A Study on Limited Liability Partnership as an Emerging Business Form for Entrepreneurs

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Abstract

Purpose – The Partnership Act, 1932, puts unlimited liability on the partner whereas, the laws regulating the companies viz. Companies Act, 1956, wants the people running the company to comply with various provisions otherwise heavy penalty has to be paid including imprisonment. A new type of business i.e. Limited Liability Partnership (LLP) came into picture with the enactment of Limited Liability Partnership Act, 2008 (the Act), which was notified on 31st March, 2009. This structure has become quite popular among Small and Medium Enterprises (SMEs), professional services and small businesses since this business form seeks to incorporate the operational flexibility of the partnership with the benefits of limited liability and separate legal identity of a company.

Therefore, this paper discusses the differences between an LLP, a partnership and a company while analyzing the procedure for setting up an LLP, conversion of an LLP from a partnership or a company, winding up of an LLP and the taxation procedure of LLPs. The paper further analyses the LLP Act, 2008 to gauge how LLP as a business form will benefit the SMEs. The paper also highlights the gray areas of the Act and other problems faced by LLPs via case studies and views of the experts.

Design/methodology/approach – The research is based on doctrinal methodology. Various statutes, views of jurist and articles have been taken into account while writing this paper.

Findings – The conclusion of this research paper is that that for SMEs which are looking for such a business structure which has a limited liability along with less cumbersome setting up and taxation procedures, LLP is the best option to go for. Also some gray areas in the LLP Act, 2008 are discussed in the paper and the paper suggests that these need to be addressed by the law makers for smooth running of such structure.

Research limitations/implications –

The scope of the paper is limited to studying and analysis the suitability of LLP for entrepreneurs who are SMEs or small businesses.

Practical implications – The result of this study will help the upcoming entrepreneurs which are SMEs and small businesses to decide how useful LLP will be as a business structure. Also, it would help them to distinguish an LLP from a partnership firm and a company.

Originality/value – This study is probably the first to distinguish an LLP from a partnership and a company as a suitable business structure for SMEs and small businesses.
Keywords  Limited Liability Partnership (LLP), Small and Medium Enterprises (SMEs), Partnership, Company, Compliance and Tax Requirements,

Paper type  Research Paper

CHAPTER-I

Introduction
The Limited Liability Partnership\(^1\) is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its members and flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form enables the entrepreneurs among others to provide services of any kind and form commercially efficient vehicles suited to their requirements.

The Limited Liability Partnership is envisaged to be a corporate form distinct from a joint stock company set up under the Companies Act, 1956 as well as a partnership firm set up under the Partnership Act 1932. Thus, the LLPs are formed under the Limited Liability Partnership Act of 2008\(^2\) which provides entrepreneurs the benefit of a separate legal entity, together with organizational flexibility and non cumbersome disclosure requirements. With that view, the Act provides for “the formation and regulation of limited liability partnerships” in India, thus founding a legal basis for this hybrid of a company and a traditional partnership, as also having some features of a *sui generis* nature.

Further, the SMEs are looking at a low risk business vehicle and with the advent of LLPs in countries like the US, UK and Singapore, this special business vehicle has the right amount of organizational flexibility with limited liability to its partners to appeal to the small businesses and the entrepreneurs as well. The Ministry of Corporate Affairs has also emphasized on the role played by the entrepreneurs to introduce the concept of LLPs in India. The Ministry felt the need to introduce the LLP structure in India in order for entrepreneurship, knowledge and risk capital to combine and provide a further impetus to India’s economic growth.\(^3\)

Thus, having presented an overview of the Act in the present Chapter, Chapter II deals with the history of LLPs in US, UK, Singapore and India. It also deals with the distinction between LLP and a partnership firm/company and the features of the LLP are also broadly discussed. Chapter III critically analyses process of incorporation, conversion, taxation and winding up of an LLP. During the course of this Chapter, various implications of the provisions of the LLP Act on the entrepreneurs is also discussed. Chapter IV tackles the question whether the LLP Act and the LLP model as present in India is beneficial to the SMEs and the entrepreneurs. Lastly, Chapter V concludes by examining the overall impact of the LLP Act on businesses, particularly SMEs and entrepreneurs.

NOTES:

1. Hereinafter called “the LLP”.
2. Hereinafter called “the Act”.
CHAPTER-II

Background & Nature of LLPs

History of the LLP Act, 2008
The LLP structure in India is broadly based on the LLP statutes of U.K. and Singapore, albeit modified to suit the Indian scenario. Whereas, the LLP structure in the U.S. is diametrically different from that of India. Hence, a brief history regarding the legislation of U.S., U.K. and Singapore will enhance the understanding the need for an LLP structure in India.

Singapore
In Singapore, a Study Team on Limited Partnerships and LLPs was set up by the Ministry of Finance in November 2002, to work out the details of the legal framework governing limited partnerships and limited liability partnerships. The Singapore Limited Liability Partnership Act, 2005 came into effect on April 11, 2005. By having a close look at the legislation, one can conclude that the Singapore LLP Act is broadly modelled on the Delaware Revised Uniform Partnership Act (the “Delaware Code”).

A LLP is required at all times to have at least two partners, with the exception that if the LLP is left with only one partner, the remaining sole partner is given a grace period of up to two years to find a new partner. If the LLP continues with less than two partners for more than two years, the remaining sole partner assumes unlimited liability and is vulnerable to winding-up by the courts.

U.S.
The idea for the LLP has been credited to “a twenty odd person law firm from Lubbock,” Texas. The LLP was a direct outgrowth of the collapse of real estate and energy prices in the late 1980s, and the concomitant disaster that befell Texas’s banks and savings and loan associations. As a result, the first law on LLP came into existence in Texas, through the enactment of Texas House Bill 278 on August 26, 1991. With the promulgation of the Revised Uniform Partnership Act (‘RUPA’) in the US in 1994, a number of states permitted the formation of LLPs, which was followed by the incorporation of comprehensive provisions dealing with LLPs in the RUPA in 1997. After Texas passed its LLP legislation, most other states quickly followed and today all 51 states have passed laws that permit the formation of an LLP. Further, the National Conference of Commissioners on Uniform State Laws adopted the Uniform Limited Liability Company Act in 1996 and revised it in 2006.

In the U.S., an LLP is considered as a special type of partnership that requires a special filing with the State where the partners operate. This partnership form offers all partners the right to participate in the management and the operation of a partnership without subjecting themselves to unlimited personal liability as is the case in general partnerships.

U.K.
In early 1997 the UK Department of Trade and Industry (“DTI”) circulated a consultation paper and their investigation focused particularly, but not exclusively, on the joint and several liability of professional defendants, seeking to ascertain whether there was an arguable case for replacing joint and several liability by, for example, a system whereby each defendant might be liable for only a proportionate share of the loss. Although the remit did not extend to
the question of joint and several liabilities within partnerships, the DTI took the opportunity to consult on the distinct but related question whether to amend the law in Great Britain to allow limited liability partnerships. This question was asked in the knowledge that the concept of LLPs was well known in some overseas jurisdictions, particularly the USA.\textsuperscript{12}

The UK Limited Liability Partnerships Act 2000 came into force on 6 April 2001. The legislation provides an LLP the organisational flexibility and taxation status of a partnership along with limited liability for its partners.

The main distinction between the US Delaware LLP model\textsuperscript{13} and the UK LLP model is that while the former regards the LLP as essentially a partnership, the latter primarily treats it as a company.\textsuperscript{14} The existence of an LLP in the UK as a separate legal entity means that it has its own rights and liabilities, distinct from those of its members.\textsuperscript{15} In the UK, an LLP differs from a company to the extent that the former has greater organizational flexibility and is taxed as a partnership. In the UK, LLPs are accorded ‘entity’ treatment whilst partnerships governed by the provisions of the UK Partnership Act are generally treated as aggregates of individuals.\textsuperscript{16}

\textbf{India}

The idea of the introduction of a limited liability partnership in India was floated as long ago as 1957 to the Law Commission of India.\textsuperscript{17} However, the suggestion was not accepted by the Commission at that time due to inherent shortcomings of the LLPs which might render the provisions of the Companies Act, 1956 which were recently made stricter.\textsuperscript{18} However, it was the Naresh Chandra Committee Report in 2003 that re-introduced the need to start LLPs in the service industry, which, it described, in a legal perspective, as a hybrid between a company and a partnership, but much closer to the private company form.\textsuperscript{19} This was soon followed by the recommendations of the J. J. Irani Expert Committee on Company Law in 2005 to enact a separate legislation for LLPs in India, and also to extend the scope of LLPs to the small enterprises.\textsuperscript{20} As a result, on November 2, 2005, the Ministry of Company Affairs introduced a concept paper on LLPs with a view to stimulating public debate over ideas, which finally led to the promulgation of the proposed Limited Liability Partnership Bill, 2006.\textsuperscript{21} The Bill was introduced in the Rajya Sabha on 15\textsuperscript{th} December, 2006 and referred to the Standing Committee on Finance, which permitted the creation of a new type of corporate entity, the limited LLP. The key features of the Bill are that it defines the characteristics of an LLP, its method of incorporation, the rights and obligations of the LLP and its partners, and lists penalties for infractions.\textsuperscript{22}

After being passed in the Upper House on October 24, 2008, the Bill was tabled in the Lok Sabha, which also passed the Bill without any changes.\textsuperscript{23} On January 7, 2009, the LLP Bill received the assent of the President and was thereafter notified in the Official Gazette in 2009, and the LLP Act was put into force by the Central Government on March 31, 2009. The LLP Rules were made effective by the Central Government from April 1, 2009.\textsuperscript{24} The Ministry of Corporate Affairs has also issued two notifications on July 5, 2011 and November 4, 2011, thereby amending the LLP Rules.\textsuperscript{25}

\textbf{Distinction from a traditional partnership firm and a company}

Since the time that LLP has been introduced in India, it has become an additional option for entrepreneurs, business owners and investors starting new ventures to incorporate their business as an LLP, instead of a traditional partnership firm or a company. Prior to the
enactment of the Act, entrepreneurs who wished to do business had to either register themselves as sole proprietors or partners or a body corporate. However, the Act introduces an alternative business vehicle namely, an LLP, which offers a hybrid of characteristics between a traditional partnership firm and a company. However, LLP is a distinct entity from either a firm or a company and therefore, a comparison between the LLP and a firm/company will highlight the distinct features of an LLP structure.

**LLP and a Traditional Partnership Firm**

In a traditional partnership firm, every partner is liable, jointly with all the other partners and also alone in his individual capacity for all the acts of the firm or other partners in course of the partnership business while he/she is a partner. Under the LLP structure, liability of the partner is limited to his agreed contribution. Further, no partner is liable on account of the independent or un-authorized acts of other partners, thus allowing individual partners to be shielded from joint liability created by another partner’s wrongful acts or misconduct.

There are differences in the administration of the provisions of the Partnership Act, 1932 in various states, as the enforcement of the Act is at the state level. For eg, filings for registration and changes in the details of the partners vary from state to state. However, the rules for enforcement of the LLP Act are made by the Central Government and hence there is uniformity in the provisions applicable to LLPs.

A partnership firm is not a legal person, i.e, it does not have a separate legal identity from its partners. However, an LLP is a body corporate having a separate legal existence. Thus, an LLP being a separate legal entity is liable for an obligation arising in contract or otherwise and the liabilities of the LLP shall be met out of its property

**LLP and a Private Limited Company**

A basic difference between an LLP and a private limited company lies in the fact that the internal governance structure of a company is regulated by the Companies Act, 1956 whereas for an LLP, it would be by a contractual agreement between partners called the LLP Agreement. Further, the management-ownership divide inherent in a company is not there in an LLP.

An LLP also has a simpler and less expensive process of formation as compared to a company. This is because the yearly cost of compliance in case of private company can be substantial. Under the Companies Act, 1956 and the rules made there under, a limited liability company is required to consider balance sheet, profit and loss account, hold meetings, directors report and auditors report; make a declaration with regard to dividend and appoint auditors, while annual compliance in case of LLP consists of presentation of statement of account and solvency along with annual report only. Practically, the effort and cost of compliance in case of LLPs is a fraction of what is required in case of a private limited company.

**Features of an LLP**

The LLP has been floated as a unique business vehicle to address the vacuum that existed between partnership law and company law. Thus, LLP is a marriage of principles of company
law and partnership law in order to address the deficiencies in both the areas for small scale business and professional firms. Thus, the features of the LLP are a combination of both the company law and partnership law to create a distinct vehicle to bridge the gap between the two.

An LLP is a “body corporate formed and incorporated under the Act” and therefore has a “separate legal entity” together with all the characteristics of separate legal personality akin to a company, i.e., perpetual succession, capacity to sue and being sued, capacity to own and otherwise deal with property, both movable and immovable and common seal. Being a separate entity, the existence, rights or liabilities of the LLP are not affected by a change in the partners. As a result, the partners are agents of the LLP and not of each other and hence, are not in general liable for its debts and obligations. Further, since an LLP is not a partnership, there is no implied duty of good faith between the members. Their relationship with the LLP will be of a fiduciary nature. The Act also provides for the residuary provision conferring upon the LLP the power of “doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.”

**The LLP Agreement**

An LLP is to be organized and operated on the basis of an agreement known as LLP Agreement. The mutual rights and duties of partners amongst themselves and those of the LLP as a separate legal entity shall be governed by the LLP Agreement. However, entering into an LLP Agreement is not mandatory. In absence of an agreement as to any matter, the mutual rights and liabilities shall be provided under Schedule I of the Act, as a matter of default. Thus, in this respect, flexibility is provided to the partners in order to customize the governance of their LLP as per their requirements. This is a very useful step for the entrepreneurs as it enables them to vary their risks and liabilities as per the LLP Agreement they form.

**Flexibility of Operations**

The LLP structure provides a lot of flexibility to the partners with respect to complying with statutory norms. For example, since LLPs are governed by the LLP Agreement, it is possible for the LLPs to provide suitable clauses in such agreement to fix the time limits for the duration of the LLP in the LLP Agreement. In such cases, after realisation of the objectives of the venture, the LLP could either be wound up, or the provisions for striking-off of the name of the LLPs can be used, instead of the winding up provisions.

One of most beneficial aspect of the LLP structure is that mandatory auditing of the LLP is not required if the turnover of the LLP does not exceed forty lakh rupees in a financial year or whose contribution does not exceed twenty five lakhs rupees. However, even where mandatory audit of the accounts of the LLP is not required, the partners can optionally choose to get the accounts of the LLP audited.

**Foreign Nationals and LLPs**

Foreign nationals including foreign companies and LLPs can incorporate LLPs in India, subject to compliance with foreign exchange laws. The latest development in this regard is that the Government of India has decided to permit FDI in LLP firms, subject to specified conditions. This provision is a laudable initiative to attract foreign direct investment and provide opportunities to global business concerns to conduct flourishing business activities in India, consequently enabling India’s economy and GDP to reap its benefits.
However, there is a flip side to this coin. The confusing part is that FDI in LLPs will be allowed only for LLPs operating in sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions (such as ‘Non Banking Finance Companies’ or ‘Development of Townships, Housing, Built-up infrastructure and Construction-development projects’ etc.).

However, despite the restrictions on FDI in LLPs, this move by the Government to introduce FDI in LLPs will boost the number of joint ventures in the country and specifically in infrastructure sector, where most of projects till date are executed in form of unincorporated joint venture where most.

NOTES:
6. Id.
7. “Limited Liability Partnerships And Other Hybrid Business Entities” report of ALBERTA LAW
14. Under the Delaware Code, para 15-101(8) (Delaware Revised Uniform Partnership Act, Title 6, Chapter 15), only a partnership may become a LLP, and hence the basis of the LLP is the partnership. See Wood, R., (1997), Limited Liability Partnerships, p. 47.
15. Limited Liability Partnership Act, 2000, S 1(2) (which provides that the UK LLP is a body corporate with legal personality separate from that of its members). See Finch, V. et al, (2002), “The Limited Liability Partnership: Pick and Mix or Mix-Up”, JBL ,pp. 475, 483
17. Id.
19. Id at pg. 8.
24. Sachdeva, supra note 22.
27. S 25, The Indian Partnership Act, 1932.
30. See Ss 34(2) and 35(1) respectively of LLP Act, 2008.
32. S 3 (2), LLP Act, 2008.
34. Id at para 2-39.
CHAPTER-III

Incorporation, Conversion, Taxation and Winding up of an LLP

Incorporation of an LLP
The incorporation of an LLP is by registration. The process for incorporation of LLP is entirely online and the filing of documents is done with the Registrar of Companies itself through the government website. This is a positive step taken by the Government to ensure ease of registration and also to embrace modern technology as a medium of promoting entrepreneurship.

However, a precedent step to the incorporation of an LLP is that the LLP should be constituted with a view to profits. Thus, a set of persons, individuals or bodies corporate, seeking to associate with each other for the purpose of carrying out charitable purposes would be better constituted as a charitable trust or a Section 25 company, since the Registrar, conferred with the jurisdiction to register LLPs, would be entitled to refuse registration for want of profit being its dominant object.

An LLP to be eligible for incorporation has to have at least two partners called the Designated Partners; however, it can also have more than two partners. There is no limit to the maximum number of partners in an LLP. The Designated Partners are responsible for looking after the statutory compliance of the LLP. Further, they have to subscribe their names to a document called an ‘incorporation document’. The document is akin to a memorandum of association required to be filed under the Companies Act, 1956.

Next, every Designated Partner would be required to obtain a “Designated Partner’s Identification Number” (DPIN) on the lines similar to “Director’s Identification Number” (DIN) required in case of directors of companies. The particulars of all the designated partners, as well as any changes thereto, are required to be filed with the Registrar. The procedural requirements for incorporating an LLP are along the lines of the procedure for incorporating a registered company under the Companies Act.

A statement must also be delivered to the Registrar that there has been compliance with all the requirements of this Act and Regulations with respect to incorporation and matters precedent and incidental thereto. The statement must be made by a subscriber 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 and a false statement with positive knowledge or absence of belief in its truth, shall be punishable under the Act. Section 8(2) draws heavily upon section 13 of the Companies Act, 1956. Next, every Designated Partner would be required to obtain a “Designated Partner’s Identification Number” (DPIN) on the lines similar to “Director’s Identification Number” (DIN) required in case of directors of companies. The particulars of all the designated partners, as well as any changes thereto, are required to be filed with the Registrar. The procedural requirements for incorporating an LLP are along the lines of the procedure for incorporating a registered company under the Companies Act.

Another condition is that 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 shall 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 a registered trade mark, or a trade mark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999. The name
shall be printed on all its invoices and official correspondence along with a statement that it is registered with limited liability. 48

The consequences of registration are that an LLP will be embodied with all the characteristics of a separate legal personality, i.e., suing and being sued, power to deal with its property, having a common seal and doing and suffering such other acts and things as bodies corporate may lawfully do and suffer. 49

Conversion into an LLP
The need for entrepreneurs to convert their business organisation into a different form of business arises for reasons such as: (i) tax efficiency; (ii) restructuring of the business, in order to take in new investors or to enable the business to scale operations further.

Thus, the Act provides significant leeway for entrepreneurs to convert their business organisations such as (a) partnership firms; (b) private limited companies; and (c) unlisted public companies into LLPs. The procedure for such conversion is provided for in the Second, Third and Fourth Schedules respectively. Conversion, for the purposes of the Act, means the “transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of a firm or an eligible company to an LLP.” 50

The procedure relating to the conversion from a firm into an LLP is listed under S 55 read with Second Schedule of the Act. Second Schedule of the Act sets out the requirements to be followed in order for a firm to convert into an LLP. A firm can apply for conversion only if the partners of the LLP into which the firm is to be converted, comprise, all the partners of the firm and no one else. 51 It means that all the partners of existing firm should compulsorily become the partners of LLP. The partners have to obtain the Director Identification Number (DIN) and Digital Signature Certificate (DSC) and have to reserve the proposed name of the LLP with the ROC. Further, an online application with the ROC with certain attachments such as:

- The LLP Agreement. This Agreement governs the mutual rights and duties among the partners and among the LLP and its partners. 53
- A declaration (from a CS/CA/advocate) under S 11 (1) of the Act.
- Statement of assets and liabilities.
- Consents from all the creditors of the firm.
- A no-objection certificate from the Income Tax authorities.
- Approval by the governing body of professionals, in case of conversion by a firm of professionals (for eg., a law firm). 54

The provisions relating to the conversion of a private company55 or a public unlisted company56 are similar to those listed above. The Second, Third and Fourth Schedule of the Act lay down the effect of registration of an LLP as follows:

“all tangible (movable or immovable) and intangible property vested in the company, all assets, interests, rights, privileges, liabilities, obligations relating to the firm/private company/unlisted public company and the whole of the undertaking of the company shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed.” 57

Thus, the effect upon such conversion, on and from the date of certificate of registration issued by the ROC in this regard is that the profits and gains arising from a transfer of capital assets are taxable under the Income Tax Act, 1961. 58 The Bombay High Court in the case of Commissioner of Income Tax v. Texspin Engineering and Manufacturing Works, , has held that a partnership firm converting itself into a limited company does not constitute a transfer as there is neither a transaction between a party and counter-party, nor any distribution of
assets involved, but merely vesting of the property in the company. Similarly, a conversion to LLP will not be a transfer for the purpose of taxation irrespective of the definition of ‘convert’. This position has been adopted by the Finance Act, 2010 which provides that conversion to a LLP will not entail any tax implications.

**Difficulty with respect to Conversion**

Conversion of an existing entity into an LLP, however, is not free from difficulty and has several latent issues. Of course, there are inherent risk management and other associated costs of conversion. A conversion, since it is an all-consent-phenomenon, may be used by minority groups as a bargaining tool to their own advantage and a hindrance to reaping the desired benefits of conversion into an LLP. A common and widely suggested precautionary step is to incorporate within the partnership agreement, a clause permitting automatic transfer of assets and liabilities to an LLP from the existing form and to provide for conversion so as to bind a dissenting minority.

Further, although a partnership can convert into a company, it is unclear whether an LLP can convert into a company. Since, there are no provisions which enable the LLP to convert into a company are absent under the Companies Act, 1956 and the Act itself, enabling provisions would be required to be made in the Companies Act for such conversion. Thus, necessary action in this regard would be taken when Companies Act would be revised.

**Taxation of an LLP**

The Indian LLP Legislation i.e. The Limited Liability Partnership Act, 2008 is silent regarding taxation of LLPs. The reason for it is, as the taxation concerns of other entities such as a company or a partnership instead of being dealt with by the Companies Act, 1956 or Indian Partnership Act, 1932 are rather dealt with by Income Tax Act, 1961. Therefore, it was inevitable that LLP Act would be silent on the issue of tax implications for an LLP.

There are two popular models for taxation of LLPs which are used in various foreign jurisdiction viz. the French Model and the other being UK and Singapore LLP Model. In the French Model, the LLP is treated as a fiscally transparent entity and merely the income of the partners are taxed and not the transparent entity. Whereas in the UK and Singapore LLP models, the practice is to accorded similar treatment to an LLP as a Partnership. India has opted for this practice, i.e., to treat an LLP at par with a general partnership, so far as the tax treatment is concerned. Section 10(23) of the Income Tax Act states that ‘firm’ shall include LLP, ‘partner’ shall include partner of LLP and ‘partnership’ shall include LLP. Hence, all the provisions concerning taxation of general partnership firms would apply mutatis mutandis to LLPs. This means that income-tax would be levied on the profits of the LLP and such profits would be taxable in the hands of the LLP itself. Profits flowing from the LLP to the individual; partners would not be includible in computing the total income of the partners liable to tax in terms of the provisions of Section 10 of the Income Tax act, 1961. The profits from the LLP which the partners obtain will not be computed for their personal income as it will be considered as ‘business income’ which is within the scope of a ‘deduction’ for computing income. In the event of failure to comply with Section 184 of the LLP Act, the remuneration paid to the partners will not be allowed as deductions on their personal income. Further, any contribution of capital assets by a partner to his LLP or distribution of such assets by the LLP to any partner, will be considered to be income of the partner and LLP respectively, and will be subject to income tax. Section 40(b) of the Income Tax Act, which provides for restrictions on payment of interest and remuneration to partners, has been modified now to uniformly apply to professional and non-professional
firms. LLPs are beneficiaries of the modification, thus making them an attractive business option for professionals forming an association. This tax treatment has however caused some unrest to potential foreign investors who would now be exposed to double taxation in respect of income arising from an LLP incorporated in India since profits would be liable to tax in the hands of the LLP in India and when the profits are distributed to the partners, such profits would be liable to tax in the respective jurisdiction where the partner is resident. This situation is not even addressed by the double taxation avoidance agreements entered into by India with other countries. Partners would, therefore, be unable to benefit from tax-structuring of profit distribution. However, there are still some tax advantages available to the LLPs, like exemptions from some of corporate taxes, such as presumptive tax, dividend distribution tax or minimum alternate tax.

Since the LLPs have been treated at par with the general partnership, they would not be liable to Dividend Distribution Tax and Minimum Alternate Tax. Further, the Budget has also scrapped the surcharge on tax for firms. Also, if the LLP is a non-resident under the IT Act (its control management is wholly situated outside India), it would continue to be taxed at 30% plus applicable cess. All the aforesaid factors make LLP an attractive mode of business so far as the tax cost is concerned. However, LLP, which is a hybrid structure between a company and a firm, could have been more attractive mode of investment if a pass through status was accorded to it for tax purposes.

**Winding Up of an LLP**

Winding up means putting an end to the life of the LLP. It is the legal process by which the LLP is dissolved. Although, winding up and dissolution are sometimes takes as the same, there is a difference between the two, albeit a thin one. The *Black’s Law Dictionary* defines winding up as “the process of settling accounts and liquidating assets in anticipation of a partnership’s or a corporation’s dissolution.” Thus, from this definition it is clear that there is a difference between winding up and dissolution. The LLP like a company is not dissolved immediately at the commencement of winding up. The corporate status and the powers of the LLP continue even after the passing of the winding up order.

The Act provides that the winding up of an LLP may be either voluntary or by the National Company Law Tribunal (NCLT) and limited liability partnership, so wound up may be dissolved. The winding up procedure broadly follows that applicable to a company and there is no concept of dissolution in the sense encountered under partnership law. Further, this provision is broadly based on the Singapore LLP Act, 2005. Besides the obvious grounds of financial insolvency, decision of the LLP to be wound up, continuance for more than six months as a single-partner LLP, acting against the sovereignty, integrity or security of India, failure to file Statement of Account and Solvency, the power to wind up on the ground that “it is just and equitable” to do so, has been reserved with the NCLT.

Further, the Central Government has been empowered to make further rules thereby ensuring an easier process for winding up as compared to the complex procedures involved in the winding up of a company. Pursuant to this, the LLP (Winding up and Dissolution) Rules, 2010 have been notified by the Central Government, which deal with the procedure for both voluntary and non-voluntary winding up.

The Rules in addition to voluntary winding up and winding up by the NCLT, provides for winding up by the creditors. An LLP may be wound up by its creditors if it is unable to pay its debts. However, if an LLP ceases to operate, and if it is not wound up as prescribed
under the rules, then its name can also be struck of the Register of LLPs. This method is called striking off and it is an alternative to the process of winding up of the LLP.\textsuperscript{81}

**NOTES:**

42. Filing of the documents is done on http://mca.gov.in/LLP.
45. S. 6(1), LLP Act, 2008
47. S.9, LLP Act, 2008.
48. S. 14, LLP Act, 2008
49. Id.
50. para 1 (b) of the Second Schedule of the Act.
51. para 3 of the Second Schedule of the Act.
52. The online application has to be made under Form 17.
53. Section 2(1)(o) of the Act.
54. See para 4 of the Second Schedule of the Act.
55. The procedure for conversion from a private company to an LLP is listed under S 56 r/w Third Schedule of the Act.
56. The procedure for conversion from an unlisted public company to an LLP is listed under S 57 r/w Fourth Schedule of the Act.
57. See paras 7 (b), 6 (b) and 7 (b) of the Second, Third and Fourth Schedules of the Act respectively.
58. See Income Tax Act, 1961 §§2(47) and 45(1).
59. (2003) 263 ITR 345 (Bom) (The expression ‘transfer of a capital asset’ in §45(1) is required to be read with §2(47)(ii)) (which states that the transfer in relation to a capital asset shall include extinguishment of any rights therein); see also Anant Pai, *LLP-Its Incidental Tax Considerations*, 6 Income Tax Rev. Vol. XXXV 61 (September 2009).
60. See Finance Act, 2010 §10 and Income Tax Act, 1961 §47.
66. Id.
69. Income Tax Act. 1961, Ss. 10(2A) and 28(v).
70. Id.
72. Id.
74. Dr. Ashok Sharma, Company Law and Secretarial Practice, V.K. (India) Enterprise (2011) at 289.
75. S 63, LLP Act, 2008.
77. See Singapore LLP Act, 2005 Fifth Schedule, Part II, para 3.
78. See S 64, LLP Act, 2008.
80. Hereinafter called the “Rules”.
81. See Rule 25, LLP Rules, 2009 to see when the LLP shall be deemed to be unable to pay its debts.
82. Dr. Madhusudan Saharay, *Textbook on Indian Partnership Act with Limited Liability Partnership Act*, New Delhi, Universal Law Publishing House, p. 246

CHAPTER-IV

Benefits to SMEs

According to the J J Irani Committee, LLPs are mostly suited partnership vehicle among professional who are already regulated such as company secretaries, charted accountants, cost accountants, lawyers, architect, engineers, doctors, etc. The Naresh Chandra Committee was constituted to “suggest a scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation”. The recommendation of this Committee is a step further to modernization and recognizing the needs of changing times and on the basis of these recommendations,

The LLP Act provides adequate breathing space to small and medium enterprises (SMEs), which till date have not been able to avail of the benefits of a corporate structure. Not only does the legislation provide benefits of corporate structure, it does away with the limitations and problems of proprietorship and the regular partnership structure. Until 2008, the SME sector largely worked through the regular partnership or proprietorship structures, wherein the partners and sole proprietor, as the case may be, were personally liable for all liabilities of the business vehicle. However, the LLP Act provided the required breather to SMEs to convert their business vehicles to a LLP, whereby the liability of business vehicle could not be tagged and made personal liability of partners constituting it.

While small and medium companies have been given special protection under the Industrial Policy of 1948, wherein banks and financial institutions are required to give loans (lesser in amount) to the sector on a priority basis, it has been difficult for them to raise funds. However, by forming an LLP, it might become easier for SMEs to get loans as security creation will get easier. This is because a LLP would be a separate entity altogether than the partners who constitute it. Banks and financial institutions will be able to enforce the securities created while granting the loans specifically as the LLP can be sued being a separate legal entity.

As SMEs have limited capital, their main focus is to keep the running cost at the bare minimum. The major chunk of these costs are relating to accounting and compliance
requirements which are very less when it comes to LLP. The LLP model benefits the SMEs in many other ways, which are as follows.

**No minimum capital contribution required**
LLP could be formed without any minimum capital contribution as opposed to the Private Limited companies’ requirement of Rs. 1 Lac. Even the contributions could be made in installments which makes the small entrepreneurs/startups avail these benefits and forge ahead. For instance that the partners can bring minimum capital say Rs. 5000/Rs. 10000/Rs. 20000/- because there is no restriction provided under the LLP Act to bring a minimum capital contribution at the time of incorporation.

**Liability is Limited**
The liability of each partner is limited to the extent of his/her contribution/share as opposed to the sole proprietorship or the traditional partnership firm where the personal assets of the proprietor or partners could be at risk in the event of a failure of the business. Thus this mode helps the partners to be free from personal liabilities or becoming bankrupt (except in cases of fraud by any partner). Its quite safe compared to the unlimited liability which offered by partnership firm.

**Separate legal entity**
LLP has its separate existence from its partners. LLP can sue and be sued in its own existence. Due to its status, the entry and exit of the partners don’t affect the LLP. As it incorporates various stakeholders(i.e. Suppliers, Customers etc.), it offers the flexibility while dealing & signing legal contracts and in many other things.

**Economics & Working**
Statutory filing fees as well as the cost of formation is less compared to forming a Private limited company. Apart from stamp duty for executing LLP agreement the registration fees are less than required for incorporation for a private Limited company. Partners are not subjected to hold 4 mandatory board meetings as required in once in a year by Companies Act. The partners can meet as per their convenience or need basis. Partners can specify about the meetings details & schedule in the LLP agreement.

**NOTES:**
86. Id.
CHAPTER-V
CONCLUSION

The LLP Act is a boon to the SMEs and entrepreneurs as its help them to control their running cost, since they already have limited capital at their disposal. The theme of inadequate financing of SMEs has been flogged to such an extent that sickness and underfunding in the SME sector have become synonymous to SMEs in the perception of many people. Further, recommendations have been made by many Committees for improving the flow of credit to this sector.

The LLP system combines the advantage of the traditional corporate structure and the entrepreneur-centric proprietary/partnership structure and will help more “marriages between brains and bank balances” take place within the small enterprise/business sector, just as is supposed to happen every time a company in the organised corporate sector issues capital to the public in the form of equity shares or debentures.\(^\text{86}\)

The LLP will tap funds not from the public but from a section of inactive co-partners of an enterprise whose liability to repay debts of the business will be limited to their investment and who will be entitled to a share in the profits of the business. While the limited partnership business will give a greater level of comfort to banks and other lenders to small businesses, it at the same time will avoid the enormous amount of documentation and strict procedure that corporate entities have to observe.

There has been a campaign of sorts to persuade SSIs to convert themselves into companies (under the Companies Act), so that their projects/business plans could become more "bankable" and their balance-sheets could gain acceptance and credibility with banks and financial institutions. This campaign has obviously not succeeded and perhaps, the limited partnership system is a more realistic and attractive option that would encourage entrepreneurs, in need of funds for modernisation and expansion, to adopt from their present position of either proprietary undertakings or partnerships.\(^\text{87}\)

NOTES:


REFERENCES

3. Margaret Bartschi, (2000), Foundations of Business Organizations for Paralegals, Delmar, West Legal Studies