Limited liability partnership in India

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ABSTRACT

There are many business relationships existing in today’s world. The oldest form of business relationships is Partnership. In terms of complex business, limited liability companies have replaced partnerships but still, the partnership is preferred for business enterprises and small trading for professionals worldwide. But nowadays partnership has lost its demand primarily for “unlimited liability of partners.” In case any liability arises, each partner in the company has the risk of exposure of personal assets. Since 1907, there have been reviews on partnership in various countries carried out by law commissions for modernization. After such reviews, Limited Liability Partnership or LLP has been introduced as the first form of such businesses.

A Limited Liability Partnership is best described as a partnership that has been protected with an outer shell of limited liability. It is a corporate business vehicle having a separate legal entity. An LLP is a corporate structure combining the “advantages of limited liability of a company at a low compliance cost” and flexibility of a partnership. It continuously exists as a company with a separate legal entity. The members have limited liability only to the extent of the contribution made by that member. But there exists unlimited liability in cases of fraud, malpractice, and wrongs. The partners in the company have a right to manage the business. It limits the personal liability of a partner for errors, omissions, incompetence or negligence of the LLP’s employees or other agents. Anyone can sue an LLP an, in turn, it can also sue. LLP’s can use its name to enter into contracts and deeds, unlike a general partnership. Neither there is any restriction on the number of members nor are there any restrictions on what an LLP can do or not. LLPs are sometimes regarded as “artificial persons in the eyes of law”.

The liability of a member is limited to his capital contributed to the firm. Where a claim is made against a member who is personally at fault [for example in a claim for negligence] he should be protected by the limited liability unless he accepted a personal duty of care or a personal contractual obligation. Experts strongly recommend the LLPs to have a private document which would include “bespoke members’ agreement” otherwise at a later stage, the provisions in the LLP regulations would not be appropriate for most of the businesses. A share capital does not exist in an LLP. Whenever there is a conversion from existing partnership to LLP status, the existing clauses can be used in the members’ agreement. Such an agreement must comply with the aspects of Company Law and The Insolvency Act, 1986. In terms of taxation, the LLP itself is not taxed. A legislation has also been drafted for making the conversion of a partnership to an LLP a neutral event. Profit shares and capital contributions are very easy to handle and there are minimum tax and legal consequences. Not only professional firms are turning into LLPs, but it is a whole new structure for other business enterprises.

2. ADVANTAGES

- Organising the internal structure of LLP is more flexible comparing to organizing the internal structure of a company.
- No upper limit for the members in LLP whereas there is an upper limit of 200 shareholders in a Private Limited Company.
Partners raise and utilize funds as per their own wish. But there are certain norms regarding funds in Companies Act, 2013.

Dividend Distribution Tax [DDT] is not paid by LLPs whereas DDT must be paid by a company.

3. DISADVANTAGES

- An act of a partner binds the LLP.
- Money cannot be raised from the public by an LLP.
- Venture Capital firms and angel investors prefer Private Limited Company over LLPs.

4. LIMITED LIABILITY PARTNERSHIP and A TRADITIONAL PARTNERSHIP FIRM

| Liability of Partners | Limited Liability Partnership | Liability to the extent of agreed contribution. He is not liable for the unauthorized acts of other partners and is free from joint liability. | Every partner in the firm is liable jointly with other partners as well as in his individual capacity as long as he is a partner. |
| Administration | LLP Act is enacted and enforced by Central Government which provides uniformity in the application. | Provisions of Partnership Act, 1932 is enforced differently in different states by the State Governments. |
| Entity | An LLP has a separate legal entity and is liable for obligations in a contract. | It does not have a separate legal entity. |

5. SOME ENGLISH PRECEDENTS ON LLPs

The decisions delivered by the English Courts on the matter of LLP are useful. This is because:

- Limited Liability Partnership Act of India, 2008 has been derived from English LLP Act, 2000.
- The Indian judges rely on the wisdom of English judges.

In Re, Rogers case, a will was executed where partners were appointed as executors and trustees. Eventually, this firm was merged with another firm and was incorporated as an LLP. The question that arose was that whether the change into an LLP was sufficient to carry out the words in the will. The Court held that a commoner would not know the difference between partnership and LLP and members are not partners in an LLP.

In the matter of Magi Capital Partners LLP, the case deals with the dissolution of LLP where it was stated that an LLP is more like a company rather than a partnership as this involves winding up of a separate legal entity incorporated under a statute. So, LLP cannot be referred for arbitration unless there involves bad faith of the members. The Court observed that “it is not an ordinary partnership, it is a limited liability partnership, it is accepted that that creates a different entity, which is a creature of statute and that is not possible to exclude the statutory right to apply to have the statutory entity wound up by the court.”

The case of Hailes v. Hood & Others involved question of constructing a settlement agreement between solicitors for plaintiff and defendant. The nature of an LLP and interest of a partner has been discussed in this case. The Court observed that the liability of the members is limited to their contribution and interest of a member is one or more of the components of his share.

6. LIMITED LIABILITY PARTNERSHIP IN INDIA

Aspirations of the people keep changing from time to time and the States should make laws accordingly to keep pace with it. There has been considerable growth in India in recent years. The professional manpower and quality of Indian entrepreneurs are acknowledged globally. The introduction of a new corporate entity was badly needed combining the characteristics of corporate and non-corporate entities. As a result, Limited Liability Partnership Act, 2008 was enacted and Limited Liability Partnership came into existence. The professionals and entrepreneurs would be able to organize and provide for a wide range of services to the corporate sector efficiently.

The Limited Liability Partnership Act is enacted to provide the advantage of limited liability partnership.

According to Section 2(n) of Limited Liability Partnership Act, 2008: “Limited Liability Partnership means a partnership formed and registered under this Act.”

Again, Section 3(1) of the Act says that: “A limited liability partnership is a body corporate formed and incorporated under this act and is a legal entity separate from that of its partners”.

LLP is a model which combines the features of a “corporate sector” and “a partnership firm structure” which provides an “efficient combination of professional expertise and entrepreneurial initiative in an innovative manner.” An LLP is like a Body Corporate and is registered under the LLP Act giving flexibility to it. It is organized and operated based on “LLP Agreement.” The Handoo and Handoo is the first LLP company in India.
7. ORIGIN AND DEVELOPMENT

The idea of introducing Limited Liability Partnership in India can be traced back to 1957. The Law Commission was not happy with the suggestion of introduction of limited liability partnership as LLPs would violate the provisions of The Companies Act, 1956. The idea of LLPs was next introduced in Naresh Chandra Committee Report in 2003 where LLP was described as “a hybrid between a company and a partnership but much closer to the private company form” from the legal perspective. The recommendations from J.J.Irani Expert Committee on Company Law in 2005 followed this which suggested for a separate legislation for LLPs in India and also to extend the “scope of LLPs to small enterprises.” On 2 November 2005, the Ministry of Company Affairs introduced a concept paper on LLPs to stimulate public debate over LLP ideas, which finally led to the declaration of the proposed Limited Liability Partnership Bill, 2006. The bill got introduced in Rajya Sabha on 15th December 2006 and was referred to the Standing Committee on Finance which gave a green signal for “creation of a new type of corporate entity, the limited LLP.” The Bill includes:

- Characteristics of an LLP
- It's method of incorporation
- Rights and obligations of LLP and its partners
- Lists penalties for infractions.

After the bill is passed in the Rajya Sabha on 24th October 2008, the Bill was tabled in Lok Sabha where the Bill was passed without any obstructions. On 7th January 2009, the President gave his assent to the bill which was then notified in The Official Gazette in 2009. The Central Government put the Act in force on 31st March 2009 and LLP rules came effectively from 1st April 2009. There had been further amendments in LLP Rules in 2011.

8. NEED FOR THE LIMITED LIABILITY PARTNERSHIP IN INDIA

We can say that in coming years, Indian professionals may provide services like legal accountancy and other technical/professional services to several entities across the world. Multidisciplinary combinations would be required to provide a variety of solutions to the international clients. But it is a risky and unattractive job to be a member of a partnership firm where there are unlimited personal liabilities in an increasingly litigious environment. This could be one of the reasons that firms of professionals like accountants and lawyers have not grown and so they could not successfully meet challenges which are put forward by international competition. So, a new corporate entity is required as an alternative to a traditional partnership with limited liability and flexible business environment to organize and operate in flexible and efficient manner. It would make possible for professionals, entrepreneurs and service providers for operating in an efficient manner so that they can stand out in the international market and give competition to the international entities.

The professionals in India like lawyers/advocates, doctors, and chartered accountants are prevented from practicing through companies. The introduction of LLP structure would provide an advantage to such professional services. It would be a suitable vehicle for partnership among professionals who are already regulated such as Company Secretaries, Chartered Accountants, Cost Accountants, Lawyers, Architects, Engineers and Doctors particularly accountants and auditors who are not legally permitted to operate as a company. The professionals who are not able to use the corporate structure and do not find the partnership structure viable find LLPs very useful.

Further, FDI investments in entrepreneurial projects which are having LLP model would be an encouragement to small entrepreneurs in India for exploration of business ventures along with foreign investment/collaboration. Leaving aside professionals and small enterprises, LLP structure is nowadays preferred by small businesses. Foreign entities which have project offices in India opt for LLP structure which reduces risk.

9. ISSUES AGAINST THE PRESENT LEGAL POSITION FOR INDIAN LLPs

Certain issues in LLP Act need to be addressed for LLP regime to take its full color. Like any other law, this Act also has ambiguities. For some of the issues, one may draw certain perspectives from the legal position in other countries; but there are important issues to ponder over.

Taxation of the LLPs – Matters relating to taxation of LLPs are not included in the LLP Act because Tax Laws include taxation related matters in India. The Finance Bill 2009 proposed for the taxation scheme of LLPs to be included in Income Tax Act. It was proposed for taxing LLPs similarly like the taxation of general partnerships under Indian Partnership Act, 1932, that is, “taxation in the hands of the entity and exemption from tax in the hands of its partners.” The Finance Bill, 2009 granted a “limited liability partnership” and a general partnership the same tax treatment. There were consequent changes in The Income Tax Act,1961 like-

a) The word ‘partner’ would include a partner of a limited liability partnership in its meaning.

b) The word ‘firm’ would include limited liability partnership in its meaning.

c) The word ‘partnership’ to include limited liability partnership within its meaning

as this has been proposed in The Finance Bill 2009 which have been defined in The Limited Liability Partnership Act,2008. It has also been proposed in the Finance Bill 2009 that the designated partner shall sign the income tax return of an LLP, or, where for any unavoidable reason such designated partner is not able to sign the return or where there is no designated partner as such, any partner shall sign the return. There will be no tax implications on conversion from a company to an LLP if there is no transfer of assets and liabilities and there is no change in rights and obligations of the partners.
The problem of Double Taxation - The foreign investors are offered the much-awaited form of business organization in India having limited liability and without double taxation which is known as Limited Liability Partnership. The small and closely-held US businesses have a remarkable effect on their ability due to the LLP which targets the ever-growing and impending Indian market. Taxing a foreign jurisdiction is often regarded as a wasteful expenditure which entails disproportionately low returns. Such treatment in tax caused some unrest among the potential foreign investors who would be taxed double in respect of income earned by an LLP located in India as the tax would be imposed upon the profits and when the profits are distributed among the partners, the partners would also be taxed on the profits received. This is not included in the double taxation avoidance agreements entered by India and other countries. But when an LLP is compared with a company, an LLP must pay tax only once and is not taxed at both levels [here exception lies in cases of foreign partners].

Unlimited Liability in Taxation – A new Section 167(C) has been introduced in The Income Tax Act, making every partner of an LLP jointly and severally liable for the taxes to be paid by the LLP for the period during which he was a partner, unless the non-recovery of taxes cannot be attributed to gross neglect, misfeasance or breach of duty on his part. Although this section appears to conflict with the scheme of the LLP Act, which does not make the partners personally liable for the liabilities of the firm, it seems to be in line with existing provisions of Section 179 of The Income Tax Act, which cast a similar liability on the Directors of a private company in liquidation.

Conversion of the Company – One of the key conditions for converting a company [Private or unlisted Public] to an LLP is that “there should be no security interest subsisting on assets or in force at the time of application.” In most cases where a company wants to get converted to an LLP, they have security interest subsisting on assets. The Union Budget also tried to remove the ambiguity of taxability, that is, there will be no tax implications when partnership firm converts to an LLP if the partners have the same rights and obligations and if there is no transfer of any assets or liabilities post-conversion. But however, there remains serious ambiguity as the government is not willing to allow tax-free conversion of unlisted companies into LLPs.

No conversion back – A firm or a company can convert itself to an LLP. But once converted, there are no provisions in the LLP Act for converting back to partnership or company.

10. PRESENT POSITION IN INDIA

There have been several amendment procedures in the laws regarding registration of LLPs to stimulate the growth of Start-ups and small businesses. Some of the procedures are merged together to make the registration process easier which have left a lasting impact on the formation of LLPs in India.

The latest amendment brought by the government includes allotment of Director Identification Number [DIN] to the ones who are willing to register the Private Limited Company. The form DIR-3 [Application for allotment of DIN] had been suspended till March 2018 where individuals must disclose their relationship with the proposed company. DIN is a primary requirement to register an LLP in India as the Designated Partners to be appointed in LLP shall mention the DIN allotted to make initial application for name approval or for LLP registration.

Due to the postponement of DIN application, the companies could not apply for allotment of DIN for changing into LLP. Till 2018, the incorporation of LLP cannot be processed. The procedure to register LLP in India is not amended and therefore the application is to be made through the filing of e-forms at MCA portal. An application to incorporate the LLP should be made by accompanying the Documents Required for Limited Liability Partnership Formation within ninety days for registration of the name of the company. LLP Agreement should be filed with Ministry within thirty days of incorporation. The entrepreneurs have only two options during the suspension, either wait to re-deployment or register themselves as “new organization type and commerce business.” Government is working continuously to ease business.

11. CONCLUSION

It is known to us that every law has loopholes. Businesses should have an accountable environment to operate for maximization of resource utilization. One of the steps taken in this regard is the introduction of Limited Liability Partnership in India. But there are many loopholes which make a great concern in future. To regulate both types of companies, the law reflects a “common minimum standard” approach rather regulating each sector differently. The justification given by the law makers is that public companies aim at public interest whereas private companies have minimal public interest. The Centre should try to make efficient laws for regulating LLPs as LLP is a new concept and requires a lot of deliberation. The implementation of the law should ensure maximum benefit to everyone involved so that LLP would be made a form of corporate governance popular and widely accepted. The Ministry has already started the mission and we can hope that it culminates at the beginning of a new law in the country in future.

12. REFERENCES

[5] 2003 EWHC 2790 (Ch)
[7] 2007 EWHC 1616 (Ch)
[10] Professional services are those where unique functions are performed by independent contractors or consultants; whose occupation is the rendering of such services. Such service providers would include accountants, brokerage firms, business consultants, business development managers, engineers, law firms, software engineers and web designers. Such services may be delivered through a host of structures including partnerships, firms, and corporations, in addition to delivery by individuals holding professional licenses.