

# Limited liability partnership Conversion and Tax implication



**‘EMERGING CORPORATE FORM’**

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# Topics to be discussed

- Concept of Limited liability partnership (**LLP**)-  
Introduction, meaning and governance
- Features of LLP
- Incorporation of LLP
- LLP Agreement
- Conversion in LLP:-
  - Partnership firm
  - Private company
  - Unlisted public company
- Taxation aspects of LLP
- Tax implication on conversion:-
  - Firm into LLP
  - Company into LLP
  - Capital gain consequences

# An Introduction

- LLP Act, 2008 passed by Lok Sabha on 12<sup>th</sup> of December 2008 and the President gave assent to the Bill on 7<sup>th</sup> January 2009.
- Limited Liability Partnership Act, 2008 came into existence by way of notification on 31st March, 2009.
- Constituent of LLP Act, 2008
  - 14 chapters
  - 81 Section
  - 4 Schedules
- First LLP was registered on 2nd April,2009.
- Conversion of Companies & Firms into LLP was notified on 22nd May,2009 to become effective from 31st May,2009.
- Taxation of LLP's was notified on 22 July 2009.

# Governing laws

- LLPs in India are governed by the Limited Liability Partnership Act, 2008
- **As per sec. 67** of LLP Act, the provisions of the Companies Act, 2013 shall apply to LLPs.
- **As per sec. 4** of LLP Act, the provisions of the Indian Partnership Act, 1932 shall not apply to LLPs.
- Ministry of Corporate Affairs of Government of India shall administer the law.

# Salient Features of LLP

- LLP is a body corporate having perpetual succession.
- LLP will be a separate legal entity distinct from its partners.
- The provision of the Indian Partnership Act, 1932 shall not apply to a LLP.
- The Central Government may, by notification , apply any of the provision of Companies Act to any LLP with suitable modification and adaption.
- LLP shall have at least 2 partners.
- Provides the benefit of limited liability of partner's with the flexibility of organizing their internal structure as a traditional partnership
- LLP contain features of both a company and a partnership .

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## Contd....

- A firm, private company or unlisted company can be converted into LLP.
- Partners of a LLP is the agent of the LLP but not of other partners.
- LLP is liable to maintain accounting records, to prepare and deliver audited account to the registrar and to submit an annual return in a similar manner as applicable to companies.
- LLP can acquire or dispose of property in its own name.
- LLP can sue and be sued.
- The winding up of LLP is either voluntary or by the high court.

# Incorporation of LLP

*Chapter III of the LLP Act, 2008 comprising sections 11 to 21 deal with the incorporation of a limited liability partnership and matters incidental thereto.*

Incorporation of an LLP can be **divided into 9 steps.**

- I. Two or more person** - Any individual or body corporate ( sec. 5)
- II. Designated partner-** At least two individual and one must be resident (nominees in case of bodies corporate).
- III. Designated Partner Identification Number (DPIN)- (Sec 7(6), Rule 10)**
  - Valid for the life time
  - Required for Designated Partner only
  - Provision of Sec 153 to Sec 159 Company Act, 2013 shall apply
  - DIN shall be sufficient
- IV. Reservation of LLP Name**
  - Accordance with Emblems and Names Act, 1950
  - Must be end with the word “Limited Liability Partnership” or the acronym “LLP”
  - Partners shall have to select name of the proposed LLP (up to 6 choices can be indicated).
  - Guideline prescribed under rule 18 of the LLP Rules. 2009

## Contents of Rule 18 -LLP Rules 2009

- Rule-18 prescribe the name of LLP shall not be one prohibited under “Emblems and Names Act”, 1950.
- A name shall not be generally reserved if-
  1. It includes any word which are offensive
  2. The proposed name has a phonetic resembles to the name of LLP in existence.
  3. It includes the words like co-operative, Sahakari or the name connotes the participation of Central govt. or State govt.
  4. It includes name of registered Trademark- however, registered if consent of owner is obtained.
  5. The proposed name is too identical with name of LLP or company incorporated outside India.
  6. It is identical with or too nearly resembles name of LLP or a company which is struck off, up to the period of 5 years.
  7. The proposed name of LLP includes the word company secretary, chartered accountant, or such similar word indicative of profession, until approval from council governing such profession shall obtained.
- A foreign LLP or a foreign company may apply in **Form 25** to the registrar for reserving its existing name.
- Application for reservation of name to registrar having jurisdiction over the registered office of the LLP.
- Intimation by registrar of availability of name within seven days of the receipt of application.
- Validity period of registration of name shall be available for a period of three months (three year in case of Foreign LLP) from the date of intimation by the registrar.



## Contd....

- V. Incorporation document** - Is the constitution of the given LLP (Part A of Form-2).
- VI. Statutory declaration** in Form No. 2, Part B
  - Can be given by CA, CS, ICWA, Advocate or by any one who subscribed his name to the incorporation document, that all the requirements of this Act and rules made there under are have been complied with.
- VII. Registered office** of LLP – In addition to the registered office address, LLP may declare any other address as its address for service.
- VIII. Limited Liability partnership agreement:-**
  - Determine the mutual rights and duties of partners and LLP.
  - In the absence of any such agreement on any matter, the relevant provisions of First Schedule shall apply to that extent.
- IX. Payment of Registration fees** – LLP Rules, 2009 prescribes the fees and depends on the contribution made by partners.

## **Incorporation Document -Part A of Form-2**

**1/3**

1. Indicate registrar's reference number for name approval(Pre-fill)
2. Name of LLP
3. State in which registered office of the LLP is to be situated
4. Name of office of Registrar in which proposed LLP is to be situated
5. Address of registered office of the LLP
6. Business activity to be carried out by the LLP on incorporation.  
(Note:- In case business activities consists of banking, insurance, venture capital, mutual fund, stock exchange, chit funds, architect, merchant banking, a copy of the in-principle approval of the regulatory authority should be attached)
7. Based on business activity, description of main division of industrial activity of the LLP as per National Industrial Classification(NIC)-2004
8. a) Total number of designated partners  
b) Total number of partners
9. Details in respect of individuals as designated partners for which this form is being filled.

## **Incorporation Document -Part A of Form-2**

**2/3**

- 10) Details in respect of bodies corporate as designated partners and their nominees for which this form is being filled.
- 11) Details in respect of individual as partners for which this form is being filled
- 12) Details in respect of bodies corporate as partners and their nominees.
- 13) Total monetary value of contribution by all the partners/ designated partners in the LLP. However, contribution cannot be less than the contribution entered at the time of name availability.
- 14) Select whether addendum to Form 2 is required to be filed or not. Addendum to form 2 shall be required to be filed in the following scanerios:
  - In case number of partners/designated partners exceed the maximum number as allowed in the e-form.
  - In case details of all the designated partners or partners cannot be provided in this form due to the size of the attechments.

## Incorporation Document -Part A of Form-2

3/3

- 15) Declaration and consent (Attach details in respect of names of partners/nominees/witness and their signatures in the below format as subscriber's sheet attachment)

Name of each partner /designated partner /nominee/ nominee & designated partner	Designation (designated partner/ partner nominee/ nominee & designated partner	Signature of partner/ designated partner/ nominee/ nominee & designated partner	Name, address and profession (along with professional membership number) of witness	Signature of witness

### Attachments

Following are the attachments required to be filled with Form 2

- Copy of authorization where the partner is a LLP or a LLP incorporated outside India or a company incorporated outside India.
- Proof of address of registered office of LLP
- Details in respect of names of partners/witnesses and their signatures.
- Attachments in respect of details of individual/bodies corporate where the number exceeds five.
- Optional attachment.

# Format of Statutory declaration - Form No. 2, Part B

## Statement by an Advocate/Company Secretary/Chartered Accountant/Cost Accountant in practice:

I..... son / daughter/ wife of..... do state as under that:

- I am
  - Advocate
  - Company Secretary in whole time practice
  - Chartered Accountant in whole time practice
  - Cost Accountant in whole time practice

engaged in the formation of the limited liability partnership and my membership number with..... (name of regulatory body) is..... (Membership Number);

- All the requirements of the Limited Liability Partnership Act, 2008 and the rules made there under have been complied with, in respect of incorporation and matters precedent and incidental thereto;
- I make this statement conscientiously believing the same to be true.

**To be digitally signed by** Advocate / Company Secretary / Chartered Accountant / Cost Accountant in practice.....

Date: .....

Place: .....

# LLP Agreement

- Section 2(1)(o) of the LLP Act defines the expression “**LLP agreement**”. Accordingly ‘LLP agreement’ means any written agreement between the partners of the LLP or between the LLP and its partners which determine the mutual rights and duties of partners and their right and duties in relation to that LLP.
- Section 22 of the LLP Act provides that , the person who subscribed their names to the incorporation document shall be its partner and any person may become a partner of LLP by and in accordance with LLP agreement.
- As per section 23(1), the mutual rights and duties of partners and partners and LLP shall be governed by LLP agreement.
- section 23(3) of the LLP Act provides that an agreement made before the incorporation, between the persons who subscribes their names to the incorporation document may impose obligation on the LLP, provide such agreement is ratified by all the partners after the incorporation of LLP.
- Section 23(4) of the LLP Act provides that in the absence of the agreement on any matter, provision of first schedule shall apply.

# Provision given in first schedule

- If no agreement in LLP on any matter, the provision of first schedule shall be apply.
- All partners share equally in the capital, profit & loss
- LLP indemnify each partner in respects of payments made and personal liability incurred by him-
- In the ordinary and proper conduct of business
- For preservation of business
- Every partner shall indemnify LLP for any loss caused to it by his fraud.
- Every partner may take part in the management.
- No partner shall be entitled to remuneration
- No partner may be introduced without the consent of all existing partners.

Cond....

# Provision given in first schedule

- Issue relating to the LLP shall be decided by-
  - Resolution
  - Each partner shall have one vote.
  - Nature of business of LLP remains same, until the consent of all the partner is obtained.
- LLP shall kept and maintain decisions taken by it at the registered office.
- Each partner render information of all things affecting the any partner or legal representative.
- Business carried without the consent of LLP by any partner same in nature as LLP business- all profit must render by him to LLP from that business.
- Every partner shall account to the LLP for any benefit derived by him from any transaction related to LLP.
- No partner can expel any partner unless power has been provided by express agreement.
- All disputes which cannot be resolved, shall referred for arbitration.



# Supplemental LLP agreements

- In simple words, supplemental agreement means mutually consented agreement that modifies (but does not replace) an existing agreement.
- This type of document is sometimes used as a means of allowing the existing agreement to remain in place with the same ending date, while adding or removing some provisions or terms to the working relationship. A supplemental agreement is often an ideal solution when there is no desire to renegotiate an entirely new contract to take the place of the current agreement.
- Supplemental agreement can be executed in case of:-
  - a. Admission of a new partner into LLP
  - b. Retirement of a partner

## Importance of LLP agreement

- The LLP agreement is one of the two most important documents of a LLP. (Incorporation document is another one).
- The LLP agreement governs the mutual rights and duties of partners and LLP and its partners.
- One of the conditions of the first schedule is that no partner shall be entitled to remuneration for acting in the business of the LLP. Therefore, for complying with the condition of sec. 184 of the IT Act and for availing of deduction of salary to partners, LLP must have an agreement.

## Filing Requirement of LLP agreement

- As per sub-section (2) of section 23, the LLP agreement and any change made there in shall be filled with registrar in the prescribed form.
- Rule 21 of the LLP rule, 2009 prescribe that every LLP shall file information with regard to the LLP agreement and any change made there in, in Form 3 with the registrar within thirty days of the date of incorporation.
- Under the present scheme of assessment of LLPs, a certified copy of LLP agreement is to be furnish along with the return of income of the LLP of the previous year relevant to assessment year in respect of which assessment is first sought in the status of a LLP.

**Note :-** In case of failure to submit a certified copy, **no** deduction is allowed regarding interest and remuneration paid to partners.

## Signature of partners on LLP agreement

- As LLP agreement specifies the rights and duties of the partner, it is necessary that it bears the signature of all the partners. Further, under section 184, the instrument of LLP shall be certified to writing by all the partners therefore the signing of LLP agreement by partners is a must.

## Registration fee (Rule-5)

<b>Sr. No.</b>	<b>Nature of LLP</b>	<b>Amount of fee (in Rs.)</b>
1.	LLP whose contribution does not exceed Rs. 1 lakh	500
2.	LLP whose contribution exceeds Rs.1 lakh but does not exceed Rs. 5 lakh	2000
3.	LLP whose contribution exceeds Rs. 5 lakh but does not exceed Rs. 10 lakhs	4000
4.	LLP whose contribution exceed Rs. 10 lakh	5000

## Fee for filing documents and forms

<b>Sr. No.</b>	<b>Nature of LLP</b>	<b>Amount in (Rs.)</b>
1.	LLP whose contribution does not exceed Rs. 1 lakh	50
2.	LLP whose contribution exceeds Rs. 1 lakh but does not exceed Rs. 5 lakhs	100
3.	LLP whose contribution exceeds Rs. 5 lakh but does not exceed Rs. 10 lakhs	150
4.	LLP whose contribution exceeds Rs. 10 lakh	200

# Conversion in LLP



## ➤ Who can convert?

- Partnership firm (sec. 55 & Second schedule)
- Private company (sec. 56 & Third schedule)
- Unlisted public company (sec. 57 & Fourth schedule)

# Procedure of conversion into LLP

<b>Forms required</b>	<b>Conversion of Firm into LLP</b>	<b>Conversion of company into LLP</b>
---	Partner Resolution	Board resolution
E- Form 7	Application for allotment of DPIN (Designated partner identification number)	DIN is sufficient otherwise Application for allotment of DPIN (Designated partner identification number)
E-Form 1	Application shall be made for availability of proposed name with the registrar	Application shall be made for availability of proposed name with the registrar
E-Form 2	Filing of incorporation document	Filing of incorporation document
E-Form 17	Filing of conversion application	-----
E-Form 18	-----	Filing of conversion application to ROC



## Contd....

<b>Forms required</b>	<b>Conversion of Firm into LLP</b>	<b>Conversion of company into LLP</b>
E-Form 3	Information with regard to LLP agreement and changes, if any, made there in	Information with regard to LLP agreement and changes, if any, made there in
E-Form 19	Registrar will issue certificate of conversion of firm into LLP	Registrar will issue certificate of conversion of Pvt. Ltd. company into LLP
E-Form 14	Intimation of conversion to Registrar of firm with whom the erstwhile firm was registered under Indian Partnership act, 1932	Intimation of conversion to ROC with whom the erstwhile private limited company/unlisted company was registered under Companies Act.

## Important consideration for conversion of company/firm into LLP (1/3)

<b>Sr. No.</b>	<b>Particulars</b>	<b>Conversion of firm into LLP</b>	<b>Conversion of private/unlisted company into LLP</b>
1.	Filing of form with registrar of LLP	Form 7 & form1 Form 17 & form 2	Form 7 & form1 Form 18 & form 2
2.	Capital in LLP	All the partners of the firm shall be the partners of LLP (no one else) with same Capital Ratio.	All the members of the company shall be the partner of the LLP (no one else) with same Capital Contribution Ratio.
3.	Consent	Consent of all the partners of the firm shall be obtained.	Consent of all the member of the company shall be obtained.
4.	Charge / Security on Assets	No security interest on assets shall be subsisting or in force on date of application.	No security interest on assets shall be subsisting or in force on date of application.

## Contd.... (2/3)

<b>Sr. No.</b>	<b>Particulars</b>	<b>Conversion of firm into LLP</b>	<b>Conversion of private/unlisted company into LLP</b>
5.	No objection certificate (NOC)	NOC is required from unsecured creditor.	NOC is required from unsecured creditor.
6.	Certified statement	-----	Statement of Assets & Liabilities certified by Auditor of not more than 30 days prior to the date of the conversion application.
7.	Approval	In case of Professional Firms, approval from Governing Council of the relevant body.	-----

**Note:-**

- Listed public company cannot be converted into LLP.
- If a private Ltd. company has given its assets as security for any loan, advance etc. it is not eligible for conversion into LLP.
- For conversion of firm to LLP, the relevant rule 38 is notified vide notification no. s.o.1324 (E) dt. 22 May, 2009 w.e.f. 31 May, 2009
- For conversion of Company to LLP, the relevant rule 39 & 40 is notified vide notification no. s.o.1324 (E) dt. 22 May, 2009 w.e.f. 31 May, 2009

# Effects of conversion into LLP (1/2)

- LLP by the name specified in the certificate of registration.
- Upon such conversion the partnership firm/company shall deemed to dissolved
- All the assets, liabilities interests ,rights, privileges, obligation of the firm/company shall transferred to and vest with LLP.
- Whole of the undertaking including agreements, contract of the firm/company shall be transferred to and shall vest with LLP and continue into force.
- All pending proceeding by or against the firm/company may be continued, completed and enforced by or against LLP.

## Contd... (2/2)

- Every contract of employment shall continue to be in force on or after the date of registration as if the LLP were the employer.
- Any approval, permit or license issued to the firm/company under any other act will remain in force subject to the provision of such other act under which such approval, permit or license has been issued.
- Partners shall continue to be personally liable (jointly and severally with the LLP) for liabilities and obligation of the firm which were incurred prior to conversion.
- **Notice of conversion upto 12 months after the date of registration in every official correspondence.**

# Advantages and disadvantages on conversion



## Advantage on conversion of partnership firm into LLP (1/2)

- There is **no limit** on maximum number of partners, therefore gives an opportunity to expand your business.
- **Liability** of partners is limited.
- **No exposure** to personal assets of the partners.
- Partners are **not agent** of another partners.
- Business will be recognized by the name of LLP and not individual partners, therefore LLP can create **goodwill of its own**.



## Contd.... (2/2)

- Partners can **transfer their right** to share profits to anyone else.
- Partner can **enter into Joint Ventures** with other parties in the name of LLP, which is otherwise not feasible in case of partnerships.
- Recognized as **body corporate** therefore it will be easy to attract finance from market.
- **No liability** of partner will arise for the wrongful act of other partner.
- **Flexibility** of organizing the internal structure.
- **No liability** will arise of partner for obligation of LLP arising out of a contract.

## Advantages on conversion of private company/unlisted company into LLP (1/2)

- **Dividend distribution tax (DDT)** is payable by resident companies on distribution of profits to its shareholders. As LLP is not a company, DDT would not be applicable on LLP.
- LLP shall be **allowed** to be **carried forward and set-off** the accumulated business loss and unabsorbed depreciation of the predecessor company if conditions specified in clause (xiiib) of section 47 are satisfied.
- **No audit requirement** unless capital exceeding 25 lakh rupees or turnover exceeding 40 lakh.
- There is **no need** of **compliances** related to meetings and maintenance of huge statutory records.

## Contd... (2/2)

- **Wealth tax** is applicable to individual , HUF and company. Therefore, LLPs are **not** Liable to pay Wealth Tax.
- **Restrictive provision** like limitation on managerial remuneration are **not** applicable on LLP.
- **Deemed dividend** Provision of Sec.2(22)(e) would not applicable to LLPs.
- All movable property or immovable property are vest with LLP. No instrument is required to be executed and hence **no stamp duty** is required to be paid. *(In our opinion this is a Judicial matter that stamp duty is required or not)*
- LLP shall continue to be enjoy **Voluntary retirement scheme (VRS)** u/s 35DDA.
- LLP can **claim** the **deduction of interest** paid to partners, provided such interest is provided by a LLP agreement.

## Disadvantage on conversion

- **MAT credit** of the predecessor company shall not be carried forwarded by the successor LLP u/s 115JJA.

# Tax aspects of LLP



# Taxation of LLP

- Tax treatment of LLPs to be same as that of partnership.
- **Section 2(23) of IT Act,1961**  
‘partnership’ include ‘LLP’ & ‘Partner’ includes the partners of LLP.
- **Section 2(31) of IT Act,1961**  
‘person’ includes a firm . By virtue of amendment in sec 2(23), ‘firm’ include LLP. So, LLP would be covered in the definition of the ‘person’.
- As per [S.10 (2A) of IT Act], Partners share of profit in LLP will be exempt.

# Eligibility (Sec.184&185)

## ➤ Basic requirements to be fulfilled so as to be taxed in status of LLP (Sec.184):-

- The LLP is evidenced by an instrument in which the individual shares of partners in the profits of the LLP are specified.
- A certified copy of LLP Agreement must be submitted with the return of income of the LLP of the previous year in which the partnership was formed.
- Revised LLP agreement should be submitted when ever there is a change in the constitution of LLP or profit sharing ratio.
- There should not be any failure on the part of the LLP while attending to notices given by the Income Tax Officer for completion of the assessment of the LLP.

## Contd....

- If the condition specified in Section 184 fulfilled then LLP shall be eligible for following deductions:-
  - I. Interest paid to partners, provided such interest is authorized by the LLP Agreement.
  - II. Any salary, bonus, commission, or remuneration (by whatever name called) to a partner will be allowed as a deduction if it is paid to a working partner who is an individual.
  - III. The remuneration paid to such working partner must be authorized by the LLP Agreement and the amount of remuneration must not exceed the given limits as per provision of sec 40(b) of IT Act.



# Remuneration to working partners – Sec 40(b)

- The LLP shall be entitled to deduction of remuneration paid to **working partner** as per provision of sec.40(b) of IT Act. The deduction shall be allowed as per the proposed limits mentioned below:-

<b>Slab of Book Profit</b>	<b>Remuneration Allowable</b>
On first 3 lacs of the book profit or in case of loss	Rs. 150000 or 90% of book profits, Whichever is higher
On balance of book-profit	60% of book profit

- Section 40(b) provides that :-
  - **“book-profit” means** the net profit, computed in the manner laid down in chapter VI-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.
  - **working partner means:-**
    - a) an individual who is a partner of a firm; and
    - b) such an individual is actively engaged in conducting the affairs of the business or profession of the firm.

## Interest to partners - Sec. 40(b)

- As per the provision of sec. 40(b) of the Act, LLP shall be entitled to deduction of interest paid to any partner on the amount standing in the name of the partner either in capital account, current account, loan account or any other account by whatever name called provided it is not in excess of 12% simple interest per annum [18% before 1-6-2002] and payment of such interest is duly authorized by the LLP agreement.

# Basic rules for computation of income of LLP

1. The interest and remuneration paid or payable to a partner are to be deducted from the income of the LLP.
2. The brought forward unabsorbed depreciation and business losses are to be deducted.
3. In view of section 112, LTCG are to be constitute a separate chunk for computing the income and tax thereon is separately calculated at a specified rate of 20%.
4. The income left with the LLP after the deduction of LTCG is to be further reduced by quantum of relief under provisions of chapter VI-A, namely sections 80G, 80GGA, 80-IA, 80-IAB etc.
5. On the balance of income so remaining tax is to be charged.
6. LLPs are liable to AMT (Alternate Minimum Tax).

# LLP -Presumptive Taxation

LLP not covered under presumptive taxation u/s 44AD of Income Tax Act . However can avail benefit under section 44AE

- Section 44AD is applicable to individuals, firms and HUFs but not applicable to LLPs. Thus, LLP will not be able to avail presumptive taxation schemes u/s 44AD.
- Section 44AE of the Act contains special provision for computing profit & gains of business of plying, hiring or leasing goods carriages. The finance Act, 2009 has not amended section 44AE so as to bar an LLP from getting benefit thereof.

# Alternate minimum taxation (AMT)

- The provision of AMT is given under Section 115JC under Chapter XII-BA of the Income Tax Act. The provision of AMT is applicable to LLPs and non-corporate assessee from 1<sup>st</sup> april,2012.
- AMT means the amount of tax computed on the **adjusted total income**. AMT is a way to collect the minimum tax from the zero tax payers. Under it, the assessee is liable to pay tax at rate of 18.5%.
- The word **Adjusted Total Income** has been defined under Section 115JC (2) of the IT Act as the total income of the assessee on which he is liable to pay income tax, is increased by-
  - Deduction claimed under Sections 80H to 80RRB, except Section 80P.
  - Deduction claimed under Section 10AA.

## PAN of LLP

- An LLP will be required to obtain PAN if it carries on business or profession whose total sales, turnover or gross receipts are or is likely to exceed Rs. 500000 in any previous year and who has not been allotted any Permanent Account Number.
- *In our opinion*, In case of conversion New PAN is required for LLP and if any PAN based registration is there before conversion (such as TAN, Service Tax etc.) then LLP is required to obtain a fresh registration with respective department.

# Return of LLP

The provisions of return of income in the Act, which are applicable to firm are same would apply to LLP as well because the definition of **Firm** includes an LLP.

- i. Due Date for filing the return of income [Sec 139 ]**
- ii. Residential status of LLP Sec. 6(2)**
- iii. LLP to file return compulsorily even if loss is incurred [Sec 139(1)]**
- iv. Filing of return of income in electronic form [sec. 139(1B)]**
- v. Signing of return of income of LLP [sec. 140]**
  - by the designated partner
  - Where for any unavoidable reason the designated partner is not able to sign the return, by any other partner.

# Taxability – LLP & Partners

<b>Sr No</b>	<b>Particulars</b>	<b>Taxability LLP</b>	<b>Taxability Partners</b>
<b>1</b>	Net profit after allowable remuneration & interest	@ 30% + 3% education cess + surcharge as applicable (if total income exceeds Rs. 1 crore)	Nil
<b>2</b>	Remuneration	Allowed as deduction to the extent of allowable remuneration	Taxable in the hands of partners
<b>3</b>	Interest on capital	Allowed as deduction to the extent of 12% p.a. simple interest	Taxable in the hands of partners



Tax implication on Conversion  
into LLP

# Tax implication on conversion of partnership firm into LLP



- A partnership firm & LLP is being treated as a equivalent(except for recovery purposes) in the Act.
- There is no provision under the Act to specifically provide that conversion of a partnership firm into LLP does not amount to transfer.
- However, conversion of general partnership firm into LLP have no tax implication if:-
  - Rights and obligation of the partners remain same.
  - There is no transfer of any assets and liability after conversion.

**Note:-In case, of violation of 2 conditions which is specified above, section 45 will be attracted and conversion would be a taxable event.**

## Tax implication on conversion of company into LLP

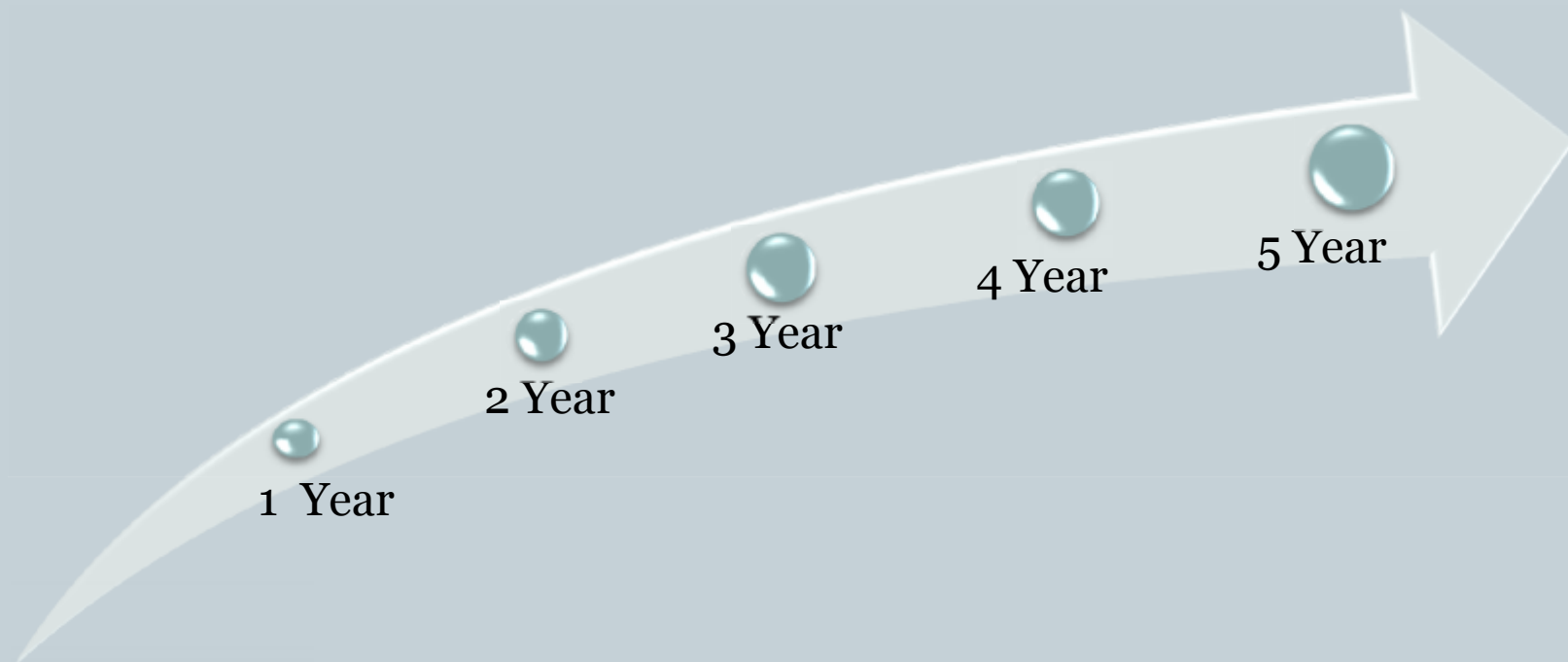
- The finance Act, 2010 has amended section 47 by inserting a new clause (xiiib), which provides that any transfer of a capital asset to a LLP or any transfer of shares by shareholder to LLP should be in accordance with provision of section 56 or 57 of the LLP Act, 2008 and shall not be regarded as transfer for the purpose of capital gain tax u/s 45, subject to the fulfillment of the following conditions specified in **Section 47(xiiib)** :-

# Conditions specified in section 47(xiiiib)

1. All the assets and liability of the company immediately before the conversion becomes  Assets & liability of LLP
2. All the shareholder of the company immediately before the conversion become 
  1. The partner of LLP
  2. And their capital contribution and their PSR are in the same proportion as their share holding in the company on the date of conversion.

Contd...

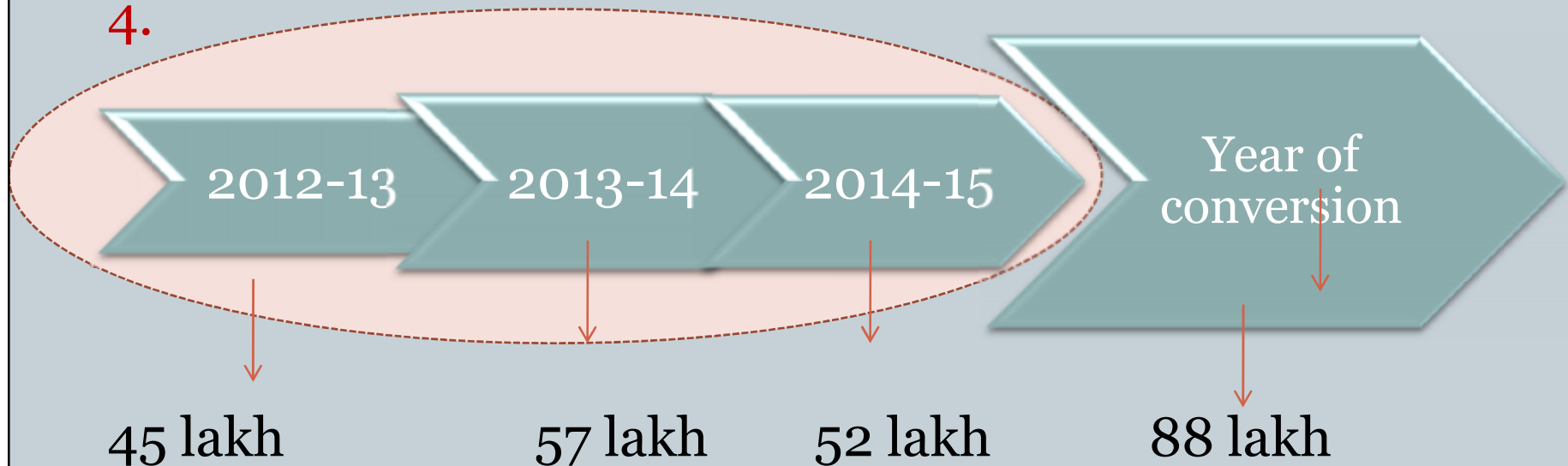
3.



- The aggregate of the profit sharing ratio of the shareholders of the company in the LLP shall not be less than fifty percent at any time during the period of five years from the date of conversion.

# Contd...

4.



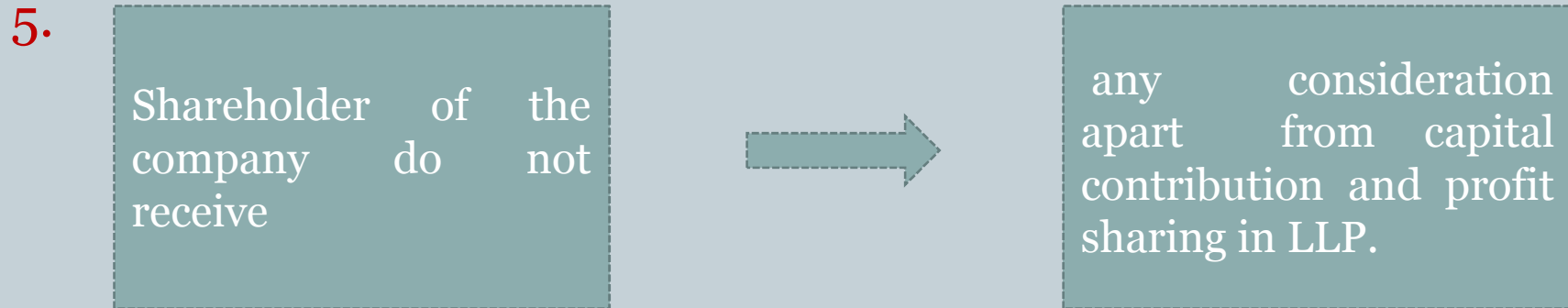
- Total Sales < INR 60 lacs in **any of three previous years** preceding the previous year in which conversation takes place.

## Contd...

### Note:-

- .Only companies whose total sales < INR 60 lacs in any of three previous years preceding the previous year in which conversion takes place can avail of a tax free conversion into LLP.
- In case of companies whose total sales > INR 60 lacs in any of three previous years preceding the previous year in which conversion takes place cannot avail of a tax free conversion into LLP u/s 47(xiii b).

## Contd...



**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 the period of three years** from the date of conversion.



## **Carry forward and set off of accumulated loss and unabsorbed depreciation allowance**

- U/s. 72A on conversion, the successor LLP, will be allowed to carry forward and set off of accumulated loss and unabsorbed depreciation allowance. However, if the conditions laid out in section 47(xiiib) are not complied with then the losses allowed as set-off will be deemed to be income of the year in which such non-compliance occurs

# Withdrawal of exemption

- The finance Act, 2010 has amended sec.47A by inserting a new clause (4) which provides that if any of the conditions stipulated in sec. 47(xiiib) are not complied, the transfer shall be deemed to be taxable capital gain of the successor LLP or shareholders of predecessor company in the previous year in which such compliances not takes place.

## Cost of acquisition of capital assets or intangible assets

- Sec. 49 of IT Act deals with cost of acquisition of previous owner of the asset. The finance Act,2010 has amended sub-clause (e) of clause (iii) of sub-section (1) of the section 49 from A.Y 2011-2012 so as to make a reference of clause (xiiib) of section 47 in the said sub-clause (e). This amendment provides that in case of company other than listed public company is succeeded by a LLP, the cost of acquisition of the assets for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it.
- Section 49(1)(iii)(e) would apply only if the transfer of assets takes place in terms of section 47(xiiib).

# Deductions not available to LLP

## ➤ LLP may not qualify for certain deductions :

- **Section 35D** – Amortization of certain preliminary expenses.
- **Section 35DD**– Expenditure in respect of amalgamation / demerger.
- **Section 35(2AB)** – Weighted deduction for Scientific Research and Development
- **Section 47(vi), (via), (vib), (vid), (vii)**:- Tax neutrality on amalgamation / demerger
- **Section 80-IA(4)(i)** – Deduction on profits of infrastructure projects

# Change in constitution of LLP ( Sec. 187)

## **i. When assessment to be made on the reconstituted LLP**

Section 187(1) of the IT Act lays down that where there is change in the constitution of a LLP in any year, assessment of the LLP u/s 143 or u/s 144 shall be made as the LLP so reconstituted at the time of assessment.

## **ii. When change in the constitution of the LLP can be said to be have taken place**

Section 187(2) contemplates two situation, where LLP shall be treated as reconstituted:-

- a) where one or more of the partners cease to be partners or one or more of the partners are admitted to LLP.

**[Commissioner of Income-tax v. Alagappa Cotton Mills [1984] 18 Taxman 302 (Mad.) HC]** Held that where a Karta of an HUF is a partner in a firm in his representative capacity and later on admitted as a partner in his individual capacity will amount to be change in constitution.

## Contd...

- b) Where all partners continued with a change in their respective shares or in the shares of some of them.

**[Dhanraj & sons v. CIT (1987) 168 ITR 557 (Bom)].**

**Note:-**Even when both the condition specified u/s 187(2), change in constitution of LLP will be considered.

### **iii. Effect of proviso to section 187(2)**

The proviso at the end of section says that if a LLP was dissolved on account of death of partner it will not to be said to be a change of constitution provided there is no contract otherwise. Because of the proviso, such a case is of succession governed by section 188 and not of change in constitution governed by section 187(2).

**[CIT v. Jasumal Devandas (1985) 156 ITR 551 (MP)]**

# Assessment in case of succession of LLP

## [sec. 188]

- Section 188 of the Act lays down that where a LLP is succeeded by another LLP and the matter is not covered by sec. 187, there will be a separate assessment on the predecessor LLP up to the date of succession and the succeeding LLP from the date of succession till the date of year close. This is to be in accordance to section 170 of the Act.

## Assessment on dissolution of LLP or discontinues of business [sec.189]

- Section 189(1) of the IT Act provides that where a LLP is dissolved or discontinues its business, its total income shall be assessed as if no such dissolution taken place and all the provision of the Act including those for levying of penalty etc., shall apply to such assessment as far as these may be applicable.
- Section 189(2) provides that , the Deputy Commissioner or the Commissioner may also levy penalty in the course of proceedings under this Act in respect of any such LLP, as if they satisfied that the firm was guilty of any of the acts specified in Chapter XXI.



## Contd....

- Section 189(3) provides that, any person who was the partner of LLP or legal representative of a deceased partner who was partner at the time of dissolution is jointly and severally liable for the payment of taxes, penalties and others sum due from the LLP.
- Section 189(4) provides, where a dissolution of LLP has taken place after the commencement of proceeding, the same may be continued against the person referred to in sub-section (3) of section 189 from the stage at which the proceeding stood at the time of such dissolution.
- In sub-section (5) of section 189 it is specifically provided that nothing in this section shall affect the provision of sub-section (6) of section 159 .

# Assessment of partner's Income

- **The following provisions of the IT Act are to be kept in view in order to have a clear understanding of the assessment of the partners.**
- i. As per [S.10 (2A) of IT Act], Partners share of profit in LLP will be exempt.
- ii. Section 15 clarifies that any salary, commission, or remuneration received by a partner from the LLP shall not be regarded as salary for the purpose of section 15 of the IT Act.
- iii. Clause (v) of section 28 provides that any interest, salary, bonus, commission or remuneration received by a partner of the LLP is to be assessed as income from business or profession.
- iv. Provided further the amount that, the amount of interest or remuneration disallowed in computing the income of the LLP under section 40(b) shall not also form part of income to be taxed in the hands of the partner.

# Liability of partner of LLP on liquidation

## [sec. 167C]

- Section 167C provides that where any tax is due from a LLP and cannot be recovered, then every person who was a partner of the LLP shall be jointly and severally liable for the payment of taxes due unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.

**Note:- Section 167C has been inserted by the finance Act, 2013 effective from 1-6-2013 so as to clarify that expression “tax due” includes penalty, interest or any other sum payable under the Act**

## Difference between company and LLP

Basis of difference	Company	LLP
Prevailing Law	'Companies Act, 2013'	'The Limited liability partnership Act, 2008'
Formalities of incorporation	The MOA and AOA are filled with prescribed fees	The LLP agreement are filled with the prescribed fees.
Name of entity	Suffix 'Limited' or 'Private Limited' has to be added to the name (except sec 8 of Companies Act, 2013)	Suffix 'LLP' or Limited Liability Partnership has to be added to the name.
Expenses for formation	Minimum Statutory Fee for incorporation of Private Company is Rs. 6000/-	Minimum Statutory fee for incorporation of LLP is Rs. 1500/- and Max. fee is Rs. 7000/- (approx.)
Charter documents	MOA and AOA	LLP Agreement
Common seal	Yes	Depends
Remuneration of managerial personnel	Can pay remuneration to its director subject to law	Depends on LLP agreement

## Contd...

<b>Basis of difference</b>	<b>Company</b>	<b>LLP</b>
Rights/duties of the partners/directors	AOA and resolution passed by the directors or shareholder	Governed by LLP agreement
Number of members	2 - 200 members in case of Pvt. & Public Minimum 7 - no limitation	Minimum 2 - no limitation
Digital Signature	At least one Director	At least one Designated Partner
Identification Number	Each director is required to have a DIN	Each Designated Partners is required to have a DIN
Foreign participation	Foreign Nationals can be a member.	Foreign Nationals can be a Partner.
Admission as partner/member	By buying shares of a company.	As per the LLP Agreement

## Contd....

<b>Basis of difference</b>	<b>Company</b>	<b>LLP</b>
Liability of partner/ members	Generally limited to the amount required to be paid up on each share.	Limited, to the extent their contribution, except in case of wrongful act by the partner.
Statutory meeting	BOD and General Meetings are required to be conducted.	There is no provision in regard to holding of any meeting.
Maintenance of minutes	BOD/ shareholders meetings are required to be recorded in minutes.	Agreement may decide to record the proceedings of meetings of Partners /Designated Partners
Share certificate	Share Certificates are proof of ownership of shares held.	The ownership evidenced by LLP Agreement.
Cessation of member/partner	Member / shareholder can cease to be a member by selling his shares.	Can cease to be a partner as per the LLP Agreement or by giving 30 days prior notice.

## Contd....

<b>Basis of difference</b>	<b>Company</b>	<b>LLP</b>
Audit of accounts	Required to get their accounts audited annually .	No audit requirement unless capital exceeding 25 lakh rupees or turnover exceeding 40 lakh
Voting Rights	Decided as per the number of shares held by the members.	Voting rights shall be as decided as per the terms of LLP Agreement.
Books of account	Books of accounts must be prepared as specified in the Companies Act.	Books of accounts must be prepared as specified in the LLP Act.
Manner of books of account	Accrual basis	Cash basis or accrual basis
Drawings	Drawings are not permitted	Drawings are permitted as per the LLP agreement.

# Similarities between company and LLP

<b>Category</b>	<b>Company</b>	<b>LLP</b>
Registration	compulsory	compulsory
Creation	Created by Law	Created by Law
Distinct entity	Yes	Yes
Perpetual succession	Yes	Yes
Dissolution	Voluntary or by order of National Company Law Tribunal.	Voluntary or by order of National Company Law Tribunal.
Annual filings	Annual Return is required to be filed with the ROC annually in the prescribed format	Annual Return is required to be filed with the ROC annually in the prescribed format
Legal Proceeding	A company can sue and be sued	LLP can also sue and be sued



## Contd....

<b>Category</b>	<b>Company</b>	<b>LLP</b>
Purchase of Property	A company can purchase movable / immovable property in its name.	LLP can also purchase movable / immovable property in its name
Change of name	The name of the company can be changed with the prior approval of Central Government.	The name of the LLP can be changed with the prior approval of Central Government.
Jurisdiction of Company Law Board (CLB)	CLB has jurisdiction over the affairs of the company.	CLB has jurisdiction over the affairs of the LLP

CASE LAWS ON SOME ISSUES  
INCLUDING  
INTEREST/REMUNERATION

## Issue-

- Whether sec. 45 is attract, if a private limited company was converted into a LLP and violate the conditions specified in sec.47xiiiib?
- If a LLP provided interest-free loan to the partners out of the reserve and surplus received by on the conversion of the Pvt. Ltd. company into the LLP, there is a violation of the provisions of section 47(xiiiib) and therefore amount of profit and gains arising from the transfer of the capital assets or shares is to be regarded as profits and gains chargeable to tax to LLP. [**Aravali Polymers LLP v. JCIT [2014] 47 taxmann.com 335 (Kolkata - Trib.)**]
- Whether deduction of bonus is allowed to non-working partner, if authorize by partnership deed and conditions stood under section 40(b) are fulfilled?
- If partnership deed authorize payment of bonus to all partners and conditions prescribed under sec. 40(b) are fulfilled then deduction of bonus is allowed to assessee firm.[**Id. Mohd. Nizamuddin v.Asst. CIT [2014] 44 taxmann.com 213 (Jaipur - Trib.)**]

## **Issue-**

- Whether claiming of Int. on capital and remuneration paid to working partner by assessee-firm u/s 40(b) is mandatory?

Where assessee-firm returned income without claiming interest on capital of its partners and also remuneration paid to working partners so that it could take benefit of brought forward losses, Assessing Officer could not enforce deduction of such interest or remuneration by invoking section 40(b), more particularly when it was not mandatory but discretionary for assessee to have made such a claim.

***[Tulsa Ram Kanhiyalal & Sons v. ITO [2008] 25 SOT 402 (Jodh. - Trib.) (SMC)]***

## **Issue-**

- Whether deduction of remuneration is allowable if partnership deed does not provided quantification of remuneration in express term?

Section 40(b) only speaks about the condition in which the remuneration or salary paid to the partner is allowable and the extent to which the same is allowable. Once the partnership deed has authorized the payment of remuneration or salary to the working partner, then the same is allowable as a deduction provided the deduction claimed is in accordance with the terms of deed of partnership. Further in view of CBDT Circular No. 739, dated 25-3-1996, merely because quantification of remuneration or salary is not provided in express terms, it would not affect the claim of deduction.

**[*ITO v. Pulimoottil Silk House* [2008] 19 SOT 4 (Coch. - Trib.)]**

## Issue-

- In case of negative amount of profit, it is mandatory to provide minimum remuneration as per section 40(b)(v)?

Unabsorbed depreciation of earlier years is a part of current year's depreciation under Section 32(2), which falls in Chp. IV-D and, therefore, for computation of book profit, unabsorbed depreciation has to be necessarily taken into account. If the resultant amount of profit after deducting unabsorbed depreciation was negative, even in the case minimum remuneration would have to be provided as per section 40(b)(v). [***Vikas Oil Mill v. ITO* [2005] 95 TTJ (Jp. - Trib.) 1126**].

## Issue-

➤ In case of insufficient profit, deduction is allowable to the extent actually paid towards salary or amt. shown in partnership deed?

- Deduction for salary paid to working partners is allowable to extent of amount actually paid towards salary and shown in books although clause in partnership deed provided for payment of higher salary which could not actually be paid due to insufficiency of profits.

**[*Sri Balaji Agencies v. ITO* [2007] 106 ITD 419 (Chennai - Trib.).**

➤ Whether Income-tax liability is to be deducted while calculating remuneration on net profit on percentage basis as per terms of partnership deed?

- Where remuneration payable to working partners, as per partnership deed was 2.5 per cent of net profits, remuneration payable to partners in terms of partnership deed for purposes of section 40(b)(ii) should be worked out on basis of net profit without deducting income-tax liability.

**[*CIT v. Kajah Co.* [2004] 136 Taxman 434/ 266 ITR 122 (Ker.)]**

## Issue-

- Whether deduction of remuneration is allowable, in case assessee had filed revised return declaring additional income as business income?

Where assessee had filed revised return declaring additional income and Tribunal had come to conclusion that additional income received by assessee was from business and not from other sources, as Tribunal had come to conclusion that additional income was from business, remuneration paid to partners had to be deducted while considering profit and loss. [***CIT v. S. K. Srigiri & Bros.*** [2008] 171 Taxman 264/ 298 ITR 13 (Kar.)]



# Issue-

- Whether deduction of remuneration is allowable if partnership deed does not provided quantification of remuneration required u/s 40(b) and CBDT Circular No. 739?

If working partners of the assessee (a partnership firm ) , made a provision in partnership deed regarding remuneration at rate as would be mutually settled from time to time subject to provisions of Act shall not be disallowed on the ground that there was no specific mention in deed about quantification as required under section 40(b) and CBDT Circular No. 739. [*Eqbal Ahmed & Co. v. ITO* [2005] 1 SOT 202(Kol. - Trib.)]

- If partnership deed authorize claiming of remuneration, whether deduction of same is allowed if no amount has been paid regarding to remuneration?

Where in relevant assessment year, assessee-firm claimed remuneration of three partners which was authorized by deed of partnership but not charged to profit and loss account on account of inadequate profits, when actually no remuneration had been paid, deduction of same could not be allowed under section 40(b). [*Rajendra & Co. Contractor v. A.C.* [2005] 146 Taxman 3 (Delhi - Trib.) (Mag.)]

## Issue-

- In case higher income was assessed on the basis of revised return, the deduction is allowable of actual amt. paid or amt. shown in books of account?

Where as per terms of partnership deed, partners of assessee-firm were entitled for maximum amount of remuneration permissible under law, if income assessed was higher than income returned by assessee-firm in original return or assessment was completed on higher amount of income on basis of revised return of income, assessee-firm would be entitled for claiming proportionate higher amount of remuneration payable to partners even if amount of remuneration debited in books of account of assessee-firm was less.

**[*Chandra Enterprise v. ITO*[2005] 96 ITD 341 (Mum. - Trib.)]**

## Issue-

- Whether deduction to assessee firm, in respect of remuneration paid to a partner who represents his HUF in his capacity is disallowed under sec. 40(b)?
- Remuneration paid by the assessee firm, to the partner who represented his HUF could not be disallowed under section 40(b) on the ground that the HUF was the partner and remuneration was paid to the partner, an individual. **[ITO v. Vegunta Surya Prakasa Rao Sons & Co. [2004] 88 ITD 322 (Vishakapatnam)(SMC)]**
- Whether validity of partnership firm will affect, if partner between themselves agreed that one of the partner entitled to share profits but not share losses?
- Section 185 r.w.s 4, 6 and 13 of the Indian Partnership Act, 1932, provided that if partner between themselves agreed that one of the partner entitled to share profits but not share losses and such a stipulation in partnership deed will not affect validity of partnership. **[ITO vs. Gimret & Co. [1987] 22 ITD 407 (Delhi)]**

## **Issue- Effective date of LLP agreement**

- The date on which LLP agreement is entered by the partners thereof would be the date of LLP agreement.

**Issue-** It is not open to partners to extend life of partnership by saying that they will be considered to have been carrying on business as from date then past

- Hon'ble high court held that partnership business can only spring into existence after partners have agreed to unite. Partnership business will be considered from moment of agreement and not prior of formation of agreement. [**Dawjee Dadabhoy & Co. vs. CIT [1963] 49 ITR 698 (CAL.)**]

## Issue-

Whether new firm comes into existence on oral agreement basis even though nonexistent during part of previous year, was entitled to registration for relevant assessment year

- Where a partnership factually come into effect under an oral agreement and later a fresh partnership's deed was executed giving retrospective effect to the partnership from the earlier date when the oral agreement was made, the registration was to be granted from such earlier date. [**Bala Prasad Kundanlal Agarwal vs. Commissioner of Income-tax [1983] 14 Taxman 306 (H.C Madras)**]



## Issue-

- If the remuneration to any partner in case of a partnership firm is within the ceiling limit of sec40(b) then Assessing Officer cannot invoke section 40A(2)(a) to disallow part of remuneration as excessive.

**[CIT Vs. M/s Great City Manufacturing Co., ITA No. 461/2009, Date of order: 10-12-2012, Allahabad (H.C)]**

# THANK YOU!!

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