Limited Liability Partnership Act, 2008

Some Issues

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Limited Liability Partnership - Meaning

A Limited Liability Partnership firm ("LLP") is a form of business organisation with each partner's liability limited to the contribution made by that partner in relation to the LLP, except in case of fraud, malpractice, wrongs, etc., in which case liability that can attach to the relevant partner may be unlimited liability.

Usually LLPs are persons in the eyes of law and are incorporated as persons, unlike normal partnership concerns which are not incorporated as persons in the eyes of law.

Origin and Development

United Kingdom

- Since the middle of the 19th century, there has been a continuing pressure to relax the provisions surrounding the limited company form and to introduce a new corporate structure for small and medium sized business organisations.

- **1980-1990:** Major accountancy firms organised in the form of partnerships with unlimited liability, wanting to limit the liability of an individual partner to acts specifically related to that partner, launched a campaign for the creation of the LLP vehicle in the UK.

- **1989:** The UK Companies Act, 1989 was amended to allow accountancy firms to work as limited liability companies. The joint and several liabilities of general partners, however, remained. Accordingly, in such an event if a wrong was done by a partner, the general partner

- **1990-2000:** In the 1990s, the accountancy firms in the UK again campaigned to secure proportional liability in Partnership firms. This finally led to the passing of the Limited Liability Partnership Act, in the year 2000.

Origin and Development

United States of America

- **Texas (1991):** The Texas LLP statute was enacted in response to the liability that had been imposed on partners of firms by government agencies in relation to massive savings and loan failures in the 1980's. Another reason for the introduction of LLPs was the increasing number of malpractice suits that were being filed against larger general partnerships. The statute protected partners from personal liability for claims related to a co-partner's negligence, omission, in competency, errors or malfeasance.

- **1994**: The Revised Uniform Partnership Act (RUPA) was promulgated in 1994 to reinforce the changes occurring in Partnership law generally. A number of states permitted formation of LLPs.

- **1997:** The success of LLPs in various states triggered the adoption of comprehensive LLP provisions into the RUPA.

- **2001:** The concept of LLPs spread rapidly from 2 states in 1992 to all 51 U.S jurisdictions by 2001

- US state laws did initially vary on the kinds of protections that they provide to partners in an LLP. Although the first Texas law protected partners from personal liability only for partnership obligations arising from the misconduct of other partners. Over a period of time more recent laws protect partners in LLPs from personal liability for all partnership debts.

Indian Legislative history

India

- **1957:** Suggestion to introduce LLP legislation rejected by 7th Law Commission on Partnership Act, 1932. The suggestion was made by the iron, steel and hardware merchants chamber at that time. The ground for seeking the creation of such business organisation was that the Companies Act had become cumbersome for private companies, with directors and shareholder interests protection clauses, company secretary being compulsory, etc. It was rejected inter alia on the basis that the whole purpose of the recent Companies Act amendment would fail if this proposal was accepted.

- **1997:** Abid Hussain Committee on Small Scale Industries recommended introduction of LLPs in India

- **2003:** Naresh Chandra Committee Report (Regulation of Private Companies and Partnerships) highlighted the grave need to introduce LLPs in India – suggested application of LLPs to service industry. It is pertinent to note that the intent was not to extend to all forms of trade as the form of the private company existed for all forms of trade. The recommendation was that LLPs should be permitted in phase 1 only for professional firms, such as chartered accountants, architects, lawyers, doctors, cost accountants, etc.

- **2005:** JJ Irani Expert Committee on Company Law recommended introduction of LLPs - suggested that small enterprises should be included in the scope of LLPs and there should be a separate LLP Act. They viewed that this could provide flexibility to small enterprises to form joint ventures and enter into agreements that enable them to access technology.

- **December 7, 2006:** 2006 LLP Bill approved by Union Cabinet

- **December 15, 2006:** 2006 LLP Bill introduced in Parliament

Indian Legislative history

- **2007:** 2006 LLP Bill referred to Parliamentary Standing Committee (PSC) headed by Mr. Ananth Kumar for examination
- **November 27, 2007:** PSC submitted its report to the Parliament recommending changes and suggestions in relation to the 2006 LLP Bill
- **May 1, 2008:** Union Cabinet gave its approval to introduction of a new bill (2008 LLP Bill) replacing the 2006 LLP Bill
- **October 21, 2008:** LLP Bill 2008 introduced in Parliament
- **October 24, 2008**: LLP Bill 2008 passed by the Rajya Sabha
- **December 13 2008:** LLP Bill 2008 passed by the Lok Sabha
- **January 7, 2009:** President's assent given to the LLP Bill 2008
- **January 9, 2009:** LLP Act 2008 published in the official gazette (YET TO BE NOTIFIED FOR IT TO COME INTO FORCE)

LLP Act 2008

A brief overview

- An LLP is a body corporate.
- Apart from individuals, even body corporates may be partners.
- Minimum two partners and two Designated Partners who must be individuals, but no limit on the maximum number of partners. Designated Partners are liable for compliance. If any compliance is not carried out, they will be liable for all penalties.
- LLP may carry on any lawful business, trade, profession, service or occupation. Unlike the Naresh Chandra Committee Report, the flexibility has been provided for LLPs to be incorporated in such manner as they deem fit.
- Inter se relationship, rights and duties between partners is governed by LLP Agreement (which would also require to be registered). In the absence of agreement principles set out in schedule 1 apply (general principles of equality, in terms of sharing of profits and losses, etc).
- The Name of the LLP must end with either the words 'Limited Liability Partnership' or the acronym 'LLP'

LLP Act 2008

- **Agency:** Every partner is an agent of the LLP and not of the other partners
- **Unauthorised Acts:** An LLP is not bound by unauthorized acts of any partner in dealing with a third person provided such third person
  - (a) is aware that the acts are unauthorised; or
  - (b) does not know or believe that the partner is a partner of the LLP
- **Wrongful Acts or Omissions:** An LLP is liable for wrongful acts or omissions of partners in the course of business of the LLP or with its authority – The partner(s) committing such act or omission will be personally liable – Other partners not to be liable for such wrongful act or omission
- An obligation of the limited liability partnership is solely the obligation of the limited liability partnership
- The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership. Accordingly, unlike the Texas first law, even liability for debt is limited.

LLP Act 2008

<u>Right to share profits transferable</u>

- Right of a partner to share profits is transferable (either wholly or in part)
- Transfer does not imply that the transferor/assignor has ceased to be a partner
- Transferee/ assignee not entitled to participate in the management of the LLP
- Transferee/assignee not entitled to any information relating to transactions of LLP

LLP Act 2008

- **Statements of Accounts and Solvency:** An LLP must prepare a 'Statement of Accounts' and 'Solvency Statement' within a period of 6 months from the end of the financial year to which the statement or solvency relates - The statements must be filed with the Registrar
- **Annual Return:** Every LLP must file in Form 11 an annual return with the Registrar within 60 days of the end of the financial year – the annual return should be accompanied by a certificate from a company secretary confirming the veracity of the particulars/statements contained in such annual return
- **Partnership Firm:** An existing partnership firm may be converted into an LLP. The partners of the LLP, on conversion, must comprise all the partners of the original partnership firm and no one else.
- **Private Company:** A private limited company registered under the Companies Act, 1956 can convert itself into an LLP. A company may apply for conversion provided all the shareholders of the Company and no one else shall be partners of the LLP
- **Unlisted Public Company:** An unlisted Public Company registered under the Companies Act, can convert itself into an LLP. A company may apply for conversion provided all the shareholders of the Company and no one else shall be partners of the LLP
- A listed Public Ltd. Company cannot convert into an LLP

LLP Act 2008

- **Foreign LLPs:** The Act states that the Central Government may make Rules for establishment of place of business for foreign LLPs in India and conduct of business by such foreign LLPs. Provisions relating to setting up foreign LLP establishments in India are contained in the Rules framed in this regard

- **Compromise, arrangement and reconstruction:** The Act provides for compromise and arrangement between the LLP and its creditors/partners. The Act also provides for reconstruction of LLPs. The Relevant provisions are contained in Chapter XII of the Act (Sections 60 – 65)

- **Defunct LLP**: The Registrar has the power to strike off the name of an LLP from the register if the LLP is not carrying any business or operation in accordance with the Act and the Rules. An application can also be made in this regard in Form 24 to the Registrar. (Section 75 and Rule 37 of the Rules)

Certain Issues

- One key condition for the conversion of a company (Private or unlisted Public) to an LLP is that the company may convert into an 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.

- One needs to analyse and understand the reason for such a clause. Under the provisions, all assets and liabilities vest in the LLP. In such an event, why such a clause? Why restrict the convertibility of a private limited company or an unlisted public company?

Certain Issues (contd.)

- 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.
- Hence even if the contract is deemed substituted with a contract with an LLP, protection against individual partners continues.

Certain Issues (contd.)

- A partner may lend money to and transact other business with the limited liability partnership and has the same rights and obligations with respect to the loan or other transactions as a person who is not a partner.
- Why is there a need for a statutory provision of this nature?
- Would this prohibit subordinate debt, where partners agree not to recover their debts until external debt is paid off?

Certain Issues (contd.)

- Section 71 – The provisions of this Act would be in addition to, and not in derogation of, the provisions of any other law for the time being in force.
- Therefore one would need to analyse provisions of various statutes governing professionals to decide whether they can take advantage of this LLP
- For instance, the Chartered Accountants Act, 1949, provides uses in a number of places the term “firm”, which would usually refer to a firm under the Indian Partnership Act, 1932. The said Act also prohibits companies from practising as chartered accountants. Are amendments necessary?
- For instance, for lawyers, under the Advocates Act, only Advocates can appear before courts. As a firm is not a person in the eyes of law, a partnership firm is permitted. In light of the LLP Act, where a firm would be treated as a person in the eyes of law with perpetual succession, it is difficult to see how an LLP can be a firm under the provisions of the Advocates Act, which could be recognised as having a right to practice. For instance, even today, a lawyer cannot be part of a company and a company cannot be the lawyer appointed for a client.

Certain Issues (contd.)

- Filing of accounts – Accounts of a firm are a private affair, except for disclosures which have to be made to the income tax authorities.
- Now accounts would have to be filed with the Registrar.
- Would this be acceptable to the Indian legal firms, chartered accountants and other professionals?

Certain Issues (contd.)

- One issue that arose in proposing a bill for limited liability partnerships 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

Certain Issues (contd.)

- The entire proposal of LLPs is based on a one way street
- While you can convert from a firm or a company to an 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

Certain Issues (contd.)

- Section 27(4) of the Act states that the liabilities of a limited liability partnership shall be met out of the property of the limited liability partnership.
- One issue that arises is whether this would preclude in any manner, lenders and contracting parties from obtaining personal and corporate guarantees from the partners as a precondition to providing any loans.
- The arguments against this is that the principles of a guarantee arise from contract law and this would not preclude the application of such principles.
- The argument in favour of treating such guarantees as void is that this is a special law that mandates that the liability is to be met out of the property of a limited liability partnership.
- Perhaps the absence of the words “exclusively” or “only” would be a determinant in the event any litigation happens around this point.

Certain Issues (contd.)

- Questions arise, whether like a traditional partnership, there could be paid partners, who do not have a share in profit or have a fixed share of profit, without being liable for losses. Could one also have a zero share partner
- In this regard, it is pertinent to note the provisions of section 23(1) which provides that the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.
- Accordingly, so long as it could be contractually provided, there should be no restriction to having such partners. It is pertinent to note that the provisions of equality come into play under Schedule 1 of the Act only in the absence of any such agreement/provision. Accordingly, contractually it could be provided that certain partners may have zero share, fixed shares, receive only remuneration or commission, etc. The law by adding section 23(1) has provided for tremendous flexibility recognising that by contract, parties may govern their inter se rights and obligations.

Certain Issues (contd.)

- Under section 34, statement of accounts are to be prepared within a period of six months from the end of the financial year. As per the draft concept rules, the filing needs to be made within a period of one month thereafter.
- Under section 35 of the Act, annual returns need to be filed within a period of sixty days of closure of the financial year.
- How is this possible??
- On an examination of the draft forms relating to such filings, annual returns seem to provide only for the details of the partners, the designated partners, their obligations to contribute and any penalties levied against them, and information of compounding of offences. Hence the times seem reconciliable for the present.

Certain Issues (contd.)

- Section 34 and 35 which deal with filing of documents, state that in the event the documents are not filed then there is a liability for payment of fine.
- On the other hand section 69 provides that if a document is not filed then within a grace period of 300 days, it may be filed along with additional fee of one hundred rupees for every day of such delay in addition to any fee as is payable for filing of such document or return. The section also provides that even after three hundred days it may be filed, without prejudice to any other action or liability under the Act.
- Would this mean that no fine can be levied for a period of 300 days as a grace period is provided.
- On one hand sections such as 34 and 35 specifically provide that if filings are not made as per those sections, there is a possibility of a fine. Sections 34 and 35 do not provide any such grace periods.
- The harmonious interpretation seems to be that section 69 does prejudice penalties and liabilities if section 69 is to be given a meaning.

Tax Treatment of LLPs

The LLP Act is silent on the issue of taxation of LLPs. In the absence of any specific provision, individuals/entities proposing to form/convert into LLPs will face uncertainty until the next Finance Bill clarifies the position. The tax treatment is more your specialisation and this is only a prima facie analysis.

Pass Through Mechanism: The Naresh Chandra committee suggested that LLPs be conferred 'pass through status'. Under such a structure the LLPs will not be taxed at all and the tax burden shall be borne entirely by the partners of the LLP. Pertinently, LLPs in UK enjoy similar 'pass through status'. In USA, a flexible system exists where the partners decide whether the tax is to be borne by the firm or the partners themselves. However, the pass through principle is also adopted in the USA.

Current Regime:

Pending clarification, under the current tax regime, an LLP would not qualify under the definition of firm or company. In the circumstances for the purposes of income tax, it may be treated as an association of persons and taxed accordingly. In this interim period it may perhaps not be advisable to recommend the setting up of any LLP to a client, until clarity emerges on the potential of a pass through status.

Conversion and Taxation:

Pending specific exemption from taxation at the time of conversion, authorities may seek to tax conversion as a capital gain. Clarity is required on this front too. The provisions of sections 47(xiii) and (xiv) of the Income Tax Act, 1961 specifically provide that transfers from sole proprietorships to companies or partnerships to companies, in case of certain conversions, would not be treated as transfers. However this does not specifically deal with partnerships into LLPs or companies into LLPs. Questions would also arise on what is the consideration that is paid, as on conversion, usually no consideration would be paid?? In other words, where is the gain?

Comparative Analysis

Significant differences between an LLP and a general partnership

	Limited Liability Partnership	General Partnership
1	Liability of Partners limited to contribution	Liability of Partners unlimited
2	Partners not jointly liable for acts of other partners	Partners jointly and severally liable
3	LLP is a body corporate having perpetual succession	Partnership firms are neither body corporates nor do they have perpetual succession
4	LLP is a separate legal entity	A general partnership is not an entity legally separate from its members
5	Incorporation of LLP is mandatory	Registration of partnership is not mandatory
6	LLP required to make financial disclosures	General Partnership not required to make financial disclosures
7	An LLP can have more than 20 partners	A general partnership cannot have more than 20 partners

Comparative Analysis

	Limited Liability Partnership	General Partnership
9	Filing of accounts, statement of solvency and annual return are mandatory	Filing of accounts, statement of solvency and annual return are not required
10	The Act silent on the issue of admission of minor as partner of LLP. Interesting question on consequence arises. Provisions of Contract Act, 1872 should apply.	Minor can be admitted to the benefits of partnership.

Comparative Analysis

Significant differences between an LLP and a Company

	Limited Liability Partnership	Incorporated Company
1	Incorporation procedure relatively simple and expeditious	Incorporation procedure more complex than LLP
2	Flexible management structure – Partners are entitled to participate in management	Management structure usually complex –Shareholders do not ordinarily participate in day to day management
4	Flexible Capital Structure	Capital structure less flexible than LLP
5	No provision relating to redressal in case of oppression and mismanagement	Elaborate provision relating to redressal in case of oppression and mismanagement
6	Limited statutory compliance as compared to Companies	Complex statutory compliance requirements

Conclusion

The hybrid structure of an LLP, which combines the organisational flexibility of general partnership and the limited liability benefits of an incorporated company is innovative, appealing and is likely to attract small and medium size entrepreneurs, service providers and professionals into setting up LLPs in India. The structure is also likely to improve the efficiency of Indian enterprises and facilitate an increased participation of the Indian service industry in the global market. Even the issues that arise are not irresolvable.

The LLP Act is, no doubt, a step in the positive direction.

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Thank You