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Limited Liability Partnership Act, 2008 – A bird's eye view

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In this article, Shri Ganesan and Shri Rajesh Relan, Head Legal & Company Secretary and Joint Secretary Heidelberg Cement India Ltd., respectively, explain the provisions of the Limited Liability Partnership Act, 2008 regulating a new alternative form of business organisation. They also highlight advantages and disadvantages of a limited liability partnership. ❖❖*EFW*❖❖

LIMITED LIABILITY PARTNERSHIP – DESIGNATED PARTNERS – PARTNERSHIP INTEREST – CONVERSION OF FIRMS/COMPANIES

INTRODUCTION

1. In India, the two most common ways to establish a business enterprise are to set up a partnership firm or to incorporate a joint stock company under the Companies Act, 1956. Both the forms of business organisation have their own merits and demerits. In the case of a partnership firm, the partners always have the fear of incurring unlimited personal liability to discharge the firm's debts. On the other hand, the directors as well as the shareholders of a company enjoy the benefit of limited liability but the compliances are onerous. In order to give an impetus to the business activity recently, a new form of business organisation has been evolved, which is known as limited liability partnership ('LLP'). LLP is a hybrid of a partnership firm and a company since it provides the dual benefit of carrying on the business activity with limited liability and minimal statutory compliances. The partners also enjoy the flexibility of organising their internal structure as partnership is based on mutually arrived agreement. Thus, LLPs have filled up the gap between business firms such as sole proprietorship and partnership firms and companies that are incorporated under the Companies Act. LLP is likely to become one of the most preferred forms of business organisation for professionals and closely held enterprises.

EVOLUTION OF LLP

2. LLPs have been subject-matter of discussion in India from past more than three decades. It was first advocated by Bhat Committee in the year 1972 followed by Naik Committee in 1992. Once again the concept of LLP was discussed in the Expert Committees on Development of Small Sector Enterprises headed by Sh. Abid Hussain in the year 1997 and by the Committee headed by Dr. S.P. Gupta (2001). The concept of LLP gathered momentum in the international sphere after enactment of Limited Liability Partnership Act, 2000 in UK. The Naresh Chandra Committee (2003) and the Committee on New Company Law headed by Dr. J.J. Irani (2005) had

also recommended suitable legislation on LLPs. Singapore also enacted the Act in the year 2005.

2.1 The Ministry of Corporate Affairs, on 2nd November, 2005 placed a Concept Paper on LLP Law on its website to invite comments from the interested stakeholders. Large number of comments and suggestions were received by the Ministry. These were examined in the light of international practices / law on the subject. Thereafter Limited Liability Partnership Bill, 2006 ('Bill') was introduced in the Rajya Sabha on 15th December, 2006. The Bill was referred to the Lok Sabha Standing Committee on Finance for examination. The Standing Committee consulted various Chambers of Commerce, professional institutes, experts and also heard the Ministry of Corporate Affairs ('MCA'). The Committee submitted its report to the Parliament on 27th November, 2007. Based on the report the MCA revised the LLP Bill and the same was passed by passed by Rajya Sabha and Lok Sabha on 24th October, 2008 and 12th December, 2008, respectively. The President gave assent to the Bill on 7th January, 2009. The Limited Liability Partnership Act, 2008 ('the Act') was notified on 31st March, 2009 and the Rules thereunder were enforced on 1st April, 2009. The first LLP was successfully registered on 2nd April, 2009 and till 29th July, 2009, 82 LLPs have been registered in India. Thus, the journey from the birth of this Act till now is just five months old.

PARTNERS OF LLP

3. LLP can be formed only for lawful business with a view to earn profit which rules out the possibility of formation of LLPs solely for charitable purposes. There must be at least two partners to form a LLP. However, there is no restriction on the maximum number of partners. Under the Indian Partnership Act, 1932 the maximum number of partners cannot exceed 20. In case the number of partners of a LLP falls to one, it does not lead to dissolution but if the business continues for more than six months, then the remaining partner shall have unlimited liability. Clause (*q*) of section 2 of the Act defines 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. Clause (*o*) of section 2 defines LLP agreement as any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of partners and their rights and duties in relation to the LLP. A partner may be either an individual or a body corporate. However, individuals who is found to be of unsound mind by a court or is an un-discharged insolvent or has applied to be adjudicated as an insolvent and his application is pending not eligible to become partners of a LLP.

DESIGNATED PARTNERS

4. Each LLP must have at least two designated partners, who are individuals, to look after the statutory compliances and at least one of them must be an Indian resident. In order to become a designated partner, the individual has to give his prior consent in Form 9. It is quite possible that two or more body corporates can join together to form a LLP. In such a case at least two individuals, who are partners of LLP or two persons who have been

nominated by the body corporates, shall act as the designated partners. Designated partners are basically responsible for appointment of auditors, signing of accounts, filing of accounts with the Registrar, intimating him regarding the changes in partners / address of registered office and filing of annual return.

4.1 There is no restriction on the number of LLPs in which a person can become a designated partner. It is worthwhile to note here that the Lok Sabha Standing Committee had made recommendation for limiting the number of LLPs in which a person can act as designated partner but the recommendation has not been accepted by the MCA. The rationale given by the MCA is that there is no limit on the number of private limited companies in which an individual can become a director and, therefore, it would be unfair to put such a restriction in case of LLPs.

4.2 The designated partners have to obtain a unique number called the designated partner identity number ('DPIN') by filing Form 7. DPIN is similar to director identification number ('DIN') allotted to directors of companies.

INCORPORATION OF LLP

5. For the purpose of incorporation of a LLP, two or more persons have to subscribe their names to the incorporation document, which is just like memorandum of association in case of companies. Briefly, the procedure for incorporation of LLPs is as follows :

- *Information to be furnished for incorporation of LLP* – The following information has to be furnished to the concerned office of the Registrar in the prescribed forms :
  - Name of the LLP
  - Proposed business
  - Address of registered office
  - Names and addresses of the persons who would be the partners
  - Names and addresses of the persons who would be the designated partners

A statement made by an advocate or company secretary or chartered accountant or cost accountant, who is engaged in the formation of the LLP and by any one who has subscribed his name to the incorporation document, stating that all the requirements of the LLP Act and the Rules made there under have been complied with. The following forms have to be used for incorporation of a LLP :

- Form 1- Application for reservation of name
- Form 2 - Incorporation document and statement
- Form 3 - Information regarding LLP agreement
- Form 4- Notice of appointment of partners / designated partners and changes among them, intimation of DPIN by the LLP to Registrar and consent of partner to become a partner / designated partner

- *Registration certificate* – On submission of the requisite documents,

complete in all respects, the Registrar shall within 14 days issue the certificate of registration of LLP. The certificate of registration issued in Form 16 is the conclusive evidence of incorporation of LLP. After incorporation each LLP is allocated a unique identity number called the limited liability partnership identity number ('LLPIN') which is similar to corporate identity number ('CIN') in case of companies.

REGISTERED OFFICE AND ITS CHANGE

6. Each LLP is required to have a registered office whose address has to be mentioned in the incorporation document at the time of incorporation. If any document is to be served on a LLP or its partner(s) or the designated partner(s), the same should be sent at the registered office of LLP. The registered office can be changed by intimating the new address of registered office to the Registrar in Form 15.

NAME OF LLP

7. While selecting a suitable name for incorporation of LLP or for change of name of an existing LLP, its partners must ensure that (*i*) the name chosen by them is not undesirable or identical to the name of any other partnership firm or LLP or body corporate, or resembles the registered trade mark, or a trade mark which is subject of an application for registration ; and (*ii*) the name must have the words 'limited liability partnership' or the acronym 'LLP' as its last words. There is a provision under the Act for getting the name reserved for three months either for the proposed LLP or for changing the name of an existing LLP. In the case after incorporation of a LLP, it is discovered that the name under which such LLP has been registered is undesirable or resembles the name of any other LLP or body corporate, then the Central Government can give direction to such LLP to rectify or change its name within a period of three months or within such longer period as may be allowed. Further, any other entity which already has a name similar to the name under which the new LLP has been registered can also apply to the Registrar in Form 23 to give a direction to that LLP to change its name. The requisite application has to be made within a period of 24 months from the date of incorporation of subsequent LLP. Notice of change of name of LLP has to be filed with the Registrar in Form 5. Every LLP must ensure that its invoices, letter heads and other publications bear its name, address of registered office, registration number and also a statement to the effect that it is has been registered with limited liability.

CONTRIBUTION TO LLP

8. The obligation of a partner to contribute money or property or any other benefit or to perform services for the LLP shall be as per the agreement. The contribution may consist of any of (*a*) tangible, movable or immovable or intangible property, (*b*) money, (*c*) promissory notes, (*d*) other agreements to contribute cash or property, and (*e*) contract for services performed or to be performed. The monetary value of contribution of each partner is to be accounted for and disclosed in the accounts of LLP in the manner stated in the agreement.

RELATIONSHIP BETWEEN PARTNERS

9. After incorporation, the persons who had subscribed their names to the incorporation document become the partners of LLP. Any other person may also become a partner of LLP in accordance with the LLP agreement. Relationship between partners is governed by the agreement, which is just like the articles of association in the case of companies. The LLP agreement and any changes therein have to be filed with the Registrar in Form 3. In case the LLP agreement is silent on any matter, the same is to be determined in accordance with the provisions laid down in the First Schedule to the Act. A major difference between a partnership firm under the Partnership Act and a LLP is that every partner of a LLP is an agent of LLP only and not of other partners, which is not so in the case of a partnership firm. In other words, under the Partnership Act each partner is not only an agent of the firm but also of the other partners. Hence, the acts of a partner bind the firm as well as the other partners of a traditional partnership firm. Although it is not necessary to have a LLP agreement because in such a situation the Schedule I will be applicable in entirety, but it is advisable to have an agreement because some of the standard conditions of Schedule I are not practical and beneficial to the partners.

EXTENT OF LIABILITY OF LLP

10. A LLP is not bound by anything done by a partner in dealing with a person if (*a*) the partner has no authority to act for the LLP, and (*b*) the person knows that partner has no authority or does not know or believe him to be a partner of the LLP. Nevertheless, the LLP is liable if the partner of a LLP is liable to any person as a result of a wrongful act or omission on his part in the course of business of the LLP or with its authority. The obligation of LLP whether arising in contract or otherwise shall be solely the obligation of the LLP. The liabilities of LLP shall be met out of the property of the LLP only. In other words, a partner is not personally liable for the obligations / debts of LLP.

LIABILITY OF PARTNERS UNDER SPECIAL CIRCUMSTANCES

11. The following are the special circumstances in which partners would be liable :

• *Liability of partner by holding out* – If a person represents himself to be a partner of LLP, then he would be liable to any person who acts with him in good faith on the basis of such representation.

• *Unlimited liability* – In case the LLP or any of its partners carry the business with intent to defraud creditors or any other person or for any fraudulent purpose, the liability of LLP and its partners shall be unlimited. However, in case of negligence or misconduct of business only the personal assets of the concerned partner would be attached and not of the other partners.

CESSATION OF PARTNERSHIP INTEREST

12. A person may cease to be partner of LLP in accordance with an

agreement with the other partners or in the absence of such an agreement by giving a notice in writing of not less than 30 days to the other partners of his intention to resign as partner. A person shall also cease to be a partner of LLP (*a*) on his death or dissolution of the LLP, (*b*) if he is declared to be of unsound mind by a competent court, and (*c*) if he has applied to be adjudged as an insolvent or is declared as an insolvent. A person who ceases to be partner of LLP (known as former partner) would still be regarded as partner of the LLP in relation to any person dealing with the LLP unless (*a*) the person has already noticed that the former partner has ceased to be partner of the LLP, or (*b*) notice that the former partner has ceased to be a partner of LLP has been delivered to the Registrar. The cessation of a partner from LLP does not itself discharge him from his obligation to the LLP and towards the other partners or to any other person which he incurred while being a partner. The former partner (or his legal heirs) on his cessation as partner shall be entitled to receive from the LLP an amount equal to the capital contribution made by the former partner to LLP. His right to share in the accumulated profits of the LLP, after deduction therefrom the accumulated losses of LLP, shall be determined as at the date on which former partner ceased to be a partner.

MAINTENANCE OF BOOKS OF ACCOUNTS, AUDIT AND FILING OF ANNUAL RETURN

13. Every LLP shall at its registered office maintain books of accounts relating to its affairs for each year of its existence on cash basis or accrual basis and according to double entry system of accounting. The LLP shall within six months from the close of the financial year prepare a statement of account and solvency as at the last day of the financial year which shall be filed with the Registrar by the designated partners of LLP in Form 8. The accounts of every LLP shall be audited. Every LLP has to file an annual return in Form 11 with the Registrar within 60 days of the close of the financial year.

CONVERSION OF FIRMS AND COMPANIES INTO LLPS

14. Sections 55 to 57 of the Act deal with conversion of partnership firms, private limited companies and unlisted public limited companies into LLPs. These sections have come into effect from 31st May, 2009. One of the biggest lacunae in conversion of firms and companies into LLPs is that the Act does not contain any provision for dealing with the issue of stamp duty as this is a subject reserved for the States. Moreover, the transaction shall also be liable to capital gains tax if the assets are transferred at values higher than the book values.

14.1 The Registrar on being satisfied that all the procedural formalities for conversion of firm / company into a LLP have been duly fulfilled, will issue a registration certificate in the name of LLP. Consequently the partnership firm or company, as the case may be, shall stand dissolved and all the government approvals, permits, licences, consents, etc., standing in the name of the erstwhile partnership firm / company shall stand transferred to and vested in LLP without any further act or deed.

14.2 It is expected that the government will come out with a practical solution to the stamp duty issue so that large number of professionals and entrepreneurs are encouraged to convert their existing set up into a LLP. It is worthwhile to note here that stamp duty issue would even be faced at the time of incorporation of new LLPs in case the individuals or prospective partners desire to transfer their personal assets as contribution to LLP instead of putting in cash as contribution in case the transfer is at a value higher than the book value.

OTHER SALIENT FEATURES OF LLP

15. In addition to the salient features of LLP covered in the above discussion some of the other salient features of LLP are as follows :

- In the absence of any LLP agreement, all the partners of a LLP are entitled to share equally in the capital, profits and losses of the LLP
- No person can be introduced as a partner without the consent of all the existing partners
- Every partner shall indemnify the LLP for any loss caused to it by his fraud in the conduct of the business of the LLP
- The provisions of Partnership Act, are not applicable to LLPs

ADVANTAGES OF LLP

16. From the above discussion we can make out the following advantages that are offered by LLP form of business organisation :

- No personal liability of partners except in case of fraud
- Easy to incorporate
- No limit on the number of partners
- Legal entity separate from its partners
- Partners act as agents of LLP only and not of the other partners
- Can purchase and own assets in its own name
- Simplicity in compliances
- Perpetual succession irrespective of changes in partners
- No requirement of minimum capital contribution
- Dissolution or winding up is easy as compared to winding up of companies
- Professionals like CS/CA/CWA/lawyers can form multi-disciplinary professional LLPs to boost their business
- Foreign nationals can also become partners of a LLP which is not possible in case of traditional partnership firms
- Statutory records/registers not required except the books of accounts
- Not dependant on the statute for determining its internal working arrangements, which facilitates results in quick decision making
- Can enter into contracts in its own name
- Can sue and be sued in its own name

- No restriction on related party transactions
- Less stringent financial disclosure norms
- Minimal governmental intervention
- Not subject to minimum alternate tax and dividend distribution tax

DISADVANTAGES OF LLP

17. Every coin has two sides. So far, we have concentrated only on the advantages of LLPs. However, LLPs are not free from disadvantages. Some of the major disadvantages of LLPs are as follows :

- LLP cannot access funds from public. Therefore, it is suitable only for small and medium enterprises
- Under some cases, liability may extend to personal assets of partners
- No separation between ownership and management
- No provision relating to prevention of oppression and mismanagement
- LLPs can be formed only to carry on business with profit motive, whereas Companies Act allows incorporation of section 25 companies which carry out activities without any profit motive
- Although chartered accountants and cost accountants can form LLPs but they can not do statutory audit or cost audit through LLPs since LLPs are body corporates (as defined under sub-section (1) of section 3 of the Act) and clause (*a*) of sub-section (3) of section 226 and clause (*a*) of sub-section (5) section 233B of the Companies Act specifically provide that body corporates can not be appointed as statutory auditors or cost auditors of companies.

TAXATION OF LLPS

18. Although the Act came into force with effect from the 31st March 2009, there was no clarity on the issue of taxation of income of LLPs. Due to this most of the entrepreneurs were reluctant to form LLP immediately after the enactment of the Act. Rather, they opted to wait until Budget 2009-10. Finance (No.2) Act, 2009, has substituted clause (*23*) of section 2 of the Income-tax Act, 1961 with effect from assessment year 2010-11 clarifying that LLPs shall be assessed as 'firms'. Thus. LLPs would be treated at par with 'partnership firms' as defined in the Partnership Act.

18.1 If the LLP does not comply with section 184 of the Income-tax Act, it shall not be entitled to deductions on account of payment of interest or remuneration to any partner of the firm while calculating profits and gains from business or profession. It is worthwhile to note here that Schedule I to the Act, which is applicable in case the partners do not prepare their own LLP agreement, does not allow the LLPs to pay remuneration to its partners. Thus, in order to take advantage of the provision of deductibility of remuneration under the Income-tax Act, it is necessary for the partners to specifically incorporate a clause with respect to payment of remuneration in the LLP agreement.

18.2 The LLP is entitled to deduction of remuneration paid to working

partners / interest paid to partners as per the provisions of sub-clause (*v*) of clause (*b*) of section 40 of the Income-tax Act, *i.e.*, at par with any traditional partnership firm to which the Partnership Act applies. The deduction in respect of remuneration to working partners shall be allowed to firms (whether professional firms/other firms) with effect from assessment year 2010-11 as per the revised slabs given below :

Quantum of book profit	*Remuneration permissible*
On the first Rs.3,00,000 of book profit or in case of a loss	Rs.1,50,000 or 90% of book profit, whichever is more.
On balance book profit	60% of book profit

RATE OF INCOME TAX ON LLP

19. The rate of tax of 30 per cent applicable for partnership firms is applicable in case of LLPs also. The LLPs having income exceeding Rs. one crore shall be subject to surcharge of 10 per cent also. The income tax and surcharge calculated shall be further increased by 2 per cent education cess and 1 per cent secondary and higher education cess. The effective rates of income-tax are as under :

- LLPs having income up to Rs. one crore : 30.90 per cent
- LLPs having income exceeding Rs. one crore : 33.99 per cent

SIGNATURE ON INCOME -TAX RETURNS

20. Designated partners have to sign the return of income of LLP. However, the clause (*cd*) of section 140 provides that the return can also be signed by any partner other than designated partner if such designated partner is not able to sign the return of income for any unavoidable reason or if the LLP does not have a designated partner. Section 167C of the Income-tax Act, as inserted by the Finance (No.2) Act, 2009, provides that in the case of a LLP under liquidation, all the partners shall be jointly and severally liable to pay income-tax unless the partner proves that non-recovery cannot be attributed to gross neglect, misfeasance or breach of duty on his part.

PENAL PROVISIONS

21. In case the documents or returns to be filed with the Registrar are not filed within the prescribed time limit, the same can be filed upto a period of 300 days from the due date on payment of additional fee of Rs. 100 for every day of delay. Further, the Act provides heavy fines, *e.g.*, fine for not filing annual accounts and statement of solvency is minimum Rs. 25,000 and maximum of Rs. 5 lakh. Similarly, fine for not filing annual return is minimum Rs. 25,000 and maximum Rs. 5 lakh. In addition thereto, the designated partner shall be punishable with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 1 lakh. These fines can be imposed only by the competent court. Although the Act provides heavy penalties for non-compliance, these offences are compoundable by the Central Government.

CONCLUSION

22. LLP is a new alternative form of business organisation which can provide a platform to small and medium enterprises, service sector and professional firms to manage their business/profession in an efficient manner and become competitive. With the growth of the Indian economy, service sector enterprises, *viz.*, venture capital, financial services, hospitality, tourism, information technology, architects, interior decorators, etc., are expected to get a big boost in their business. LLP is likely to be the most suited form of business organisation for carrying on such business activities since the entrepreneurs can enjoy the benefit of limited liability without much cumbersome compliances. It is earnestly hoped that LLP would become a preferred form of business organisation among the small and medium enterprises as well as the professionals. The Act is a very welcome sign since it not only removes the defects of traditional partnership firm but at the same time retains flexibility in operations.

Government should be model or ideal litigant

"The State, under our Constitution, undertakes economic activities in a vast and widening public sector and inevitably gets involved in disputes with private individuals. But it must be remembered that the State is no ordinary party trying to win a case against one of its own citizens by hook or by crook, for the State's interest is to meet honest claims, vindicate a substantial defence and never to score a technical point or overreach a weaker party to avoid a just liability or secure an unfair advantage, simply because legal devices provide such an opportunity.

The State is a virtuous litigant and looks with unconcern on immoral forensic successes so that if on the merits the case is weak, government shows a willingness to settle the dispute regardless of prestige and other lesser motivations which move private parties to fight in court. The lay-out on litigation costs and executive time by the State and its agencies is so staggering these days because of the large amount of litigation in which it is involved that a positive and wholesome policy of cutting back on the volume of law suits by the twin methods of not being tempted into forensic show-downs where a reasonable adjustment is feasible and ever offering to extinguish a pending proceeding on just terms, giving the legal mentors of government some initiative and authority in this behalf. I am not indulging in any judicial homily but only echoing the dynamic national policy on State litigation evolved at a Conference of Law Ministers of India way back in 1957.

– Dilbagh Rai Jarry v. Union of India [1973] 3 SCC 554