

AN ANALYSIS OF LIMITED LIABILITY

PARTNERSHIP BILL

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INTRODUCTION

The Limited Liability Partnership Bill, 2006 is currently under consideration by the Rajya Sabha. If the Bill is passed in the Parliament, it will be a path breaking legislation in India. The Bill is of considerable significance in view of the fact that India is emerging globally as a major economic superpower and flexibility in the laws relating to conducting business in India will encourage foreign investment in India. In this paper writer aims to analyse different aspect of the Bill and the issues relating thereto.

WHY LIMITED LIABILITY PARTNERSHIP

Limited liability concept was introduced in order to adopt a corporate form, which combines the organizational flexibility and tax status of partnership with the advantage of limited liability for its partners. Limited liability partnership (LLP) is a body corporate formed and incorporated under the Limited Liability Partnership Bill, 2006, which is a distinct legal entity separate from its partners. It has perpetual succession.

In India, businesses mainly operate as companies, sole proprietorships and partnerships. Each of these is subject to different regulatory and tax regimes reflecting their organization and ownership. LLP, as a new business structure, would fill the gap between business firms such as sole proprietorship and partnership,

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which are generally unregulated and limited liability companies, which are governed by the Companies Act, 1956. In addition to an alternative business structure, LLP would foster the growth of the services sector and will provide a platform to small and medium enterprises and professional firms of company secretaries, chartered accountants, advocate to conduct their business/profession efficiently which would in turn increase their global competitiveness. In view of the increasing role of the service sector in the Indian economy, a need has been recognised for a new corporate entity, that is, LLP that will combine the characteristics of corporate and non-corporate. This will enable professionals to organise and provide a wide range of services to the corporate sector in a comprehensive and efficient manner. In today's, global scenario, where economic trends enable investment and services to flow across borders, service and knowledge based enterprises are fast growing and as international competition in service sector is increasing, Indian entities will greatly benefit if LLP form of organisation is introduced in India.

Problems Presently Faced

At present, being a member of a partnership firm is a very risky affair because under partnership law, the partners are liable jointly and severally and most importantly their liability is unlimited which means that the personal property of the partners also be attached for the satisfaction of the debts in addition to the capital contributed by the partners in the firm. Hence, being a member of a partnership firm is a very risky affair as the liability is unlimited. This is the principal reason why partnerships firms of professionals, such as accountants, lawyers, companies secretaries, etc have not grown in size to meet the challenges posed today by international competition.

The concept paper by the Ministry of Company Affair on LLP has acknowledged the fact that the unlimited liability for partners in the case of general

partnerships has become an increasing cause for concern in the light of general increase in the incidence of litigation for professional negligence, the size of claims and the risk to a partner's personal assets when a claim exceeds the sum of the assets of partnership. History has been witness as to how in an increasingly competitive and litigious business environment, there are several disadvantages attached to the general partnership firm. This was first observed in the 1990s, when many US law firms went insolvent in the wake of a US\$ 980 billion loan and saving scandal as a result of suits decreed in malpractice litigation. Not only were firm assets completely liquidated under standard principles of partnership law, the partners were joint and severally liable for the entire liabilities of the partnership.

Therefore, in India, despite the rapid growth of the service sector in the last few years, there has been meagre growth of service-based organisations, despite the fact that they have the capacity to provide world-class service on the basis of their professional competence. As compared to the India's global reputation, service sector organisations based on doctors, lawyers, accountants, managers etc have not grown very fast. Besides, law does not permit incorporated companies to practice as companies secretaries, chartered accountants, lawyers or related professionals. The only option left is to either work in a conventional partnership firm set up or as a sole proprietor.

However, the unlimited liability of the partners in a partnership firms and the increasing number of claims valuing beyond the assets of the firm make this an option that is very risky. Further, the traditional form of partnerships in India has the disadvantage of not being in a position to expand beyond 20 partners. This is because as per the Companies Act, 1956, s. 11, an association of more than 20 persons formed for any profit motive, may not exist unless it is incorporated as a company under the aforementioned enactment. And any such associations without

being incorporated as company will be illegal under the Partnership Act, 1930. Thus present system act as a deterrent for the growth and expansion of service based organizations. And most importantly, it have depressing effect on the economy and the development prospects of the firm, as every business organisation would have to grow and diversify to reach larger client base around the world. Not only the present legal framework regarding setting up business is incompatible with the policy of globalisation and liberalisation India adopted during 1990s, but it will also have detrimental impact on the foreign direct investment in India.

COMMITTEES RECOMMENDATION

J J Irani Committee

The J J Irani Committee set up by the Government of India to recommend on various aspects of company law strongly pleaded for a separate legislation on LLP. The committee said that in view of the potential for growth of the service sector, requirement of providing flexibility to small enterprises to participate in joint ventures and agreements that enable them to access technology and bring together business synergies and to face the increasing global competition, the formation of LLP be encouraged. The committee further said that LLP would be a suitable vehicle for partnership among professionals who are already regulated such as company secretaries, chartered accountants, cost accountants, lawyers, architects, engineers, doctors etc. The committee further said that it might also be considered for small enterprises not seeking access to capital markets through listing on the stock exchange.

Naresh Chandra Committee Recommendation

The Naresh Chandra committee analysed the concept of LLP with regard to the following broad areas:

- (1) application of the LLP regime;
- (2) incorporation, registration and number of partners;
- (3) limited liability;
- (4) financial safeguards; and
- (5) tax treatment of LLPs.

DIFFERENCE BETWEEN GENERAL PARTNERSHIP AND LIMITED LIABILITY PARTNERSHIP

The committee, first of all, pointed out the distinction between general partnership and limited liability partnership in the following way.

General Partnership

The partnership simpliciter be constituted under the Indian Partnership Act, 1932. Each of the partners is jointly and severally liable for any liability arising out of or in respect of the partnership.

Limited Liability Partnership

The LLP is a separate legal entity with unlimited capacity where no member or partner is liable on account of the independent or unauthorized actions of one's partner, and whose liability is limited to the respective stake of each in the LLP. The members of an LLP would have the option to have a general partner or more with unlimited liability, but it would not shield the partners from legal liability arising out

of their own personal acts which are not done for and on behalf of the LLP, that is, any act done beyond the acts and powers of the partners as laid down in the incorporation document. Further, a partner's liability is not limited when the misconduct is attributable to him or to an employee under the supervision or control of that partner. An LLP only protects a partner, other than a general partner from the liability arising from the misconduct or personal acts of other partners.

Application of the LLP regime

Law may be enacted to provide for establishing LLP. The LLP form might initially be made available only to those providing defined professional services like lawyers, company secretaries, accountants and the like. To be eligible for this form of partnership, the profession must be governed by a regulatory enactment that adequately controls and disciplines, errant professional conduct. The Department of Company Affairs may notify such professions from time to time. LLP may be extended, at a later stage, to other services and business activities once the experience gained with the LLP form of organisation has been evaluated and tested.

The Committee was of the view that the LLP in the first instance be made available to firms providing professional services, as opposed to trading firms and or manufacturing firms, for several reasons. Firstly, because Indian professional firms are precluded from practicing under any other legal form in view of the restrictions imposed by their respective regulatory laws; trading firms or manufacturing firms, however, have the option to carry on business as a private limited or public company under the Companies Act, 1956. Secondly, as the professionals are also governed and regulated by their respective professional, regulatory bodies, which also control and monitor professional conduct, extending the LLP structure only to professionals

minimises the risk inherent in testing new waters. Thirdly, there is no special advantage that small private companies or SSI units would derive from being an LLP, especially in light of the fact that this committee itself is simultaneously recommending a considerable easing of regulations on private companies, especially small private companies. It was felt that extending the LLP structure to professionals, in the first instance, would help evaluate its advantages and risks; and based on such evaluation and experience, the LLP form be considered for extension to small-scale manufacturing and/or trading firms as well in the future.

Incorporation, registration and partners

- (1) An LLP must be incorporated by using a formal mechanism of filing the incorporation document with the Registrar of Companies (RoC). Further, there be no restrictions on the number of partners in an LLP;
- (2) two or more professionals who wish to associate for the purpose of providing an identified professional service may subscribe their names in an incorporation document in the prescribed form;
- (3) the relations inter se the partners and between the partners and the LLP may be governed by individual agreements between the parties concerned. Such agreement must be filed with the RoC; changes made in the agreement will also have to be filed with the RoC;
- (4) the LLP agreement contains information as may be prescribed by the Department of Company Affairs;
- (5) no limit is placed on the number of partners in an LLP. Any person may become a partner by entering into an agreement with the existing partners in the LLP. Further, when a person ceases to be a partner of an LLP he/she continue to be treated as a partner unless
 - (a) the partnership has notice that the former partner has ceased to

be a partner of the LLP; or (b) a notice that the former partner has ceased to be a partner of the LLP has been delivered to the RoC. A partner having resigned from an LLP would continue to be liable for acts done by him during his tenure as member of the LLP; and

- (6) LLPs be regulated and administered by the Central Government to ensure uniform standards, and since many of the state governments might not have adequate infrastructure and expertise for ensuring effective regulation.

Limited liability

- (1) as opposed to the concept of joint and several liabilities, applicable in general partnerships, the liability for partners in a LLP may be limited. In other words, the LLP would assume liability in the event that a partner of the LLP commits an act of commission or omission for and on behalf of the LLP that results in such liability. The partners would be liable only to the extent of their respective agreed contribution to the LLP without any recourse to the personal assets of a partner. However, the partners would still continue to be liable for their personal acts, which are not done for and on behalf of the LLP, and were committed in their personal capacity, if a partner knowingly causes the LLP to commit a felony or tort;
- (2) provisions dealing with insolvency, winding up and dissolution of an LLP be similar to those provided for private companies in the Companies Act, 1956. There also be provisions detailing the liability of partners to contribute to the assets of the LLP in the event of its being wound up;
- (3) every partner of the LLP would be an agent of the LLP. However, an LLP would not be bound by anything done by a partner in dealing

with a person if (a) the member in fact had no authority to act for the LLP by doing that act; and (b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP;

- (4) where a partner of the LLP is liable to any person or entity as a result of his wrongful act or omission in the course of the business of the LLP, the LLP would be liable in such circumstances. However, the partner would be liable only to the extent of his/her contribution to the LLP;
- (5) in the event of an act carried out by a LLP, or any of its partners, fraudulently, the liability would not be limited; it would, in fact, become unlimited as provided in the Companies Act, 1956, s. 542;
- (6) a partner will not be liable for the personal acts or misconduct of any other partner; and
- (7) the provisions relating to insolvency, winding up and dissolution of companies as contained in the Companies Act, 1956 may be examined and suitably modified to conform to the philosophy of LLPs. The partners may have to contribute to the assets of the LLP in the manner provided for in this regard.

Financial safeguards

Compulsory Insurance

To protect the interest of persons who might have claims against an LLP, all LLPs be compulsorily required to take out an insurance policy that would cover its

liabilities as an LLP to a reasonable extent. This is necessary as such persons might not get any real relief, since there will be no access to the assets of partners of the LLP except to the extent of his/her liability in the LLP. This would deter the creation of shell LLPs or asset-thin LLPs. Further, an LLP, on request by persons dealing with them, permit inspection of the register containing the number and names of partners, the pattern and extent of liability of partners, the amount of insurance coverage and other such matters. Thus, the committee was of the view that there be insurance cover and/or funds in specially designated, segregated accounts for the satisfaction of judgments and decrees against the LLP in respect of issues for which liability may be limited under law. The extent of insurance be known to, and filed with the RoC and be available for inspection to interested parties upon request.

Financial Disclosure

As far as financial disclosures are concerned, the committee recommended that the standards of financial disclosure as applicable to private companies also be made applicable to an LLP. The advantages gained from having the privilege of limited liability be coupled with the responsibility of making adequate financial disclosures so as to minimise the chances of fraud and mismanagement. This be subject to such privilege as may be available to a professional in his relationship with his or her client in maintaining confidentiality, and it may be different for different professions.

Tax treatment of LLP

UK LLP Act, s. 10 lays down that a trade, profession or business carried on by an LLP, with the view to profit, will be treated as carried on in partnership by its members and not by the LLP itself. Thus, any asset held by an LLP, or any tax

chargeable on gains made will be treated as held by the partners, or gains made by the partners, and not by the LLP itself. In other words, an LLP enjoys a pass-through status and is not taxable as such; the taxation liability falls on the partners in their individual capacity. In the USA, too, LLPs enjoy a pass through status for the purposes of taxation. The profits or losses of the LLP pass through the business and are reported on each partner's personal returns.

The committee recommended the same pass through status for LLPs in India. However, the committee recognised that it has neither consulted, nor got the views of the Ministry of Finance (Department of Revenue) in this regard. While recommending a taxation regime similar to that obtaining in the USA and UK, the committee urged the Department of Company Affairs to incorporate such a regime in consultation with the tax authorities concerned.

Thus, according to the committee, the LLPs be governed by a taxation regime that taxes the partners as individuals, rather than taxing the LLP itself, that is, the LLPs be treated in the same manner as the firm under the tax laws.

FEATURES OF LLP BILL

Applicability

An LLP will be a body corporate having perpetual succession and a legal personality of its own. It will have at least two partners but there will be no limit on the maximum number of partners that it have. If at any time the number of partners of an LLP falls below two and the business is carried on for more than six months, a person who is a partner of an LLP during the time it carries on business after those six months and is cognisant of this fact will be liable jointly and severally with the

LLP for the obligations of the LLP during that period. Any individual or body corporate may be a partner in an LLP. An LLP being a body corporate, the law relating to partnerships is not generally applicable to a limited liability partnership. Similarly any change in the partner does not affect the existence, rights and liabilities of the LLP. Every LLP will ensure that it has a manager who is an individual and resident in India. The role of a manager is to perform the administrative and filing duties of the LLP and will be held personally liable for all the penalties imposed on the LLP unless he satisfies the tribunals that he not be held liable. Further, in all cases where the manager is liable the LLP will also be liable to the same extent for such defaults. The particulars of such persons, his consent to act as a manager and any change of manager will be lodged with the registrar in prescribed manner and form. A manager need not be a partner of the LLP. However, if no manager is appointed; each partner who is resident in India will be treated as a manager. The LLP will appoint a manager within 60 days from the date on which a person ceases to be a manager.

Incorporation

To form an LLP, there must be at least two persons who are associated for carrying on a lawful business with a view to profit and who subscribe their name to a document called an incorporation document. The incorporation document must be delivered to the registrar in the prescribed form and manner. A statement must also be delivered to the registrar there has been compliance with all the requirements of the enactment. A subscriber must make the statement to the incorporation document and by either an advocate, or a company secretary, or a chartered accountant in whole time practice in India, who is engaged in the formation of the LLP. The incorporation document must contain information such as the name of the LLP, its proposed business, address of its registered office, the name, address

and photographs of the persons who are to be its partners and manager(s) on incorporation. When the registrar receives the incorporation document he will retain and register it. Once the documents have been registered, the registrar will issue a certificate that the LLP is incorporated by the name specified in the incorporation document. The certificate issued by the registrar is evidence that all the requirements have been complied with. Every LLP is required to have registered office in India to which all communications will be made and received. Any change in the registered office will be intimated to the registrar. An LLP, will by its name has the power to sue and being sued, hold and dispose property, have a common seal and to do and suffer such other acts as bodies corporate may lawfully do and suffer. Every LLP is required to have either the words limited liability partnership or the acronym LLP as the last words of its name. An LLP will not be allowed to register with a name, which is undesirable or identical to a name of any other LLP or body corporate or to registered trade mark which is the subject of an application for registration, of any other person under the Trade Marks Act, 1999. The name will be printed on all the invoices and official correspondence along with a statement that it is registered with limited liability.

Partnership

The first partners of an LLP are those who sign the incorporation document. After incorporation, any person may become a partner of an LLP by agreement with the existing partners. The provisions of any agreement between the partners govern the rights and duties of the partners of an LLP to one another and to the LLP. In case, a matter has not been specifically dealt with in the agreement, the provisions set out in the first scheduled will apply. Certain particulars contained in the LLP agreement as may be prescribed and any changes made therein will be filed with the registrar. A person may cease to be partner by death, dissolution of the LLP or in accordance

with any agreement with the other partners of the LLP. While there is no agreement a partner may cease to be a partner by giving 30 days notice to the other partners. However, a person will be regarded as a partner, in relation to any person dealing with the LLP unless the third person has notice that the former partner has ceased to be a partner or a notice in this regard has been delivered to the registrar. Moreover, a former partner may continue to be liable for the acts done in his tenure. Where a person ceases to be a partner of an LLP, a person entitled to his share in consequence to death or insolvency may not interfere with the management or administration of the LLP, but may receive any amount to which he is entitled. Where a person becomes or ceases to be a partner, the manager of the LLP will within 30 days from the date on which the partner becomes or ceases to be partner notify the registrar in the prescribed form and manner. In the case of admission of a partner, a statement by the incoming partner that he consents to be a partner may also be filed in the prescribed form and manner. Similarly where there is any change in the name and address of a partner, the same will be notified. If a person ceases to be a partner and believes that the LLP will not lodge the statement with the registrar, he will himself lodge it.

Extent and Limitation of Liability

Each partner of the LLP is an agent of the LLP but not of other partners. Therefore, a partner will be held personally liable for his own wrongful act or omission, but will not be liable for wrongful act and omission of any other partner of the LLP. An LLP however is not bound by the actions of a partner where that person has no authority to act for the LLP, and the person dealing with the partner is aware of this or does not know or believe that the partners was in fact a partner of the LLP. Further, where a partner of an LLP is liable to a person for a wrongful act or omission in the course of business of the LLP or with its authority, the LLP will be liable to the same

extent as the partner. An LLP being a separate legal entity is liable for an obligation arising in contract or otherwise and the liabilities of the LLP will be met out of its property. A partner will not be held personally liable, directly or indirectly for an obligation of the LLP, solely by reason of being a partner of the LLP. However, this liability shield will be withdrawn in case of an act carried out by a LLP with the intent to defraud creditors or for any other fraudulent purposes.

Duties and Standards of Conduct

The partners of the LLP have obligations of loyalty, due care and good faith.

Financial Disclosures

A LLP is required to maintain proper books of accounts at its registered office relating to its affairs for each year of its existence on accrual basis and according to the double entry system of accounting. An LLP will take reasonable precautions to maintain the records so as to prevent loss or destruction, falsification of entries and facilitate detection and correction of inaccuracies. If default is made in complying with these provisions, the manager will be punishable under the enactment. The manager of an LLP will lodge with the registrar a declaration as to whether in his opinion the LLP appears to be able to pay its debts in the normal course of business or not. The declaration is to be lodged within 15 months of registration and subsequently every financial year at intervals of more than 15 months. If the manager fails to lodge the declaration or makes a declaration without having reasonable grounds for his opinion, he will be punishable under the enactment. Further, if any person makes a statement or furnishes information to a manager that is false or misleading in a material particular, then that person will also be punishable under the enactment. The registrar will have the power to call for further information as he

may require and any person, who fails to comply with any summons or requisition of the registrar or provides false information, be punishable. He will also have the powers to enforce the lodging or filing of any return, account or other document. Further, the registrar may destroy any document lodged, filed or registered with it, if it is no longer necessary or desirable to retain the same.

Taxation

The partners of an LLP, which is carrying on a business in partnership with a view to profit, are treated for the purpose of income tax and capital gains tax as if they were partners carrying on business in partnership, despite the fact that an LLP is a body corporate. It also provides that property of LLP will be treated for those purposes as property of its partners. This ensures that the partners will be individually liable to tax on their share of the profits of the trade, profession or business carried on by the LLP. Further, the assets of LLP will be treated as assets held by partners for the purpose of taxing capital gains. This ensures that the partners of LLP, rather than the LLP itself, will be liable to tax for capital gains on the disposal of LLP assets. This approach brings LLPs in line with the approach adopted for partnerships, which similarly treats assets as held by the partners rather than by the partnership.

Assignment and Transfer of Partnership Rights

A partner's economic rights, which include the rights of the partner to a share of the profits and losses of the partnership and to receive distribution in accordance with the limited liability partnership agreements, are freely transferable. However, a transfer in whole or in part of the transferable interest does not imply the partner's disassociations or dissolution and winding up of the LLP's activities. Further, they do not entitle the assignee to participate in the management or conduct of the LLPs

activities or access information concerning the LLPs transactions. Moreover, the non-economic right will not be transferable unless specified by the LLP agreement.

Winding up and Dissolution

The winding and dissolution of limiter liability partnership may be either voluntary or by the tribunal. The regulations will make provisions for the winding up and dissolution of limited liability partnership.

Others

The bill provides for investigation of the affairs of a limited liability partnership. It also contains provisions regarding conversion from firm, private company, and unlisted public company to a limited liability partnership. The second, third and fourth schedules contains provisions for conversion from firm to LLP, conversion from private company to LLP and from unlisted company to LLP respectively. The bill also deals with foreign limited liability partnership and provides that the regulations will make provisions about features of foreign limited liability partnership. It also contains provisions regarding amalgamation, merger and de-merger of LLP.

ANALYSIS OF THE BILL

Nature of Books

As per the Bill, the liability for maintaining the books of account falls on the manager, but there is no basis provided for determining his liability. It would be unfair to hold the manager liable for any discrepancy in the maintenance of books of

accounts if the law does not clearly states the nature of books that are to be maintained. The law relating to LLPs may mention the kind of books that are to be maintained by the manager. One major drawbacks of the concept paper is that it does not provide any provision for imposing duty on the partners to furnish information to the manager so that he build an opinion on the solvency of LLP as the ultimate responsibility of the fairness of the document of Declaration of Solvency is on the manager and in default of which he is liable. So, the position of manager in the proposed LLP is vulnerable because ultimately he is liable for any irregularities.

Transfer of Assets

Upon conversion of an existing firm into LLP, the assets of such firm or partnership will have to be transferred to LLP. But for such conversion, the law requires that stamp duty and capital gains tax is to be paid. These dual impediments may discourage the conversion of existing firm into LLP. Hence, to make practicable the conversion a more liberalized policy must be followed as far as stamp duty and Capital Gains Tax are concerned. The limited liability partnerships Act, 2000, of the United Kingdom, contain provisions for relief from charges of stamp duty for instruments transferred or conveyed to an LLP after fulfillment of some conditions. The proposed bill incorporates similar provisions. Similarly, as far as capital gains tax is concerned, appropriate exemption must be granted under section 47 of the Income Tax Act, 1961 whereby on conversion of a firm into LLP the transfer of property must not be regarded as a taxable transfer for the purpose of levy of Capital Gain Tax. In the absence of such provisions, the partners of the firm have to pay huge sums as capital gain tax at the time of transfer and it may act as a detrimental for those firms willing to convert itself into LLP.

Manager

Under the LLP Bill, each LLP is required to appoint a manager who is responsible for ensuring statutory compliance for the LLP. The manager need not be partner of the firm and any person be appointed as a manager. The only condition is that the manager be an individual and not an artificial person and that he be the resident of India. There are no qualifications prescribed for the manager nor any disqualifications similar to those regarding appointment of director as provided in Section 274 of the Companies Act, 1956. There is a possibility that partners may appoint manager who is not qualified enough and that person in due course may become scapegoat for the irregular and illegal activities of the partners since he is ultimately responsible to law as far as statutory compliance of LLP is concerned. Then there is also a possibility that an insolvent person is appointed as a manager. In such a situation, nothing may be realized from the firm if the firm turns insolvent and thus creditors remain unpaid. The Bill also does not deal with the manner in which remuneration is to be paid to the manager. Thus, the proposed law provides clear provisions as far as manager is concerned since he is ultimately responsible to the law for acts and omission of the firm.

Auditing of account is another important requirement that has been overlooked by the Bill. There must be an obligation upon every LLP to get its account audited by an auditor. As to who may be an auditor, the conditions be similar to those specified in the Companies Act. The auditor be responsible for the true account of the firm. This is necessary so that accounts show true and fair picture of the LLP so that creditors and all other persons dealing with the firm are having true information about the affairs of the firms.

Compulsory Insurance

A very important aspect of LLP laws all over the world is the provision for compulsory insurance. Compulsory insurance is required to protect the interests of persons claiming against the LLP and to ensure that creditors do not suffer loss. Provisions for compulsory insurance may be found in most LLP laws. The state of Virginia in the US requires LLP to carry liability insurance of at least one million dollars. Liability insurance is generally designed to cover different kind of omissions, negligence, wrongful acts, malpractices and misconduct for which liability is otherwise limited. Insurance companies in UK provide professional indemnity insurance to cover all reasonable costs incurred in the defence or settlement of claims arising from the above as long as they are accidental or unintentional acts. So, it would be better if the Indian law also contains similar provisions relating to compulsory insurance to safeguard the interest of the outsiders. The Naresh Chandra Committee has also recommended in favour of compulsory insurance of all LLPs.

Miscellaneous Provisions

The Bill provides that the Central Government may at any time direct the application of any of the provisions of the Companies Act, 1956 to LLPs. This will not be easily acceptable to those who wish to convert from a company or a partnership firm to an LLP for the simple reason that procedures required under the Companies Act is cumbersome and technical and LLPs aim to avoid such technical procedures. If people do not have assurance that the procedures of company law will not be applicable to the LLPs, they may be reluctant to adopt LLP model. Secondly, the bill does not provide any basis on which the Central Government must make the above direction. Hence, uncontrolled discretion is vested with the government, which is likely to be misused in the absence of proper guidelines.

FEDERATION OF INDIAN CHAMBERS OF COMMERCE AND INDUSTRY'S REACTION TO THE BILL AND SUGGESTIONS

Federation of Indian Chambers of Commerce and Industry (FICCI) has supported the bill and has recommended certain changes in the bill so as to make the proposed enactment as comprehensive as possible and to remove the ambiguity prevailing in the Bill. FICCI has suggested 13 changes in the bill, which are as follows:

- (1) to protect the interest of persons who might have claims against an LLP, UK Laws have provision for compulsory insurance policy for satisfaction of judgment and decrees against the LLP to a reasonable extent. Provisions on compulsory insurance may be incorporated in the LLP legislation in India as well;
- (2) it would be necessary to align LLP legislation in tune with other economic legislation by making appropriate amendment/clarifications to Foreign Exchange Management Act, 1999 (FEMA)/Foreign Direct Investment (FDI) guidelines;
- (3) the Bill provides that the Central Government direct that any provisions of the Companies Act, 1956, will apply to any LLP with such exception, modification and adaptation, as the government may notify. This would lead to an LLP being governed by the Companies Act, 1956, just like a private company. It is suggested that making suitable provisions in the LLP Act itself in this regard will reduce unguided discretion of the government;
- (4) in UK, an LLP must be established and then the business and the assets of the existing partnership or company transferred. There is stamp duty relief on any property transferred within the first year of conversion. A stamp duty relaxation be made available on conversion

of existing partnerships/private and unlisted public companies to LLP in India (this would be in line with the Companies Act, 1956, pt. IX);

- (5) the taxation aspects may be dealt with separately by making suitable amendments to the Income-tax Act, 1961 rather than in the LLP enactment. Does the Ministry of Company Affairs have authority to bring out legislation dealing with taxation? FICCI is of the view that Ministry of Company Affairs and Ministry of Finance have to work in tandem with respect to taxation issues while bringing LLP legislation;
- (6) the taxation described in the Bill seems to be in conflict with the provisions in the Income-tax Act. The Bill regards an LLP to be a body corporate. Therefore, under the Act, the LLP would be regarded as a company and accordingly would be taxed as a company (that is at an entity level) and would also be subject to dividend distribution tax (DDT) in case of dividend distribution. Therefore, if it is desirable to have a pass through treatment for an LLP, suitable amendment would be required in the Income-tax Act, 1961. A separate scheme of taxation for LLPs would be required in the Income-tax Act, 1961;
- (7) with regard to conversions to LLP, the Income Tax Act, 1961 would need to be amended to provide specific exemptions from capital gains tax for gains arising on conversion - exemptions provided for in s. 47 would need to be extended to cover such conversions as well;
- (8) from an exchange control/FDI perspective it needs to be clarified that LLPs would be eligible entities for receiving foreign investment under the automatic route;

- (9) cof all the partners is required before a new partner is inducted. This unanimity may be impossible and difficult to secure, especially if the LLP is very large. The norm would be rule by democracy with the exception being unanimity for venturing into new business. Once again, it is possible that an LLP may be stopped in its tracks by an intransigent minority of one or two. Three-fourth majority for major decisions, including venturing into new businesses, may, therefore, be the norm;
- (10) though there may be a statutory and compulsory requirement to have at least one manager or general partner with unlimited liability, the liability of the LLP in no case may be extended to all partners. Further, it may be ensured that a LLP does not have a dummy for a manager. Hence, proper qualifications in terms of being a partner having sound financial and accounting knowledge might be specified in the enactment especially since he is responsible for ensuring compliance with the significant provisions of the enactment;
- (11) the Bill requires an LLP to maintain proper books of account but does not explain what constitute 'proper books of account'. In the absence of any clarification, it would be very difficult to evaluate compliance with the provision. In this context, it may also be clarified whether electronic records would be considered as proper books of account;
- (12) LLPs having characteristics similar to private companies do not need to have free transferability of partners share. It may be left to the partnership agreement amongst the partners. The provisions of the Bill in this regard may be made subject to the agreement among the partners; and

- (13) there is a need to incorporate relevant provisions relating to foreign LLP and amalgamation, Merger, de-merger of limited liability partnerships in the enactment itself. The provisions may not be onerous (like those in the Companies Act, 1956) and provide for a simple way of amalgamations, de-merger and even dissolution.

CONCLUSION

The LLP will act as an engine of growth for economic development of the country and would lead to the growth of professional services in the country. With the liberalisation and globalisation of Indian economy since 1990s, the LLP, as an alternate mode of carrying business, will encourage joint ventures and would make Indian service sectors globally competitive. The issues raised by the writer during the analysis of the Bill needs to be addressed so that proposed law become more comprehensive in tune with requirement of the modern business environment.

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