

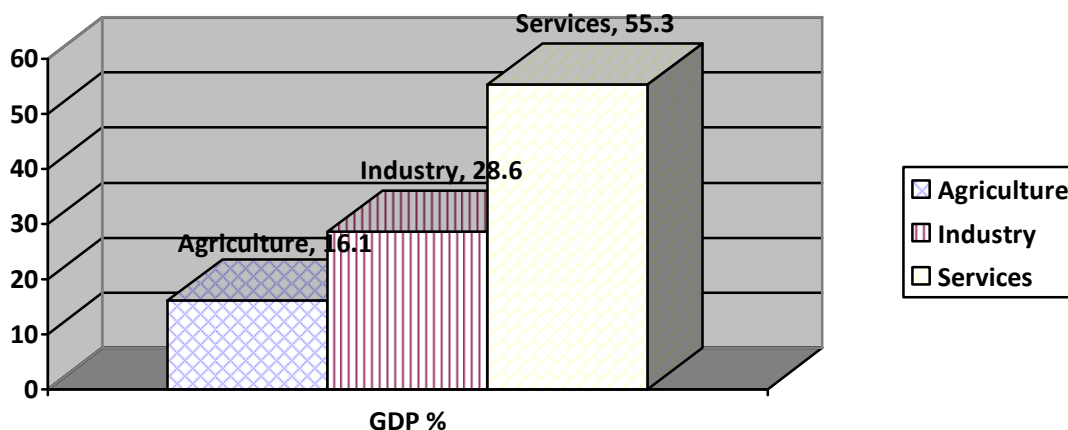
LIMITED LIABILITY PARTNERSHIP

Before I get into the intricacies of LLP, let me give u a briefing of the context that led to the evolution of LLP...

*Till recently the small and medium scale enterprises (SME's) in India had only two options to choose from to organize and expand their business – either a general partnership firm or an incorporated company. Now, both these forms of business structure had their own shortcomings. The feature of unlimited liability inherent in general partnerships as well as the fragility of its structure makes it highly risky. Likewise, the array of statutory compliances that inevitably come with incorporated companies make them not so alluring a venture. **Thus, in view of the lacunae of the existing two forms, a need was long felt for a new form of business organization structure that will combine the characteristics of corporate and non-corporate entities.***

And the need was answered in the form of enactment of the Limited Liability Partnership Act, 2008.

*The growing influence of the **SERVICE SECTOR** provided the added impetus for the introduction of a **Limited Liability Partnership (LLP)** to enable professionals to organize and provide a wide range of services to the corporate sector in a comprehensive and efficient manner. **The GDP figures for fiscal year 2011 give a distinct picture of the domination of the service sector in the Indian Economy.***



In an increasingly litigious environment, the prospect of being a member of a partnership firm with unlimited personal liability is a very dicey affair and hence unattractive. Indeed, this is the prime reason why partnership firms of professionals, such as accountants, lawyers etc. have not grown in size to successfully meet the challenges posed today by international competition...But with the advent of LLP this is all set to change

❖ *Now let's get to know what LLP is exactly??*

MEANING -

LLP is a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership.

Now this sounds like a lot of TECHNICAL JARGON!!

So to make things a little easier to understand....

LLPs are basically a **hybrid between a company and a partnership**:

- *Externally, they have all features of a company.*
- *Internally, they are run and managed by the partners.*
- *The idea is to clothe a partnership with*
 - *Limited liability and*
 - *Perpetual succession*

The concept tries to bring in the advantages of both a partnership firm and a company, while trying to mitigate their drawbacks. On the one hand, an LLP offers partners the security of a limited liability, the inception of a new corporate form of governance, while on the other hand it does so by minimizing the onerous procedures that an incorporated company is required to follow. In addition, an LLP also does away with the ownership-management divide that is a necessary consequence of an incorporated company.

❖ *Now, let's take a look at the various aspects which go into the making of an LLP –*

VARIOUS ASPECTS –

- ✓ **REGISTRATION** – All LLPs are mandatorily required to be registered under the LLP Act, 2008. Incorporation documents need to be filed to ROC of the state in which the LLP would be situated. The name of an LLP must end with Limited Liability Partnership or LLP.
- ✓ **CONTRIBUTION** – The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature.

- ✓ **PARTNERS** – A minimum of two partners will be required for the formation of an LLP. There will not be any limit to the maximum number of partners.

However every LLP shall be required to have at least two Designated Partners who shall be individuals and at least one of the Designated Partner shall be a resident of India.

In case of an LLP in which all the partners are body corporates or in which one or more partners are individuals and body corporates, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

- ✓ **RIGHTS AND DUTIES-**

The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the LLP Act 2008.

- ✓ **TRANSFER OF 'ECONOMIC RIGHTS'** A partner's economic rights (i.e. rights of a partner to a share of the profits and losses of the LLP and to receive distribution at the time of winding up) in the LLP shall be transferable. However, such a transfer shall not by itself cause the partner's disassociation with the LLP or a dissolution and winding up of the LLP.

Moreover, such transfer shall not entitle the transferee or assignee to participate in the management or conduct of the LLP's activities. Therefore, the transferee would not be deemed to be a 'partner' of the LLP just because a partner has transferred him the 'economic rights'.

Since LLP is a unique blend of General Partnership and Limited Company some of its features can be better understood by contrasting them with those of Partnership firms and companies –

❖ **COMPARISON WITH PARTNERSHIP FIRMS:**

LIABILITY OF PARTNERS

Under "traditional partnership firm", every partner is liable, jointly with all the other partners and also severally for all acts of the firm done while he is a partner.

However, in case of LLPs every partner of an LLP would be, for the purpose of the business of the LLP, an agent of the LLP but not of the other partners.

Thereby the liability of partners shall be limited except in case of unauthorized acts, fraud and negligence. But a partner shall not be personally liable for the wrongful acts or omission of any other partner.

Thus an obligation of the limited liability partnership whether arising in contract or otherwise, is solely the obligation of the limited liability partnership.

❖ **COMPARISON WITH COMPANIES:**

INTERNAL GOVERNANCE

A basic difference between an LLP and a joint stock company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act, 1956) whereas for an LLP it would be by a contractual agreement between partners. As a result LLPs have more flexibility as compared to a company.

The management-ownership divide inherent in a company is not there in a limited liability partnership. LLP have lesser compliance requirements as compared to a company.

Now as we are talking about the multifarious benefits and advantages of an LLP...an important question arises – Whether it is possible for the existing partnership firms and small pvt ltd cos. to avail the benefits of LLP?? YES INDEED!!

CONVERSION INTO LLP

To make available the benefits of the LLP structure to the existing partnership firms, private ltd companies and unlisted public limited companies suitable provisions have been made for their conversion into LLP subject to the following conditions :-

- **Firms:**

A firm can be converted into an LLP only if all the partners agree to become partners of LLP.

- **Private companies:**

Similarly, a private company can be converted into LLP only if:

- a.) All shareholders agree to become partners of LLP and
- b.) There is no security interest subsisting like mortgage.

- **Unlisted Public Companies:**

Likewise an unlisted public company can also be converted into a Limited Liability Partnership.

Now when making the decision to convert into an LLP, firms are faced with weighing up the risk management benefits versus the costs of conversion. The level of costs will depend on whether the firm undertakes the legal work in-house, or enlists the help of an external specialist who has experience of other conversions.

❖ *Now let's take a look into a very relevant and interesting aspect of LLP –*

TAXATION

- In India LLP is a tax opaque juridical entity i.e. tax is payable by the LLP as a separate assessee.
- For taxation purposes LLP is treated just like a general partnership firm. So there is no Minimum alternative Tax on LLP which is applicable to cos.
- Profit distributed by LLP is exempt in the hands of the partners – SEC-10(2A) of the Income Tax Act, 1961
- All the other sections of the Income Tax Act which govern the taxability of Partnership firms like provisions relating to cap on Remuneration, Interest payable to partners etc are applicable to LLPs also.
- Now, one major issue relating to LLP taxation is the levy of capital gain tax on conversion of Cos into LLPs.

Objectivity is vital to ensure that the LLP is an attractive and a feasible option in comparison with the present corporate vehicles. For this reason, appropriate exemptions were required under Section 47 of the Income Tax Act, 1961 whereby on conversion to an LLP, the transfer of the property must not be regarded as a taxable transfer for the purpose of levy of Capital Gains Tax. In the absence of such a provision, the partners of an LLP could end up paying huge sums as Capital Gains Tax at the time of transfer, which is clearly undesirable.

- The Finance Act, 2010 has amended **section - 47** so as to insert a new **clause (xiiib)**. The clause provides that subject to certain conditions specified therein any transfer of a capital asset or intangible asset by a company shall not be treated as transfer under section 45 where a private company or unlisted public company is converted into a limited liability partnership in accordance with the provisions of section 56 or 57 of the Limited Liability Partnership Act, 2008.

- Also, **SEC -72A** has been amended by inserting a **new sub-section (6A)** whereby in case of succession of business, a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47,

The accumulated loss and the unabsorbed depreciation of the predecessor company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the successor limited liability partnership for the previous year in which business reorganization was effected and LLP shall be allowed to set off and carry forward such loss and allowance for depreciation.

However, The Finance Act, 2010 expressly provides MAT credit outstanding with the predecessor co. shall not be available to the successor LLP – **SEC -115JAA(7)**

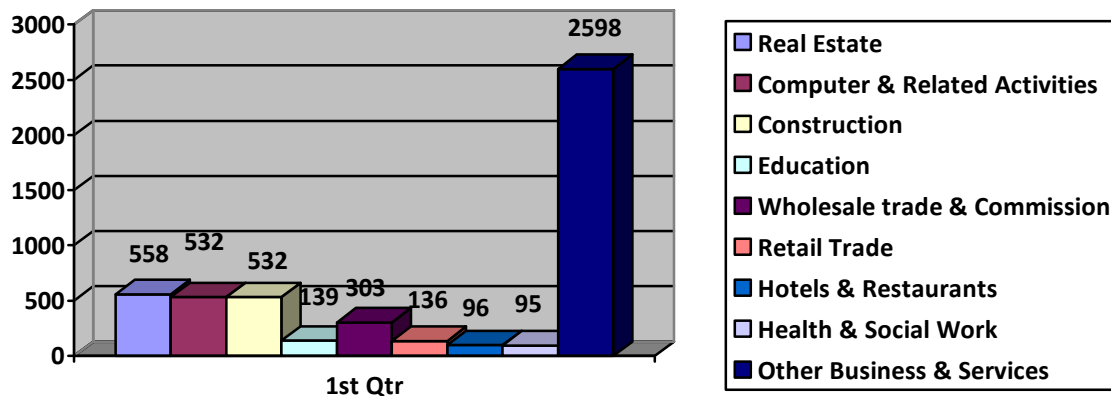
Now, LLP being a recent phenomenon, a number of issues relating to it keep cropping up for consideration by the Ministry of Company Affairs.

LLP among CHARTERED ACCOUNTANTS!!!

One such issue was raised in a representation by the ICAI wherein they had stated that under Sec- 226(3)(a) of the Companies Act, 1956 a body corporate is disqualified from appointment as auditor by a company and since LLP is a body corporate as per the LLP Act, 2008, LLP among chartered accountants will not be qualified for appointment as auditor under Sec-226(3) of the Companies Act, 1956.

The Ministry has clarified the matter vide **General Circular No. 30A/2011 dated 26-05-2011** that LLP OF Chartered Accountants will not be treated as a body corporate for the limited purpose of Sec-226(3)(a) of the Companies Act, 1956 .

Before I conclude let's take a look at the latest statistics of LLPs in India. As on 30-05-2011 4989 enterprises are registered as LLPs in India.



To sum up...

Although LLP is still a new concept in India, it is accepted world wide as an effective corporate vehicle...Big Multinational professional services organizations like Deloitte and Ernst & Young have opted for the LLP status.

India has witnessed considerable growth in services sector and the quality of our professionals is acknowledged internationally. It is necessary that entrepreneurship knowledge and risk capital combine to provide a further impetus to our impressive economic growth. Indian professionals have been providing accountancy, legal and various other professional/technical services to a large number of entities across the globe. Such services would require multidisciplinary combinations that would offer a menu of solutions to international clients.

Therefore in the Indian context LLP is relevant since the law does not permit incorporated companies to practice as company secretaries, chartered accountants, lawyers or related professionals. The only option that remains is to either work in a conventional partnership firm setup or as a sole proprietor. However, the unlimited liability of partners in a partnership firm makes this an option that is not only risky but also at times unfeasible. Thus, an LLP will provide Indian professional organizations a level playing field with international counterpart.



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