth of professional firms. In keeping with the international practices related to partnerships, the Government of India has enacted, the **Limited Liability Partnership Act, 2008** (the "Act") which was approved by the Lok Sabha on December 12, 2008 and came into force **with effect from January 9, 2009.**

**II. WHAT IS A LIMITED LIABILITY PARTNERSHIP:**

A LLP is a **body corporate**, with a **distinct legal entity** separate from that of its partners. It has perpetual succession and a **common seal**. A LLP, which is a separate legal person, will be liable to the third parties independent of the other partners. **Any change in its partners, will not affect the existence, rights or liabilities of the LLP. The primary intention of LLP is that its external structure should mirror that of the limited company but in terms of conduct of internal affairs it would be similar to traditional partnership.** The need was recognized for small businesses which may require a framework that provides elasticity and is better suited to the needs of service, knowledge and technology based enterprises, without forcing upon them detailed legal and procedural requirements intended for large widely held companies. **The concept tries to bring in the advantages of both partnership firm and a company, while trying to mitigate their drawbacks.** The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be suitable vehicle for small enterprises and for investment by venture capital.

- LLP had its **origin in Italy**. Eventually the idea of LLP spread out to other European countries, particularly France, Germany, Great Britain and other countries like U.S.A., Singapore and Japan. The LLP Act, 2008 heavily leaned on UK and Singapore Acts. With the gush in cross border economic activities, small and medium entities carry on their businesses competing with large enterprises. Recognition of legal entity status to them became indispensable.
- **MSMEs Development Act, 2006** was passed and the **Acts governing the C.A.s, C.S.s and C.W.A.s professions were amended in 2006. Naresh Chandra Committee Report II(2003)** indirectly suggested this form of organization by suggesting to reduce the regulatory blow of the Companies Act. Directly, it came out as a recommendation of the **J.J. Irani Committee(2005)** to be adopted as a new form of business. A need was also felt for a new corporate form that would provide an alternative to the traditional partnership for professionals such as accountants, lawyers, architects etc.



### III. INTERNATIONAL SCENARIO:

The LLPs are very popular form of business in *United States and United Kingdom*.

**US:** LLPs emerged in the early 1990s. While only two states allowed LLPs in 1992, over forty had adopted LLP statutes by the time LLPs were added to the Uniform Partnership Act (UPA) in 1996. In the US, each individual state has its own law governing their formation. Although found in many business fields, the LLP is an particularly popular form of organization among professionals, particularly lawyers, accountants and architects.

**UK:** The LLP is a recent innovation of UK law and has been introduced by the LLP Act 2000. The Act became law on 1/4/2001. In a LLP, all partners have a form of limited liability, similar to that of the shareholders of a corporation. However, the partners have the right to manage the business directly, and (in many areas) a different level of tax liability than in a corporation. Under UK law, the LLP is a "*fiscal transparency*". In other words, it is not subject to taxation. Only the members are liable to taxation. The same has also been *reflected in the India UK Tax Treaty (DTAA)*.

### IV. ADVANTAGES OF LLP:

- a. A LLP provides *limited liability benefit* to its partners. Though personal liability arises in case of wrongful acts or omissions, a partner is not personally liable for such acts or omissions of other partner
- b. As in general partnership, the *internal structure* of LLP can be organized *as per mutual agreement*
- c. The *requirements* as to board meetings, resolutions, annual meetings, etc. are not there in case of LLP. There is less paperwork in case of LLPs, even the formation of a partnership agreement is *not mandatory*. The Act provides for default provisions in Schedule I. *The filing requirements are also less as compared to a company*
- d. The *salaries and other compensation*, distribution of profits paid to partners are *not questionable* by any authority as in case of companies
- e. There is *no limit as to the maximum number of members* in a LLP
- f. Since LLP is a *separate legal entity*, its existence is not effected by the entry or exit of partners
- g. Before the introduction of this concept, professionals like accountants, lawyers and others had only two options for forming an organization – sole proprietorship or partnership, both requiring unlimited liability of the owners

### V. DISADVANTAGES OF LLP:

- a. *Low public perception*. Due to limited liability, it is difficult for the public to lay faith in its process and functioning. *Example*, consider a project involving redevelopment of a building. In case of a LLP, it may happen that a few partners may leave the project undone. In case of a low capital LLP with high secured creditors, there is a good chance that inhabitants of the society are left hapless and homeless.
- b. *Lack of financial secrecy*
- c. *Mandatory registration* with ROC
- d. *Taxation and FDI issues* not resolved yet
- e. *Accounting Standard* not yet notified

### VI. COMPARATIVE ANALYSIS OF LLP WITH PARTNERSHIP FORM OF BUSINESS AND PRIVATE LIMITED

**LIABILITY COMPANY FORM OF BUSINESS:**

The Partnership form of business fails to recognize the difference between Partnership and Partners. It also restricts the maximum number of partners to 10, in case of banking business and 20 in case of other business and it imposes unlimited liability on each partner for acts committed by another and by Partnership as a whole. The Private Company form of business, by its articles of association, limits the number of its members to fifty (excluding the past and present employees of the company), restricts the right of its members to transfer its shares and prohibits an invitation to the public to subscribe to any shares in or the debentures of the company. *(Further details in 'Annexure A' as appended)*

**VII. OVERVIEW OF THE LLP ACT 2008:****1. PRELIMINARY**

Section 1 - The Act will extend to the *whole of India*

Section 2 - defines 21 expressions used in the Act. LLP 2008 and has introduced *4 new definitions*- Advocate; Court; Entity and Schedule

**2. NATURE OF LLP**

Section 3 - LLP to be a body corporate A LLP is a

- *Body corporate*
- *Formed and registered* under this Act
- Is *separate legal entity* from its partners
- Having *Perpetual succession*
- *Change in partners shall not affect* existence, rights, liabilities

Section 4 - Non –applicability of Indian Partnership Act, 1932

Section 5 - Partners

- An *individual or a body corporate* may become a member
- LLP Act 2008 has indicated the *disqualifications* that will prevent an individual from becoming a member.

Accordingly, an individual shall not be capable of becoming a partner of a LLP, if :

- a. He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- b. He is an undischarged insolvent; or
- c. He has applied to be adjudicated as an insolvent and his application is pending.

Section 6 – Minimum Number of Partners

- Minimum number of partners 2
- In case the number is reduced below 2 and LLP carries on Business for more than 6 months, then such sole partner with whom business is carried on, *if he has knowledge of such fact*, shall be *personally liable* for obligations of LLP during that period;

Section 7 – Designated Partners

- 2 designated partners and *at least 1 should be resident in India*, and should have given his consent to act as such.
- *Particulars* of every partner shall be *filed with the Registrar within thirty days* of his appointment
- Every designated partner shall *obtain* a Designated Partner Identification Number [ *DPIN* ] from the Central Government

Section 8- Liabilities of designated partners [earlier 9(2)]

- Answerable for doing of all acts, matters and things as are required to be done by LLP pursuant to the Act and responsible for filing of document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement
- Are liable to all penalties imposed on the LLP for any contravention of the specified provisions

Section 9- Changes in designated partners

- If vacancy arises in office of designated partner, then duty of LLP to appoint a DP within 30 days
- However, if no designated partner appointed OR if at any time there's only 1 designated partner, then each Partner will be deemed to be designated partner

Section 10 – Penalties

- If LLP *does not have Min 2 designated partners* out of which 1 is Resident in India, then LLP and Every Partner will be liable to a Fine of not less than `10,000/- but up to 5 lakhs

- If *non compliance with* sub section (4) and sub section (5) of Section 7, 8 or 9 then LLP and its every partner shall be liable to a fine of `10,000/- up to `100,000/-

### 3. INCORPORATION

#### Section 11- Incorporation document

- Two or more persons associated for carrying on a lawful business with a view to profit can subscribe their names to an incorporation document
- The Incorporation document shall be *filed with the registrar of the State* in which the registered office of the LLP is to be situated with prescribed fees along with the Incorporation document there shall be filed a statement
  - a. the prescribed form
  - b. by an advocate or company secretary or chartered accountant engaged in the formation of the LLP or by anyone who has signed the incorporation document.
  - c. Stating that all the requirements of the LLP Act and the related rules have been complied with, in respect of incorporation and other matters precedent and incidental to it
- Any person making such statement knowing it to be false, or not believing it to be true, shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees

#### Section 12 - Incorporation by Registration

The Registrar may accept the statement as sufficient evidence that the requirement of two or more persons associated for carrying on a lawful business with a view to profit subscribing their names to the incorporation document has been complied with. When all the requirements have been complied with, *the Registrar shall within a period of fourteen days*

- a. Register the incorporation document; and give a certificate
- b. that the LLP is incorporated by the name specified in the incorporation document
- c. signed by him and authenticated by his official seal
- d. as a *conclusive evidence* that the LLP is incorporated by the name specified in the incorporation document.

#### Section 13 - Registered office of the LLP and change therein

- All communications and notices may be addressed to and received by the registered office of the LLP
- A document may be served on a LLP or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other mode, which may be prescribed, or by leaving at its registered office
- A LLP may change the address of its registered office by filing with the Registrar notice of such change in such form and manner as may be prescribed and any such change shall take effect only upon such filing
- Contravention of any of these provisions shall make the LLP and its every partner *punishable with fine* which shall be not less than two thousand rupees but which may extend to twenty-five thousand rupees

#### Section 14 - Effect of registration

The LLP shall have the power of

- a. suing and being sued
- b. acquiring, owning, holding and developing or disposing of property, both movable and immovable
- c. having a common seal; and d) Doing and suffering such other acts and things as bodies corporate may lawfully do and suffer

#### Section 15 – Name

Every LLP shall have either the words "limited liability partnership" or the *acronym "LLP"* as the last words of its name.

- A LLP *cannot be registered with a name* which, in the opinion of the Central Government is *undesirable; or is identical or too nearly resembles* to that of any other partnership firm or LLP or body corporate or a
- *registered trade mark*, or a trade mark which is subject of an application for
- registration, of any other person under the Trade Marks Act, 1999.

#### Section 16 – Reservation of Name

A person may apply to the Registrar in the prescribed form with the prescribed fees for reservation of name for proposed LLP or proposed changed name for an existing LLP. If the Registrar is satisfied, the *name will be reserved for 3 months*

#### Section 17- Direction by the Central Government

The Central Government may direct a LLP to change its name if it is satisfied that such LLP has been registered under a

name which does not meet the requisites of Section 15. The LLP shall comply with the direction within three months after the date of the direction or such longer period as the Central Government may allow. Failure to so comply shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

#### **Section 18 & 19 – Change of Name**

Any entity which already has a name similar to the name of a LLP which has been incorporated subsequently, may apply to the Registrar in the prescribed form for a direction to such LLP to change its name. Where the second ground is the basis of the application, the Registrar should receive the application within twenty-four months from the date of registration of the LLP under that name.

#### **Section 20-Penalty for improper use of word “limited liability partnership” or “LLP”**

If any person or persons carry on business under any new name or title of which the word "Limited Liability Partnership" or "LLP" or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated as LLP be punishable with fine which may extend to five lakh rupees.

#### **Section 21 - Publication of name and limited liability**

Every LLP shall ensure that its invoices and official correspondence bear the following, namely:

- a. The name, address and registration number of the LLP; and
- b. A statement that it is registered with limited liability

**Contravention** in this respect shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

#### **4. PARTNERS AND THEIR RELATIONS**

- All persons who subscribed their names to the incorporation document shall be partners of LLP and any other person may become a partner by and in accordance with the LLP agreement.
- The *mutual rights and duties* of the partners of the LLP, and the mutual rights and duties of a LLP and its partners shall be *governed by the LLP agreement*
- The LLP agreement and any changes made therein shall be filed with the Registrar.
- In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of LLP and the partners shall be determined by the provisions relating to that matter as are set out in the First schedule
- A person may cease to be a partner of a LLP in accordance with an agreement with the other partners or in the absence of agreement with the other partners as to cessation of being a partner, by giving a notice of not less than thirty days to the other partners of his intention to resign as a partner. A person may also cease to be a partner of a LLP by his death or dissolution of the LLP
- The cessation of a partner from the LLP does not by itself discharge the partner from any obligation to the LLP or to the other partners or to any other person which he incurred while being a partner

#### **5. EXTENT AND LIMITATION OF LIABILITY OF LLP AND PARTNERS**

- Every partner of the LLP is an agent of the LLP, but not of the other partners
- A LLP is *not bound by anything done by a partner* in dealing with a person if the partner has no authority to act for the LLP in doing a particular act and the person knows that he has no authority or does not know or believe him to be a partner of the LLP
- The liabilities of LLP shall be met out of the property of the LLP
- A *partner is not personally liable*, directly or indirectly for an obligation of the LLP, whether arising in contract or otherwise solely by reason of being a partner of the LLP
- A *partner is personally liable for his own wrongful act or omission*, but shall not be personally liable for the wrongful act or omission of any other partner of the LLP
- Any person who by words spoken or written or by conduct represents himself or knowingly permits himself to be represented to be a partner in the LLP is liable for any credit given to the LLP based on the misrepresentation. Further, the LLP shall also be liable for allowing such misrepresentation and gaining financially thereof. Also, if the business is continued after the partner's death under the same LLP name, it does not render the legal heirs to be liable for any events occurring after the partner's death
- In the event of *an act carried out by a LLP, or any of its partners, with intent to defraud creditors* or any other person, or for any other fraudulent purpose, the liability of the LLP and its partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

### Section 30 - Provisions on whistle blowing

The Act lays down the situations where the Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a LLP if the Court or Tribunal is satisfied that:

- a. Such partner or employee has provided useful information during investigation of such LLP; or
- b. When any information given by any partner or employee (whether or not during investigation) leads to LLP or any partner or employee of such LLP being convicted under this Act or any other Act.

Further, the ***Act prohibits the discharge, demotion, suspension, threatening, harassment, or any other form of discrimination against the terms and conditions of partnership or employment of any LLP or any partner or employee of any LLP merely because of his being a whistle blower.***

### 6. CONTRIBUTIONS

- A contribution if a partner may consist of tangible or intangible property or other benefit to the LLP, including money, promissory notes, other agreements to contribute case or property, and contracts for services performed or to be performed and any such obligation shall be as per the LLP agreement.

### 7. FINANCIAL DISCLOSURES

- The LLP shall be required to ***maintain such books of accounts as may be prescribed on cash or accrual basis and according to double entry system of accounting*** and shall maintain the same at its registered office for such period as may be prescribed.
- Every LLP shall, ***within a period of six months from the end of financial year*** prepare a statement of account and solvency and shall be filed with the Registrar every year as per the rules prescribed.
- Every LLP shall be required to get its accounts audited as per the rules prescribed and file an annual return with the Registrar within 60 days of closure of the financial year
- ***In case of failure,***
  - a. The LLP shall be ***punishable with fine***, which shall not be less than one lakh rupees but which may extend to five lakh rupees ' The designated partner shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees
  - b. The statement of accounts and solvency and annual return filed by each LLP shall be available for inspection in the office of Registrar.
  - c. In order to obtain information as may be necessary to carry on the provisions of the Act, the Registrar may require any partner or designated to of a LLP to answer any question or make declaration supply related particulars.
  - d. The Registrar may destroy any document filed or registered with him in physical form or in electronic form in accordance with such rules as may be prescribed.

### 8. ASSIGNMENT AND TRANSFER OF PARTNERSHIP RIGHTS

#### Section 42

- The rights of a partner to a share of the profits and losses of the LLP and to receive distributions in accordance with the LLP agreement are ***transferable either wholly or in part.***
- The transfer of any rights by any partner ***neither by itself causes the disassociation of the partner*** or a dissolution and winding of a LLP ***nor entitles the transferee or assignee to participate in the management or conduct of the activities of the LLP or access information concerning the transactions of the LLP***

### 9. INVESTIGATION

#### Section 43 to 54

The Central Government shall appoint inspectors for investigation on a declaration that such an investigation ought to be conducted by:

- a. The Tribunal on its own or after receiving an application from ***not less than one-fifth*** of the total number of partners of the LLP concerned; or
- b. Any Court

### 10. CONVERSION INTO A LLP

#### Section 55 to 58

The provisions of the LLP Act provides for the conversion of a firm, private company or an unlisted public company into a LLP. The Act also contains provisions relating to effect of conversion into a LLP.

### 11. FOREIGN LLP

**Section 59**

The Central Government shall make rules for provisions in relation to establishment of place of business by foreign LLP within India and carrying on their business therein by applying or incorporating, with such modifications, as appear appropriate, the provisions of the Companies Act, 1956 and in all other respect the provisions of the Act shall apply.

**12. COMPROMISE, ARRANGEMENT OR RECONSTRUCTION OF LLPS****Section 60 to 62**

**Section 60** seeks to provide the *manner in which compromise or arrangement of LLPs* shall be proposed, agreed by members or creditors of a LLP and confirmed by the Tribunal. It also seeks to provide the *time-limit within which the order made by Tribunal shall be filed with the Registrar* and the *effect of such filing*. It also seeks to provide that if default is made in complying with provisions relating to filing of such order of Tribunal with the Registrar, the LLP and every designated partner of the LLP shall be *punishable with fine* which may extend to one lakh rupees.

**Section 61** seeks to provide that where the Tribunal makes an order sanctioning a compromise or an arrangement in respect of a LLP, it—

- a. Shall have power to supervise the carrying out of the compromise or an arrangement; and
- b. May, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement, as it may consider necessary, for the proper working of the compromise or arrangement.

The said Section further seeks to provide that if the Tribunal is satisfied that a compromise or an arrangement sanctioned cannot be worked satisfactorily, it may make an order for winding up of the LLP.

**Section 62** seeks to provide that where an application is made to the Tribunal for sanctioning of a compromise or arrangement which relates to reconstruction of any LLP or LLPs, or the amalgamation of any two or more LLPs and under a scheme the whole or any part of the undertaking, property or liabilities of any LLP concerned in the scheme is to be transferred to another LLP, the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provisions for matters like transfer to the transferee LLP of the whole or any part of the undertaking, property or liabilities of any transferor LLP, the continuation by or against the transferee LLP of any legal proceedings pending by or against any transferor LLP; the dissolution, without winding up, of any transferor LLP; the provision to be made for any person who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement; and such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out. It also seeks to provide that if default is made in complying with provisions relating to filing of such order of Tribunal with the Registrar, the LLP and every designated partner of the LLP shall be punishable with fine which may extend to fifty thousand rupees

**13. WINDING UP AND DISSOLUTION [Section 63 to 65]**

- The winding up of a LLP may be either voluntary or by the Tribunal if,
  - a. if the LLP decides that it be wound up by the Tribunal, b. the no of partners is reduced below two, c. LLP is unable to pay its debts, d. LLP has acted against the interests of the sovereignty and integrity of India, e. LLP has made a default in filing with the Registrar the statement of account and solvency or annual return for any five consecutive years, f. if the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.
- The Central Government shall make rules towards the same.

**14. MISCELLANEOUS PROVISIONS [Section 66 to 81]**

- All the partners of a LLP are entitled to *share equally* in the capital, profits and losses of the LLP.
- The *LLP shall indemnify each partner* in respect of payments made and personal liabilities incurred by him in the ordinary course of business or in anything necessarily done for the preservation of the business or property of the LLP.
- Every partner may *take part in the management* of the LLP.
- *No partner shall be entitled to remuneration* for acting in the business or management of the LLP.
- No person may be introduced as a partner without the consent of all the existing partners.
- A partner may lend money to and transact other business with the LLP and has the same rights and obligations with respect to the loan or other transactions as a person who is not a partner.
- The Central Government may direct that any of the provisions of the Companies Act, 1956 shall apply to any LLP.
- The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

- The Central Government shall have the powers to investigate the affairs of a LLP, if required, by appointment competent inspector for the purpose.
- The Act provides that the Central Government may by notification make rules for the purposes of carrying out the provisions of the Act.
- Whoever fails to comply with any order made by the Tribunal under any provision of this Act shall be punishable with imprisonment which may extend to six months and shall also be liable to a fine which shall not be less than fifty thousand rupees

#### **VIII. MUTUAL RIGHTS AND DUTIES OF PARTNERS AND LLP APPLICABLE IN THE ABSENCE OF ANY AGREEMENT ON SUCH MATTERS [First Schedule]**

The mutual rights and duties of the partners and the mutual rights and duties of the LLP and its partners shall be determined, *subject to the terms of any LLP agreement* or in the absence of any such agreement on any matter, by the *provisions in this Schedule*.

- All the partners of a LLP are entitled to share equally in the capital, profits and losses of the LLP and the LLP shall indemnify each partner in respect of payments made and personal liabilities incurred by him:
  - a. in the ordinary and proper conduct of the business of the LLP; or
  - b. in or about anything necessarily done for the preservation of the business or property of the LLP.
- Every partner shall *indemnify the LLP for any loss caused to it by his fraud* in the conduct of the business of the LLP.
- Every partner may take part in the management of the LLP.
- No partner shall be entitled to remuneration for acting in the business or management of the LLP.
- Any matter or issue relating to the LLP shall be decided by a *resolution passed by a majority in number of the partners*, and for this purpose, each partner shall have one vote. However, no change may be made in the nature of business of the LLP without the consent of all the partners.
- Every LLP shall ensure that decisions taken by it are *recorded in the minutes within thirty days of taking such decisions* and are kept and maintained at the registered office of the LLP.
- Each partner *shall render true accounts and full information* of all things affecting the LLP to any partner or his legal representatives.
- If a partner, without the consent of the LLP, *carries on any business of the same nature as and competing with the LLP*, he must account for and pay over to the LLP all profits made by him in that business.
- Every partner shall account to the LLP for any benefit derived by him without the consent of the LLP from any transaction concerning the LLP, or from any use by him of the property, name or any business connection of the LLP.
- No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.
- *All disputes* between the partners arising out of the LLP agreement *which cannot be resolved in terms of such agreement shall be referred for arbitration* as per the provisions of the Arbitration and Conciliation Act, 1996.

#### **IX. CONVERSION OF A FIRM INTO LLP [Second Schedule]**

Conversion of a firm to a LLP means transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the firm to the LLP. The provisions of the Second Schedule have to be complied with in this respect.

#### **X. CONVERSION OF A PRIVATE COMPANY/ UNLISTED COMPANY INTO LLP [Third and Fourth Schedule]**

The provisions of the Third Schedule and Fourth schedule have to be complied with respectively. *As per the Finance Act 2010*, conversion from private limited company or a public unlisted company to a LLP *would not be regarded as a transfer for the purpose of capital gain tax under section 45* on fulfillment of prescribed conditions.

#### **XI. TAXATION OF A LLP:**

- Taxation scheme for LLP prescribed on the *same lines as currently applicable for Partnership Firms*, i.e. tax will be levied on LLP and Partners will be exempt from tax. Also, Minimum Alternative Tax (*MAT*) and Dividend Distribution Tax (*DDT*) *will not be applicable to a LLP*
- In the case of LLP, the *return of income shall be signed and verified by the designated partner* and where for

any unavoidable reason the designated partner is not able to sign the return of income or where there is no designated partner, by any other partner.

- ***In the case of liquidation of a LLP***, every person who is a partner of the LLP at any time during the previous year shall be ***jointly and severally liable for the payment of any unrecovered tax*** unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.
- The ***remuneration paid*** will be taxable as 'Income from business and profession' and must not exceed the given limits as follows:

Book Profit	Maximum deductible remuneration
On the first `300,000 of the book-profit or in case of a loss	`150,000 or at the rate of 90% of the book-profit, whichever is more
On the balance of the book-profit	At the rate of 60%

## XII. TAX ISSUES FACED:

- The ***tax treatment of the LLP is not addressed in the Act*** and would need to be dealt with separately as a part of the Income Tax Act, 1961. In the United Kingdom the concept of 'fiscal transparency' has been applied to a LLP. Although the 'tax pass through' mechanism has its own administrative issues, the LLP should be treated as a 'pass through' entity.
- ***Section 34 of the Act imposes an obligation upon the LLP to file the 'statement of account and solvency' with the registrar every year.*** Further, Section 36 of the Act provides that the incorporation document, names of partners and changes (if any), statement of account and solvency and annual return shall be available for inspection by any person. Since the accounts of the LLP also need to be made public, the professional firms before taking the decision to convert into a LLP will also consider these corporate governance aspects which are inherent to a LLP but different from the way traditional law firms have been operating in India.
- Court related mergers, acquisitions and winding up of companies have traditionally been ***time consuming and expensive***. Unless the rules made under the Act, specify for a settlement of these in a time bound manner, ***mergers, and winding up*** of the LLP may also face the same challenges as faced by an incorporated company.
- Since, foreign LLPs have been permitted under the Act, the ***Foreign Exchange Management Act will need to be amended accordingly***. As of now only non resident Indians and persons of Indian origin can make investments in partnerships on a non-repatriation basis.
- The government's plan to levy tax on LLPs instead of taxing its individual members, is ***likely to put off investors abroad who are keen to forge partnerships here***. Taxing the entity instead of the individuals may lead to a higher tax burden for the partners and dual taxation for foreign partners.

This could prove to be a major setback for professionals here who were hoping to enter into riskier businesses such as venture capital funding and insurance consultancy in the LLP format with overseas partners. ***Example***, a UK partner in a cross-border partnership may end up paying tax in Britain for his income from the partnership registered in India even if the entire income of the partnership has been taxed in India. Secondly, if the LLP generates income here as well as abroad, the entity will have to pay tax here even for the income that is generated abroad. Taxing the individual partners will do away with both these disadvantages. In that case the Indian partner would pay tax only for whatever income he gets from the partnership's activities here, while the foreign partner will not pay any tax here. He may pay the tax applicable in his home country as per the law there.

Taxing the partners may be more transparent, but it could result in differences among the partners and litigation. ***Apart from administrative issues, it could also affect the government's revenues and pose further numerous questions and litigations on interpretation of the Indo-UK Double Tax Avoidance agreement.***

- One key condition for the conversion of a company (Private or unlisted Public) to a LLP is that the company may convert into a LLP provided there is no security interest subsisting on its assets or in force at the time of application. ***It is difficult for most companies to be in a scenario where there is no security interest subsisting on any assets.***
- For conversion of an unlimited liability partnership concern to a limited liability partnership concern, there are no

provisions requiring the consent of the lenders. Lenders may have a position on the re-organisation, but that is irrelevant. Possibly, as personal liability will continue for all contracts and liabilities which were contracted prior to such conversion, even after such conversion.

- One issue that arose in proposing the Act for LLPs was that paper thin LLPs should not be permitted as they could completely undermine the credibility of LLPs. At that point of time the *Naresh Chandra committee had suggested that there should be provisions for Compulsory Insurance under the LLP Act. The proposal has disappeared in the winds of changes.*
- The entire proposal of LLPs is based on a *one way street*. While you can convert from a firm or a company to a LLP, there are no provisions for erring and deciding to reconvert back into a partnership or a company. In such a case, the decision has to be well weighed realising that there is no “u turn” available down the road

### **XIII. CONCLUSION**

The enactment of the Act has definitely been a *positive step towards assisting Indian professional organizations to expand and compete at an international level*. However, since the *tax treatment of LLPs are still unclear and the procedural formalities are yet facing issues* causing a hindrance to a new rush of LLPs.

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[Click here for Annexure A](#)