

Limited Liability Partnership – Concept & Taxation

Introduction

Limited Liability Partnership Act was made applicable from 01st Apr 2009 in India. However the LLP structure never became as popular as was envisaged. However, after the enactment of Companies Act there is a renewed interest in the LLP structure. There is high enquiry both from new business who want to take an informed decision as to whether to organize themselves as a private limited company or as a LLP as also from existing companies to explore possibility and benefits of conversion into LLP.

The article seeks to provide an in-depth analysis of the various provisions relating to a Limited Liability Partnership (LLP).

Key features of LLP

- a. LLP is a body corporate & legal entity distinct from its partners. LLP has perpetual succession. All the partners shall act as the agent of the LLP but not of the other partners. It is capable of entering into contracts and holding property in its own name.
- b. LLP is managed as per the LLP agreement and within the framework provided by LLP Act, 2008. In absence of LLP agreement as to any matter, execution of mutual rights and liabilities of partners shall be determined or governed as provided under Schedule I to the LLP Act. LLP agreement must specify partner remuneration and interest on capital to take benefit of deduction for Income tax.
- c. Registration of LLP is compulsory under the Act. The certificate of incorporation is the conclusive evidence of its formation. All partners shall have to obtain DIN (Form-7) & DSC, take approval for LLP name (Form-1), file for incorporation (Form-2), obtain certificate of incorporation, file for LLP agreement (Form-3) and then file for partner consent (Form-4). Stamp duty on LLP agreement to be paid as per State Stamp Act.
- d. Only an individual or a body corporate can become a partner in a LLP. A firm or HUF is neither an individual nor a body corporate and hence they cannot become a partner in a LLP. There is no upper limit on maximum number of members in a LLP while the minimum partner requirement is two.
- e. LLP are required to maintain proper books of accounts at its registered office. They have to file a Statement of Account and Solvency within 30 days from the end of 6 months from the closure of FY (Form-8). They are also required to file an annual return with the Registrar within 60 days from close of financial year (Form-11). Audit is mandatory only if turnover > 40 lacs / contribution > 25 lacs unlike a company where audit is compulsory even if there is no transaction. Further unlike a company they can follow either of cash system or mercantile system.
- f. The minimum capital contribution is only Re 1 as compared to a private limited company, where the minimum paid-up capital should be Rs 1 lacs. However a LLP cannot raise money from public.
- g. A firm, private company or an unlisted public company would be allowed to be converted into LLP in accordance with the provisions of the LLP Act, 2008. Upon such conversion, on and from the date of certificate of registration issued by the Registrar in this regard, the effects of conversion as specified in the LLP Act, 2008, all tangible (movable & immovable) and intangible property, all assets, interests rights privileges, liabilities, obligations relating to the firm or the company, shall be transferred to and shall vest in the LLP without further deed / act and the firm or the company, shall be deemed to be dissolved and removed from the records of the Registrar.

- h. A LLP cannot be formed for charitable purposes. It can be formed only with a view to profit may be business or profession. The good part is that professionals can form multi-disciplinary Professional LLP, which was not allowed earlier.
- i. LLP Act is much simpler than the Companies Act and does not have several restrictions such as related party transactions, accepting deposits, loans to directors, making loans & investments, corporate social responsibility etc.
- j. It is not mandatory to register charges unlike in a company. This is perhaps the biggest impediment from perspective of raising loans from banks and FIs and there is some resistance in sanctioning loans to LLP.

Taxation of LLP

Most important thing to note is that a partnership formed under the LLP Act, 2008 shall also be treated as a partnership firm akin to a partnership formed under the Indian Partnership Act, 1932. As per Income Tax Act, 1961 the words partnership, partner and firm shall include LLP, partner of LLP & LLP respectively. Accordingly both are allowed a deduction of Interest on loan & capital from partners up to 12% pa. Salary, bonus commission, royalty, or remuneration by whatever name called to a working partner allowed as deduction upto the maximum following limit: i) on the first Rs 3 lacs of the book profit or in case of a loss: Rs 1.5 lacs or 90% of book profit whichever is more. ii) on the balance of the book profit: at the rate of 60% of such book profit above Rs 1.5 lacs [Sec 40(b)]. And such interest, remuneration shall be chargeable as business profit in the hands of the partner. Share of profit of a partner from a firm / LLP is exempt u/s 10(2A). Therefore though LLP is a body corporate, but its tax treatment is akin to a firm. The only difference is that while Sec 44AD is applicable to a firm, it is not applicable to a LLP.

Some specific aspects of taxation of LLP are discussed below: -

a. Introduction of capital asset into partnership:

As per Sec 45(3) of the Income tax, capital gain in the hand of partner shall be calculated by deeming sale consideration as the value at which it is recorded in the books by the partnership / LLP. However as per rule 23 of the LLP Rules 2009, when a partner introduces contribution (capital) by a non cash asset, it has to be valued by a CA and accounted accordingly in the books of the LLP. Hence it is advisable that assets be introduced at justifiable valuation.

b. Withdrawal of capital:

As per Sec 45(4) the FMV on the date of such transfer shall be deemed to be the full value of the consideration on distribution of capital asset by a firm whether upon dissolution or otherwise. As per Karnataka HC in CIT vs. Dynamic Enterprises 2013-ITRV-HC-KAR-146, Sec 45(4) does not apply if the retiring partner takes only money towards the value of his share and there is no distribution of capital assets among partners.

c. Conversion of partnership into LLP:

While Income Tax Act is silent as to taxability on conversion of a partnership firm into a LLP, however in the opinion of the author conversion of firm into LLP shall be exempt from capital gain taxation if: there is no change in the rights & obligations of the partners and there is no transfer of assets or liabilities post the conversion.

Condition as per LLP Act: A partnership firm may apply to be converted into LLP only if it comprise of all the partners of the firm and no one else. Further partnership should be a registered under Indian partnership Act 1932.

d. Conversion of pvt. ltd company or unlisted public company into LLP:

As per Sec 47, the same shall not be regarded as transfer either in the hands of the company or in the hands of the shareholders if the following conditions are fulfilled: -

- i. All assets and liabilities immediately before conversion are transferred.
- ii. All shareholders immediately before conversion become members in same profit sharing ratio.
- iii. The shareholders do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital consideration in the LLP.
- iv. The aggregate of the PSR of the shareholders of the company in the LLP shall not be less than 50% at any time during the period of 5 years from the date of conversion.
- v. The total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the PY in which conversion takes place does not exceed Rs 60 lacs.
- vi. No amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of 3 years from the date of conversion.

Condition as per LLP Act: A Pvt Ltd co may apply to be converted into LLP only if it comprise of all the shareholders of the company and no one else and there is no security interest on its assets should be subsisting or in force at the time of application. Requirement of NOC from unsecured creditors. Requirement of a statement of assets and liabilities certified by Auditor of not more than 30 days prior to the date of the conversion application. After receiving Conversion Certificate the same to be filed within 15 days with the Registrar of Companies in Form-14.

e. Carry forward & set off losses on conversion of company to LLP:

As per sec 72A, losses can be carried forward if provisions of Sec 47 are complied with. However MAT tax credit cannot be carried forward.

f. Difference in taxation with a corporate

LLP do not attract dividend distribution tax, deemed dividend & wealth tax which are applicable to a company. Remuneration to directors need to be justified u/s 40A (2), the same is not the case on remuneration to partners but the same has to be within limits of Sec 40(b). However for an entity with profit between 1 cr – 10 cr, surcharge in case of LLP shall be 10% but 5% in case of a company. Company is liable to pay Minimum Alternate Tax (MAT) whereas a LLP is subject to Alternate Minimum Tax (AMT)

MAT vs. AMT

	MAT	AMT
Based on	Book profit i.e. profit as shown in P&L a/c as per Company's Act provisions add income tax, deferred tax, provision for contingent liabilities, dividend, provision for diminution in the value of any asset etc	Adjusted total income i.e. total income + deduction Sec 10AA & u/c VIA-Part C (Sec 80-IA, IB etc.)
Increased profits in books due to less rate of depreciation charged in books as compared to allowed under IT Act, 1961	MAT payable on the same.	AMT not payable
Loss brought forward or unabsorbed depreciation	Loss b/f or unabsorbed depreciation, whichever is less as per books is allowed to be reduced before applying MAT.	Loss b/f or unabsorbed depreciation, both as per IT laws is allowed to be reduced before applying AMT.