Limited Liability Partnership Concept & Taxation

# Introduction

Limited Liability Partnership Act was madeapplicable from 01st Apr 2009 in India. However

the LLP structure never became as popular aswas envisaged. However, after the enactment of

Companies Act there is a renewed interest in theLLP structure. There is high enquiry both from

new business who want to take an informeddecision as to whether to organize themselves as

a private limited company or as a LLP as alsofrom existing companies to explore possibility

and benefits of conversion into LLP.

The article seeks to provide an indepthanalysis 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 (Form7)& DSC, take approval forLLP

name (Form1),file for incorporation (Form2),obtain certificate of incorporation, file for LLP

agreement (Form3)and then file for partner consent (Form4).

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 30days from the end of 6 months from the closure of FY

(Form8).They are also required to file an annual return with the Registrar within 60 days from

close of financial year (Form11).

Audit is mandatory only if turnover > 40 lacs / contribution > 25lacs unlike a company where audit is

compulsory even if there is no transaction. Further unlike acompany 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 paidupcapital 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 multidisciplinary

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.

 Asper 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:

1. 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 2013ITRVHCKAR146,

Sec 45(4) does not applyif the retiring partner takes only money towards the value of his share and

there is no distribution ofcapital 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

thehands 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

fromthe 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

shouldbe 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 daysprior to the date of the conversion application. After receiving Conversion Certificate the

same to befiled within 15 days with the Registrar of Companies in Form14.

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 corporateLLP do not attract dividend distribution tax, deemed

dividend& wealth tax which are applicable to acompany. Remuneration to directors need to be

justified u/s 40A (2), the same is not the case onremuneration to partners but the same has to be

within limits of Sec 40(b). However for an entitywith profit between 1 cr – 10 cr, surcharge in case of

 LLP shall be 10% but 5% in case of acompany. Company is liable to pay Minimum Alternate Tax

(MAT) whereas a LLP is subject toAlternate Minimum Tax (AMT)

MAT vs. AMT

|  |  |  |
| --- | --- | --- |
|  | MAT | AMT |
| BASED ON | Book profit i.e. profit as shownin P&L a/c as per Company’sAct provisions add income tax,deferred tax, provision forcontingent liabilities, dividend,provision for diminution in thevalue of any asset etc | Adjusted total income i.e. totalincome + deduction Sec 10AA& u/c VIAPartC (Sec 80IA,IB etc.) |
| Increased profits in books dueto less rate of depreciationcharged in books as comparedto allowed under IT Act, 1961 | MAT payable on the same. | AMT not payable |
| Loss brought forward orunabsorbed depreciation | Loss b/f or unabsorbeddepreciation, whichever is lessas per books is allowed to bereduced before applying MAT. | Loss b/f or unabsorbeddepreciation, both as per ITlaws is allowed to be reducedbefore applying AMT |

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