VOL. XV- February 2009 ISSUE 1 www.aralaw.com

LIMITED LIABILITY PARTNERSHIP

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» Limited Liability Partnership □ A new corporate form in India

The Government of India has enacted the Limited Liability Partnership Act, 2008 (the □LLP Act□) which has come into force with effect from January 9, 2009. The Act proposes to introduce Limited Liability Partnerships (LLP) as an alternative corporate vehicle that allows benefits available to a company under the Companies Act, 1956 (□Companies Act□) and also allows its members the flexibility of organizing their internal management on mutual agreement as in the case of a partnership firm under the Indian Partnership Act, 1932 (Partnership Act). Set out is a brief description of the key provisions of the LLP Act and brief comparisons with companies under Companies Act and partnerships under the Partnership Act.

1. Nature of LLP

LLPs have been defined to be a □Body Corporate□ formed and incorporated under the LLP Act having perpetual succession and a legal entity separate from its partners. The term "Body Corporate" has the same meaning assigned to it under the Companies Act, 1956 but also includes LLPs/companies incorporated outside India thus giving a wider connotation to the constitution of LLPs in India. Contrary to partnerships under the provisions of the Partnership Act, any change in the partners of a LLP under the LLP Act would not affect the existence and constitution of the LLP. The LLP Act does not restrict this form of business to classes of professionals only and permits this vehicle to be available for use by any venture that fulfills the requirements of the LLP Act.

2. Formation of LLP

2.1. Taking a cue from the Companies Act, formation of LLP would also be a paperless affair under the MCA 21 project of the Ministry of Corporate Affairs. The incorporation documents shall be filed with the Registrar of Companies (as under the Companies Act) of the state where LLP is proposed to have its registered office. The incorporation documents shall include details such as name, proposed business, partners□ details, registered office address and other information as may be prescribed. Two or more persons associated for carrying on a lawful business with a view to get profit may subscribe their name to an incorporation document. Use of the words □Limited Liability Partnership□ or the acronym □LLP□ as last words of its name shall be mandatory for LLPs.

2.2. Similar to the provisions of Companies Act, the LLP Act also provides that the certificate of incorporation issued by Registrar of Companies shall be the conclusive evidence of the formation of the LLP. Pre-clearance of proposed names is also mandatory before filing of incorporation documents. However, unlike a company under the Companies Act, change of names of LLPs only requires intimation to Registrar with payment of prescribed fees.

3. Management of LLP

3.1. Partnership Agreements: On incorporation, the subscribers to incorporation document will become partners of LLP and additional partners can be introduced in accordance with the terms of the Limited Liability Partnership Agreement (☐LLPA☐) entered between the partners, or between the partners and LLP. In concept, LLPA seems to be similar to the Articles of Association of a company under Companies Act and primarily includes provisions governing the mutual rights and obligations of partners. The LLP Act provides flexibility to devise LLPA as per choice of the partners. Any modification of LLPA would need to be filed with the RoC, which is different from conventional partnerships under the Partnership Act wherein the registration of partnership deed is not mandatory.

3.2. Schedule 1 of the LLP Act: The LLP Act *per se* does not provide for specific provisions related to holding of meetings, maintenance of minutes and statutory registers as in the case of companies under the Companies Act and such issues seem to be left open to be decided in LLPA. However, if there is no LLPA between the partners, Schedule 1 of the LLP Act will become applicable which provides *inter-alia* that all matters pertaining to the LLP shall be decided by a resolution passed by majority with each partner having one vote (except in case of change of business wherein consent of all partners is required). The Schedule also requires that all decisions shall be recorded in minutes within 30 days and the minutes☐ book is to be maintained at the registered office. Consequently, entering into an LLPA would be necessary if the partners propose to have differential voting rights amongst themselves.

4. Partners and their responsibilities

4.1. Designated Partners: LLP shall have at least two designated partners one of which shall be a resident of India (residing in India for not less than 180 days in the previous year) with no limit on the maximum number of partners. Similar to the responsibility of a Managing Director under Companies Act, the designated partners are responsible for managing the affairs of the LLP and complying with the requirements of the LLP Act such as filing of statutory documents/annual returns and shall also be liable for penalties imposed on the LLP for any non-compliance. The designated partners are required to consent to act as such under the LLP Act and their consents are required to be filed with the RoC. In the event the LLP does not have two designated partners, all the partners of the LLP shall be deemed to be designated partners. Further, in line with recent amendments to Companies Act, the designated partner shall be required to obtain a Designated Partner Identification Number (☐DPIN☐) from the Central Government. A notice to the RoC shall be filed with each admission and cessation of the partners (including designated partners) in LLP within 30 days of admission or cessation as the case may be. A body corporate may also become partner in LLP with its nominee acting as designated partner.

4.2. Liability of Partners: Partners of LLP shall not be personally liable for the wrongful acts or omission of any other partner(s) except in the case of unauthorized acts, fraud and negligence. The liability of partners shall be limited to the extent of investment made by them in the LLP. Hence the concept of joint and several liability of the traditional partnership form of business shall not be applicable in the case of LLPs. The LLP Act also does not restrict a partner from entering into a business relationship with the LLP. The LLP Act has introduced the concept of ☐Whistle Blowing☐ wherein the liability of any partner/employee may be reduced/waived if such partner/employee has given vital information during any investigation or such information leads to the LLP and/or its other partners to conviction and the LLP Act shelters such partner/employee by clarifying that the LLP shall not penalize the partner/employee merely for sharing of information.

4.3. <u>Contributions by Partners</u>: Contributions by partners to the LLP may be in the form of tangible or intangible assets including movable, immovable property, money, promissory notes, cash, contract for services performed or other benefits to LLP. The respective obligations of partners to contribute to the LLP would be governed by the terms of LLPA.

4.4. <u>Transferability of partnership</u>: The LLP Act provides for transferability of rights of a partner in profit share and losses and also to receive distributions in accordance with LLPA. The LLP Act however, clarifies that such transfer would not automatically entitle the assignee/transferee to participate in the management and administration of LLP and the partner does not get disassociated or it does not lead to winding up of LLP. This seems to suggest that the modalities/effect of transfer would be such as agreed between the partners in LLPA.

5. <u>Miscellaneous:</u> Apart from the above key provisions, the LLP Act lays down procedures for mergers and amalgamations of LLPs and provides for conversion of a firm, private company or an unlisted public company into an LLP. The winding up of an LLP would either be voluntary or may be ordered by the National Company Law Tribunal (□NCLT□) to be established under the Companies Act. The LLP Act clarifies that LLPs will not be wind up on the death or insolvency of a partner.

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» Limited Liability Partnership □ A Tax angle

The Concept Paper on the earlier version of the LLP suggested that LLP should be treated as a □firm□ under the Income Tax Act, 1961 (□IT Act□) and the partners of LLP be placed at the same footing as partners under the Partnership Act vis-à-vis income/capital gains tax. This is despite of the fact that LLP would be bodies corporate. Notwithstanding the same, the aspect of tax treatment of LLPs to be formed under the LLP Act remains an area of uncertainty as of now.

Notwithstanding the observations made in the Concept Paper, the Ministry of Corporate Affairs in one of its report to the Ministry of Finance has suggested that LLPs should be free to choose whether the tax would be paid by the LLP or by the partners based on their mutual understanding.

Two possible modes of taxation of LLPs can be analyzed as follows:

a. LLPs to pay tax on its profits after deduction of business expenditure, salaries and interest paid to the partners wherein partners will be liable to pay tax on salary and interest receipts and the share in profits would be exempt (this is the same as the current provisions of the IT Act with respect to taxation of a partnership firm). This is also similar to taxation of LLPs formed in the UK.
b. Alternatively only the profits in the hands of partners of the LLP will be taxed. The partners will be liable to pay taxes on their respective share of profits received in their hands from the LLP. This is also known as *Tax Transparency and Pass through Status* to LLP. Particularly in context of India, it is very important because today to set up a domestic venture capital fund normally the trust structure is implemented. A trust structure is very much possible but it has its own issues and limitations alongwith the fact that it is regulated by an antiquated legislation. Hence in a way the LLPs would be more tax efficient vehicle compared to trust and would be an incentive to go for LLP similar to General Partnerships and Limited Partnerships in US. However this would be contrary to the existing system of taxation of partnership firms under the IT Act.

The ambiguity on taxation of LLPs to be formed under the LLP Act could be put to rest only on promulgation of appropriate directives/notifications under the IT Act.

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» Limited Liability Partnerships □ A Comparative Analysis with UK and US Models

LLPs in UK: With the introduction of Limited Liability Partnerships Act 2000 in April, 2001, the LLP concept remains somewhat of a novelty among UK laws. Still, the Indian Parliament seems to have used the UK Act as a model for the LLP Act. LLPs under the UK Act and the LLP Act shield partners from personal liability for each other□s actions and (save for situations of fraud or wrongful trading) limit losses to the partner□s contribution. However, the LLP Act differs from the UK LLP Act in a few important ways. First, the UK Act has no □resident□ requirement, whereas the LLP Act requires at least one designated partner to be □resident□ of India. Second, the Act requires two designated partners for incorporation whereas the UK LLP Act requires only one. Third, unlike the UK LLP Act, the LLP Act specifies a time limit for which an LLP can operate with one partner. Fourth, the UK Act requires LLPs to buy an insurance policy for satisfaction of liabilities pursuant to contrary judgments (if any), which concept has not been inculcated in the LLP Act.

LLPs/LLCs in US: LLPs originated in the United States in the 1990□s as a number of business scandals prompted lawyers to worry about personal liability and lobby for more protection than under general partnership law. American LLPs would differ markedly from the proposed Indian LLPs under the LLP Act. The LLP Act would apply uniformly throughout the country, whereas US LLP policy differs from state to state. Some states, like New York, limit LLP status to professionals requiring licenses whereas the LLP Act proposes no such limitation. Moreover, LLPs in states like Texas limit the liability to the partnership□s non-malpractice contractual and tort liabilities. Other states, like Delaware, mirror the LLP Act by extending liability to all obligations of the partnership. The LLP Act may best resemble American Limited Liability Companies (□LLCs□) statutes because United States LLCs and Indian LLPs generally protect owners from personal liability for business debts and claims. However, LLCs in the United States can be distinguished from Indian LLPs. Unlike Indian LLPs, LLCs are not technically a □body corporate□ and can be formed for non-profit purposes.

Conclusion

The implementation of the LLP Act is a way forward in the right direction. The legislation provides the flexibility for entrepreneurs/professionals to organize and operate their business/profession in an innovative and efficient manner. However it is yet to be seen how far this structure would remain tax effective as the promulgation of tax rules for LLPs is not likely to take place before the budget. Hence effective implementation of the Act probably would be a post election affair.

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