



Tax and regulatory aspects relating to LLPs

Study circle: Bangalore branch of ICAI

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Overview of LLP

History and evolution

- ▶ Limited Liability Partnership ('LLP') is a form of business presence that gives the benefit of limited liability of a company and the flexibility of a partnership
- ▶ It is an entity with 'hybrid' features i.e. features of a body corporate as well as traditional partnership
- ▶ Partnership entities formed under Partnership Act 1932 have the downside of unlimited liability of all partners. Also, as they are not separate legal entities
- ▶ JJ Irani Committee on New Company Law (2005) recommended simpler regulatory regime for small companies through a separate LLP legislation
- ▶ Limited Liability Partnership Act, 2008 (LLP Act) and Limited Liability Partnership Rules, 2009 (LLP Rules) introduced to govern the regulatory aspect
- ▶ Level of acceptance of LLP structure in India has picked up over last couple of years post liberalization of FDI regime in 2015

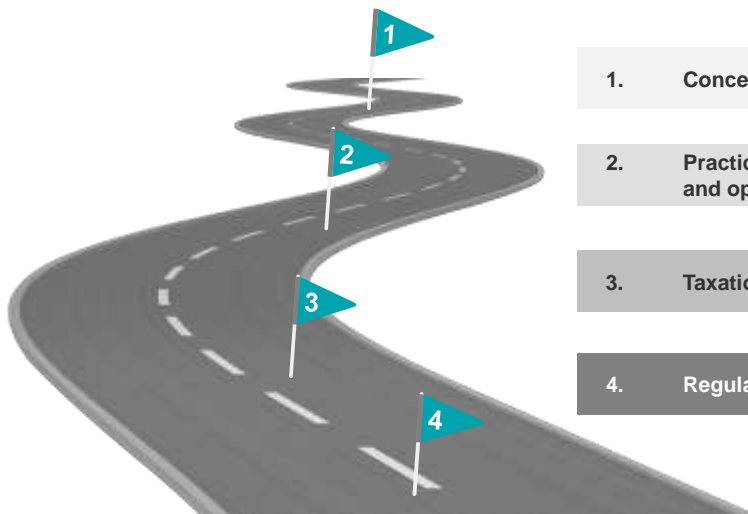
Overview of LLP

History and evolution

- ▶ From an international context, LLPs have been prevalent in large number of countries including US, UK, Canada and Singapore
- ▶ In US, UK and Singapore LLPs are also considered fiscally transparent for income and corporation tax purposes
- ▶ Use of hybrid entity form (i.e. LLP) is very common in international structures for establishing joint ventures, private equity funds etc.
- ▶ LLP is a suitable vehicle for partnerships among professionals such as Chartered Accountants, Cost Accountants, Company Secretaries, Lawyers etc.
- ▶ Other areas where LLP is set up:
 - ▶ In India, as per SEBI guidelines, an Alternate Investment Fund can be established through an LLP structure
 - ▶ LLP structure is also commonly used as a beneficiary entity in succession planning through a family trust

Agenda

Topics covered



1. **Concept of LLP**
2. **Practical aspects of LLP set up and operation**
3. **Taxation of LLP**
4. **Regulatory aspects**

LLP – key concepts

LLP – Key concepts

Regulatory framework

- ▶ LLP shall be a body corporate and a separate legal entity administered by Registrar of Companies (RoC)
- ▶ LLP has perpetual succession – any change in the partners of an LLP shall not affect the existence, rights, liabilities of the LLP
- ▶ Partners' liability can be limited to contribution as agreed in the LLP Agreement
- ▶ At least 2 'individual' designated partners (DP), one of whom has to be a resident in India (stay in India for at least 182 days in the preceding year)
- ▶ Where LLP comprises only of body corporates, it can appoint its 'individual' partner/ nominees as Designated Partners
- ▶ 'Body corporate' includes foreign company, foreign LLP, another Indian LLP
- ▶ Designated Partners responsible for compliance obligations, penalties, receive notices, verify statement of account/ annual solvency status, etc.



Practical approach to LLP

Practical approach to LLP

Incorporation matters

- ▶ 3 Stages of setting up the entity –
 - ▶ Name Availability;
 - ▶ Incorporation Application; and
 - ▶ LLP Agreement
- ▶ Main objects not to contain words like – Finance, Loan, etc.,
- ▶ Name availability application can be filed only by one of the DPs who could either be individual Partners or authorised representatives of body corporate
- ▶ Body corporates to be Partners in proposed LLP have to pass a Board Resolution providing for:
 - ▶ Consent to act as Partner & investment in LLP;
 - ▶ Amount of Capital contribution;
 - ▶ Nominating an individual to represent the body corporate;
 - ▶ Appointing the individual as a DP, if applicable, etc.
- ▶ Documents executed outside India have to be notarized and apostilled:
 - ▶ ID and Address proof documents (not older than 2 months), subscription sheets, Board resolution, etc.

Practical approach to LLP

Operational aspects

- ▶ LLP can commence business operations soon after incorporation and need not wait till filing of LLP Agreement
- ▶ Capital contribution by Partners can be in form of tangible as well as intangible properties and valuation would be important to record the actual value of contribution
- ▶ Partner can do business transactions with his LLP as if he is an outsider
- ▶ Convertibility of LLPs into a Company and vice-versa
- ▶ In case of conversion of Partnership firm (being an audit firm) to LLP, the auditee companies are required to pass a Board resolution taking note of such conversion of the form of audit entity
- ▶ In case of conversion of Pvt. Co. to LLP, the LLP need not intimate RoC within 15 days as per Sec 58(1) of LLP Act, since the corresponding Rule 39(3) of LLP Rules have been amended, although the Section requires the intimation

Practical approach to LLP

Practical concerns

- ▶ Stamp duty payable at the time of amending LLP Agreement each time
- ▶ Applicability of Accounting Standards to accounts maintained by an LLP
- ▶ Foreign Company setting up 'place of business' in India can have its name reserved for 3 years by applying to RoC, Delhi
- ▶ LLP can provide any other address other than its Registered office address for the purpose of receiving statutory communications (Form 12)
- ▶ If subscribers sheet is executed in India then the witness should always be a professional and not any other person, except if executed outside India
- ▶ LLP Agreement has to mandatorily contain capital contribution and profit sharing ratio
- ▶ If no business is carried on by LLP, then returns are required to be filed only up to the date of carrying on of business and not up to the date of filing for winding up
- ▶ No designated court for LLP in case of compounding of offences

Practical approach to LLP

Conversion Process

- ▶ Procedure for conversion of Partnership Firm, Private Co., and Public Co., to an LLP

Step 1 - Decide the DPs (one should be a Resident) and obtain DPIN and DSC



Step 2 – Application for name availability (Form 1)



Step 3 – Application and statement for conversion to LLP (Form 17 & 18)



Step 4 – Application for incorporation (Form 2)



Step 5 – Registrar to issue Certificate of Registration upon conversion



Step 5A – Intimation to Registrar of Firms (Form 14) – Only for Partnership firms



Step 6 – File LLP Agreement (Form 3)

- ▶ LLP can get converted to Company as per Sec 366 of CA, 2013 read with Companies (Authorised to Register) Rules, 2014

Practical approach to LLP

Conversion Issues

- ▶ In case of conversion to LLP, neither LLP Act nor Rules prescribe for 'NoC' from unsecured creditors, however, the authorities may insist for the same, at their discretion
- ▶ LLP Act or Rules is not clear on the date when Statement of Assets and Liabilities have to be provided, however, the authorities insist that the said Statement should not be older than 15 days from the date of filing the application for conversion
- ▶ Conversion to LLP may not be permitted if the Company is into investment activities
- ▶ The authorities would insist specifically for using the words "true and correct" in the Auditor's certificate with respect to contents of Statement of Assets and Liabilities
- ▶ Companies may be required to submit an Auditor's Certificate stating that the List of Creditors is 'true and correct' and the Company is in compliance with the provisions of Sec 73 of CA, 2013 and there are no charges on the assets of the Company
- ▶ Newspaper publication may be required depending on case to case basis

Key tax implications



Key tax implications

Key concepts

- ▶ Finance Act, 2009 introduced the provisions relating to taxation of LLPs
- ▶ Taxation of LLP kept at par with 'general partnership' (firm)
 - ▶ 'Firm' definition amended to include an LLP
 - ▶ 'Partner' definition includes a partner of an LLP
 - ▶ 'Partnership' includes an LLP
- ▶ Residential status of LLP determined based on 'control and management' test
 - ▶ LLP resident in India even if control & management of its affairs is partly in India
- ▶ In order to be assessed as a firm, the LLP requires an instrument where partners' shares are specified
- ▶ LLPs will be subject to AMT at the rate of 18.5% (plus surcharge & education cess) of the adjusted total income if the regular income tax payable is lower than the AMT

Key tax implications

Key concepts

- ▶ Allowed deductions:
 - ▶ Payment of salary/ bonus / commission/ remuneration to working partners, if provided in the partnership deed
 - ▶ Interest paid to partners such that the interest amount is up to 12% p.a. on capital calculated on simple interest basis
- ▶ Salary / bonus / commission received by a partner from the LLP will not be treated as salary (Exp 2 to Sec 15)
- ▶ Interest/ bonus/ remuneration received by a partner from the LLP shall be chargeable to income tax as profits and gains from business (Sec 28(v))
- ▶ Share of income from LLP is exempt in the hands of the partners (Sec 10(2A))
- ▶ No DDT applicability to LLP

Key tax implications

Comparative analysis

Particulars	LLP	Private Company
Corporate tax rates:		
I. Taxable income < 1 crore	30.90%	30.90%
II. Taxable income > 1 crore	34.61%	33.06%
III. Taxable income > 10 crores	34.61%	34.61%
Tax rate if FY 2015-16 Turnover < 50 crores (FA 2017)	30% + SC + cess	25% + SC + cess
Tax rate of 25% for new Manuf. Companies set up after 01.04.2016 (S. 115 BA)	Not applicable	Favorable tax rate of 25% provided conditions u/s 115 BA are satisfied
DDT applicability (S. 115-O)	No	Yes

Key tax implications

Comparative analysis

Particulars	LLP	Private Company
Taxation in the hands of partners/ members (S. 10(2A) and S. 10(34))	Share of profit is exempt	Dividend is Exempt provided DDT is paid by the Company. Dividends received by members > 10 lacs taxed @ 10%
Taxation of dividends > 10 lacs received from domestic companies (S. 115BBDA)	Taxable for LLPs	Not taxable for companies
Taxation of dividends received from specified foreign Company (S. 115BBDD)	Benefit not available	Beneficial rate of 15% (plus SC + EC) available

Key tax implications

Comparative analysis

Particulars	LLP	Private Company
Deemed Dividend (S. 2(22)(e))	Loan by LLP to partners not taxable as deemed dividend in his hands	Loan/ advances by Co. to shareholders might be construed as deemed dividend
Base for MAT/ AMT	Total income is adjusted	Book profits are adjusted
Taxation of exempt incomes under MAT / AMT (S. 115JB and S. 115JC)	Dividends under S. 10 (34) and capital gains under S. 10 (38) are not taxable	Dividends under S. 10 (34) and capital gains under S. 10 (38) are taxable
Presumptive taxation under S. 44 AD	Not applicable	Not applicable
Eligibility for deduction u/s. 35 (2AB)	No	Yes

Key tax implications

Comparative analysis

Particulars	LLP	Private Company
Interest on capital contribution by participants	Allowable as a deduction in the hands of the LLP subject to limits	Not applicable
Managerial remuneration S. 40(b) and S. 40A(2)	Allowable as deduction in the hands of LLP subject to limits	Allowable as deduction in the hands of company.
Carry forward and set off of losses – Reconstitution	Proportionate loss shall not be allowed (S. 78)	Entire loss shall not be allowed (S. 79)
Premium taxation under S. 56 (2) (viib)	Not applicable	Premium in excess of FMV of shares is taxed

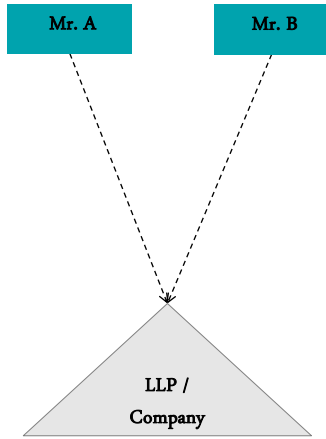
Key tax implications

Comparative analysis

Particulars	LLP	Private Company
Taxation under S. 56(2)(x)	LLP interest is not a 'property', hence not applicable	Shares of a company is covered under 'property' hence gift taxation applies
Ind – AS applicability	Not applicable	Applicable as and when the net worth exceeds the prescribed threshold
Capital gains exemption under renegotiated India-Mauritius Tax Treaty	Seems applicable	Not applicable

Case study 1

Company Vs. LLP – Tax rates



Facts:

- ▶ Mr. A and Mr. B are contemplating to set up Entity A to undertake manufacturing business
- ▶ Taxable income during the year is likely to be INR 150 Lakhs
- ▶ Distribution to be made to partners/share holders is likely to be INR 50 Lakhs

Query:

- ▶ Should Entity A be set-up as an LLP or a Private Company from tax perspective?

Case study 1

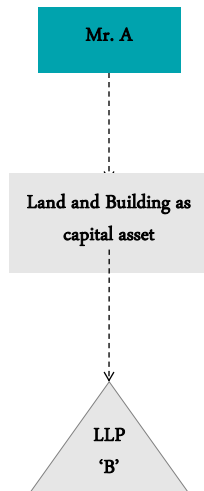
Company Vs. LLP – Tax rates

(Amount in INR)

Particulars	LLP	Private Company
In the hands of LLP / Company		
A. Total income	150 Lakhs	150 Lakhs
B. Tax @ 30% / Tax @ 25%	45 Lakhs	37.50 Lakhs
C. Surcharge @ 12% / Surcharge @ 7%	5.40 Lakhs	2.62 Lakhs
D. Cess @ 3% (on B + C)	1.51 Lakhs	1.20 Lakhs
E. Total Tax (B+ C + D)	51.91 Lakhs	41.32 Lakhs
F. DDT on distribution @ ~ 20%	-	10 Lakhs
In the hands of partner / share holders		
G. Dividend income @ 10%	-	5 Lakhs
H. Total Effective Tax (E + F + G)	51.91 Lakhs	56.32 Lakhs
I. Effective tax rate (H / A)	34.61%	37.55%

Case study 2

Capital contribution by partner to LLP



Facts:

- ▶ Mr. A holds Land as Capital asset
- ▶ He contributes such land to LLP 'B' as capital at FMV

Query:

- ▶ What would be the capital gains implications in the hands of Mr. A?
- ▶ Section 45(3) v. 50C
- ▶ Can LLP B record the land at a value other than FMV in light of S. 32 (2) of the LLP Act, 2008 and Rule 23 of LLP Rules, 2009?
- ▶ Application of amendments to provisions of S. 43 (1)

Key tax implications

Conversion to LLP – key conditions

- ▶ Conversion of private/ unlisted company into LLP made tax neutral in hands of LLP and shareholders, subject to stipulated conditions (S. 47(xiiiib)):
 - ▶ Conversion is in accordance with S. 56/ 57 of LLP Act
 - ▶ All assets and liabilities of company to become that of LLP
 - ▶ All shareholders to become partners in LLP in same proportion
 - ▶ Shareholders not to receive any consideration except share in LLP
 - ▶ Aggregate of profit sharing ratio of the shareholders of company in LLP \geq 50% for a period of 5 years
 - ▶ Sales, turnover/ gross receipts of company in any of 3 years < INR 60 lakhs
 - ▶ Total assets of the company in preceding three years < INR 5 crores *
 - ▶ No direct/ indirect payment to any partner out of accumulated profits of company for a period of 3 years post conversion date
- ▶ Violation of stipulated conditions leads to LLP paying tax in the year of violation on:
 - ▶ Capital Gains exempted in the hands of company and the shareholder [S. 47A(4)]
 - ▶ Forfeiture of loss claimed by LLP [Proviso to section 72A(6A)]

Key tax implications

Conversion to LLP – tax provisions

Cost of capital asset

- ▶ Actual cost of capital asset of company to be the actual cost to LLP [Sec 49(1)(iii)(e)]

Depreciation

- ▶ Aggregate of depreciation allowed to LLP and company not to exceed amount of depreciation as would have been allowable to the company without such conversion [5th proviso to Sec 32]

Cost of shares

- ▶ Cost of shares in company would represent cost of LLP interest for partner [Sec 49(2AAA)]

Unused MAT Credit

- ▶ Unused MAT credit of the Company not available for carry forward and set off to LLP [Sec 115JAA(7)]

Carry forward

- ▶ LLP can carry forward unabsorbed business losses/ unabsorbed depreciation [Sec 72A(6A)]
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Key tax implications

Judicial precedent

Judicial precedent in Texspin Engineering & Manufacturing Works (263 ITR 345) (Bom HC) highlights the following principles:

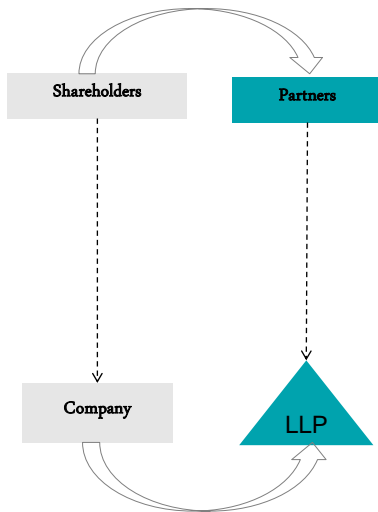
- ▶ Conversion is statutory vesting with no two persons existing at the same point of time
- ▶ Transfer of capital asset requires two ingredients:
 - ▶ Existence of a party and a counter party
 - ▶ Incoming consideration in the capacity of the transferor
- ▶ In the absence of two parties and consideration, there is no transfer of assets and hence, no Capital gains should trigger on conversion

The above principles has also been applied in the following:

- ▶ Umicore Finance Luxembourg (2017) 291 CTR 174 (Bom)
 - ▶ Rita Mechanical Works (2012) 344 ITR 544 (P&H)
 - ▶ Lincoln Pharmaceuticals (2006) 5 SOT 599 (Ahmedabad)
 - ▶ Krishna Electrical Industries (2004) 4 SOT 143 (Delhi)
 - ▶ Veto Electropowers (2011) 8 ITR (T) 76 (Jaipur)
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Case study 3

Conversion - Company to LLP



Facts:

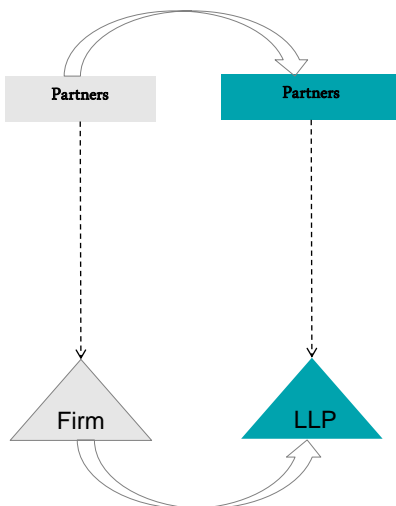
- ▶ A Company is converted to a limited liability partnership as per the provisions of LLP Act 2008

Question:

- ▶ Can we use the principles in the above rulings to argue that no two persons existing at the same point of time and no consideration has been received, hence there is no transfer of assets and hence, no Capital gains?
- ▶ Tax implications in the hands of shareholders/members?

Case study 4

Conversion – Firm to LLP



Facts:

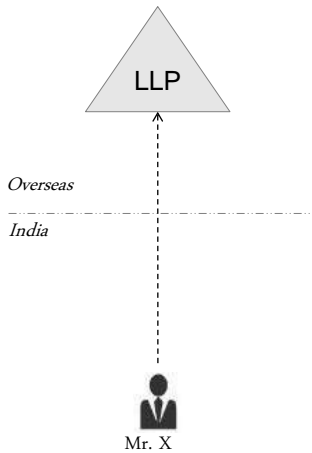
- ▶ A Partnership Firm is converted to a Limited Liability Partnership as per the provisions of the LLP Act, 2008

Question:

- ▶ What will be the tax treatment on conversion as per the provisions of ITA?

Case study 5

Foreign LLP and Indian Partner



Facts:

- ▶ Mr. X is a foreign citizen and qualifies as a tax resident of India
- ▶ He is a partner in a foreign LLP ('LLP'), which qualifies as a Non-resident ('NR') in India since the management and control is located outside India
- ▶ The LLP does not have any Indian sourced income
- ▶ Foreign LLP is not taxed at entity level. Mr. X is taxed in individual capacity on their share of partnership income

Question:

- ▶ Whether Mr. X's share of income from such Foreign LLP will be subject to tax in India?

Case study 5

Foreign LLP and Indian Partner

View 1:

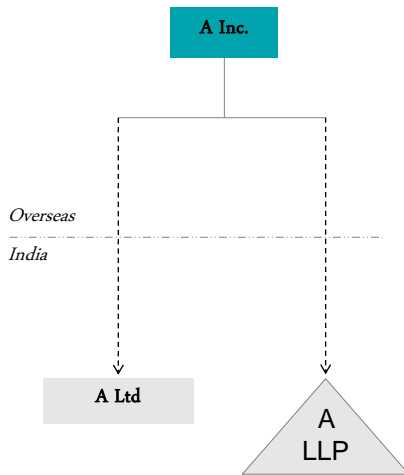
- ▶ From domestic tax perspective, LLP is an assessable unit and share of profit from LLP is exempt in the hands of partners u/s. 10(2A)
- ▶ Such proposition equally applies to a NR firm and a resident partner who derives income from such NR firm triggers no further tax liability in India
- ▶ Whether the NR firm is taxed in the other country at entity level or individual partner level is not relevant

View 2:

- ▶ A resident person is chargeable in respect of his global income including share of profit from an overseas firm
- ▶ Since the overseas firm is not assessed to tax in India, exemption u/s 10(2A) is not available

Case study 6

GAAR



Facts:

- ▶ A Inc. is a US based company which is into software development
- ▶ A Inc. is the majority shareholder in A Ltd which provides back office support for A Inc.
- ▶ A Inc. desires to outsource certain software development functions to India
- ▶ Though, A Ltd has the required expertise to perform such software development, A Inc. decides to set-up A LLP to undertake this activity

Question:

- ▶ Whether the setting up of A LLP to undertake software development in India would be construed as an impermissible avoidance arrangement and thereby attract GAAR provisions?

Case study 6

GAAR

- ▶ Can Tax Authorities contend that the LLP was set-up only to gain undue tax advantage in India
- ▶ The authorities may argue that 'tax benefit' through NIL levy of DDT
- ▶ The taxpayer can rely on CBDT circular 7/2017 according to which GAAR provisions will not interplay with the right of a taxpayer to select or choose the method of implementing a transaction
- ▶ Additional comfort where A Inc. / A Ltd is able to indicate commercial considerations driving the choice of vehicle, illustratively:
 - ▶ Significant difference in activity profiles of A Ltd and A LLP
 - ▶ LLP provides ease of governance and administrative convenience
 - ▶ LLP is a recognized form of business presence under the Indian exchange control regulations
 - ▶ Ease in formation and limited procedural compliances as compared to company structure



Regulatory aspects

Regulatory aspects

Key concepts - FDI

- ▶ FDI in LLP has been permitted subject to the following conditions:
 - ▶ FDI upto 100% will be permitted under automatic route (i.e. without the prior approval of FIPB) for the sectors falling under 100% automatic route
 - ▶ Foreign investment shall not be allowed in LLP engaged in the following:
 - ▶ Where FDI-linked performance related condition is attached (minimum capitalization, lock-in period)
 - ▶ Sectors which are prohibited
 - ▶ Sectors which are restricted with caps
 - ▶ Sectors which are under the approval route
 - ▶ Investment by FIIs, FPIs and FVCI in LLP is not permitted
 - ▶ An Indian Company/ LLP having foreign investment permitted to make downstream investment in LLP engaged in sectors where 100% FDI is allowed under Automatic route without any FDI linked performance conditions
 - ▶ Company with foreign investment can be converted into LLP under Automatic route only if engaged in in sectors where 100% FDI is allowed under Automatic route without any FDI linked performance conditions

Regulatory aspects

Key concepts - FDI

- ▶ FDI law requires LLPs in India need to follow all the conditions as prescribed under the LLP Act, 2008
- ▶ LLP would not be eligible to raise External Commercial Borrowing
 - ▶ Interest on capital would not be allowed under FEMA as the same would be treated equivalent to interest on ECBs
- ▶ The designated partners would be responsible for compliance and would be held liable for all penalties for any contravention

Investment by NRIs under the non-repatriation route

- ▶ Based on DIPP Press Note NO. 12 of 2015, investments made by NRIs on non-repatriation basis under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000 will be deemed to be domestic investment at par with investment made by residents
- ▶ As per Schedule 4, an NRI may contribute, on non-repatriation basis, to the capital of an LLP without any limit

Regulatory aspects

Key concepts - FDI

- ▶ As per FEMA Notn. Dt. Nov 7, 2017, an LLP which has received indirect foreign investment needs to comply with entry routes, sectoral caps, pricing guidelines and other conditions as applicable for foreign investment
- ▶ Form LLP(I) to be filed with RBI within 30 days of receipt of capital contribution from abroad
- ▶ Form LLP(II) to be filed with AD Bank within 60 days of receipt of funds, in case of disinvestment / transfer of capital contribution or profit share from resident to non-resident or vice-versa
- ▶ Return of FLA to be filed with RBI on or before July 15, each year, where there is foreign investment during previous year
- ▶ LLP to obtain an annual certificate from its statutory auditors on compliance with downstream investments and any qualifications therein has to be intimated to RBI and obtain acknowledgement

Summary

At a glance

- ▶ LLP is an alternate corporate business structure with hybrid features
- ▶ LLP is relatively easier to incorporate and is subject to lower compliances as compared to companies
- ▶ From a tax stand-point, the absence of tax on distribution of profits and beneficial AMT regime puts LLP at an advantage over companies
- ▶ However, certain benefits such weighted R&D deduction, 25% tax rates, lower rate of tax on dividends from specified foreign companies etc. are available only to companies
- ▶ Tax neutrality of conversion of firm / company to LLP is also a very important factor
- ▶ Post liberalization of FDI regime in 2015, FDI is permitted upto 100% under automatic route for sectors falling under 100% automatic route

