



LLP & Partnership

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Keeping the pace with advance countries and considering risk in business, Limited Liability Partnership Act, 2008 was enacted. However Limited Liability Partnership (LLP) was allowed to be incorporated on or after 1-4-2009 only. LLP is hybrid entity with the best features of companies and partnership firms. Since the formation of new type of business entity, questions were raised about its taxability. Whether it would be taxed as company or as firm or other entity?

LLP Act was enacted on the recommendation of Naresh Chandra Committee. Initially LLP Bill, 2006 also provided for the tax provisions. However, new Bill of 2008, which was subsequently enacted, did not consist tax provisions. In foreign countries, LLP for the purpose of income tax is considered as transparent or pass through entity. In other words LLP is not taxable but the individual partners are taxed with respect to the income from LLP. It was expected that LLP would not be liable for taxation and income germane to partners, for their association with the LLP would be taxed in their own hands. Finance Minister while presenting the Budget 2009-10 has moved various amendments with respect to taxation of LLP in India which is in contrast with the provisions of earlier LLP Bill, 2006, recommendation of Naresh Chandra Committee and general global practices.

Meaning of Firm, Partnership & Partner

As per the proposed amended definition of "firm" and "partnership" shall mean, firm and partnership as defined under Indian Partnership Act, 1932 and shall also include within its ambit LLP as defined in the Limited Liability Partnership Act, 2008.

Further partner shall mean partner as per Indian Partnership Act, 1932 and shall include minor admitted for the benefit of the firm and partner of the Limited Liability Partnership Act, 2008.

LLP taxation

With this amendment various speculations for LLP tax treatment are set to rest. Hence for the purposes of taxation, LLP would be considered as a general partnership firm and shall be taxed accordingly as an opaque entity. It shall enjoy all tax benefits as enjoyed by a general partnership firm and shall need to comply with the various provisions applicable to the general partnership firm.

Following sections applicable to firms shall be applicable to the LLP too:

- a. S. 184 – Assessment of the firm viz. instrument of partnership firm, shares of partner determinate, submission of instrument of partnership firm etc. to treat LLP as 'partnership firm assessed as such';
- b. S. 40(b) – Restriction on payment of interest and remunerations to partners;

- c. S. 45(3) – Contribution / transfer of assets by partner to firm;
- d. S. 45(4) – Distribution of capital assets by firm to partner;
- e. S. 78 – Restriction for carry forward and set off of losses in the case of change in constitution of firm.

LLP firm shall be assessed as AOP in case of failure to comply with the provisions of S. 184 and S. 144 (if assessment on LLP is made as best judgment assessment). Further if provisions of S. 184 are not complied interest and salary, remuneration paid to the partners will not be allowed as deduction while computing income of LLP.

Since LLP is not considered as a company, it would not be liable Minimum Alternate Tax u/s 115JB, Dividend Distribution Tax u/s 115-O and amount received from LLP would not be considered as deemed dividend u/s 2(22)(e) and surcharge at the rate 10 per cent on tax.

Presumptive taxation and LLP

S. 44AD allows small and medium enterprises having turnover up to Rs 40,00,000 to declare profit on presumptive basis. However, as per the proposed amended provision of S. 44AD applicable from A.Y. 2011-12, LLP would not be an eligible assessee to declare profits on presumptive basis.

LLP and partners' salary, remuneration

Since LLP is treated at par with firms, partnership firms for tax purposes, remuneration paid to working partners of the LLP would be allowed as deduction while computing income of LLP. However, LLP deed needs to provide for working partners and their remuneration. It may be noted that designated partners may not be working partners nor working partners be designated partners.

Partners' income

Interest and remuneration which is allowed as deduction while computing the income of the LLP shall be taxed as business income u/s 28(v) of the LLP partner. Further, share or profit received from firm shall be exempt u/s 10(2A) in the hands of partner.

Conversion of firm to LLP

No specific tax treatment has been provided for the conversion of proprietary concern, partnership firm or company to LLP and LLP to any proprietary concern, partnership firm or company.

However explanatory memorandum has stated that, as an LLP and a general partnership is being treated as equivalent (except for recovery purposes) as per income-tax provisions, the conversion from a general partnership firm to an LLP will have no tax implications, if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of S. 45 shall apply.

This created vague picture surrounding the tax impact on conversion to LLP. Many practical difficulties may arise at the time of conversion. Clarity on various issues needs to be provided eg

- Though the status of LLP and firm is same, whether assessment of firm (pre conversion) and LLP (post conversion) would one or two different assessments?
- Whether same PAN, TAN, etc. would continue post conversion?
- Memorandum provided that post conversion rights and obligations of partners should remain same. There cannot be blanket proscription on variation in rights and obligations of partners. Clarity needs to be provided

for the period of status quo to be maintained. Further what if partner retired by operation of law say death post such conversion?

- Memorandum also provided that there should be no transfer of any assets or liabilities after conversion. Again here clarity would be required whether all the assets and liabilities need to be transferred upon conversion? What if some assets like tenancy rights can be transferred only after concurrence of third party and such transfer takes place subsequently?
- Carry forward and set off of losses of existing entity on such conversion to LLP?

S. 47 provides certain transactions which are not regarded as transfer. For the sake of clarity and shun future disputes, provisions of the said section should have been suitably amended to provide exemption from capital gain on conversion of any entities to LLP. Similar provisions currently exists in clauses (xiii) and (xiv) to section 47 providing exemption on conversion of partnership firm or proprietary concern to a company.

To make a conversion of an LLP attractive and tax neutral, clarity on Stamp duty also needs to be provided. It may be noted that stamp study is a State subject. Upon conversion, all the assets and liabilities shall be transferred and vested with the LLP, without any further act or deeds. Courts have held that when partnership registers under Part IX of the Companies Act, 1956 as a company, no separate conveyance is required for vesting property of the firm in the name of company and hence no stamp duty is payable. Countries like UK have specifically provided stamp duty exemptions upon conversion.

Liability of LLP partners

Currently as per S. 188A, every partner and legal representative of the deceased are

jointly and severally liable along with the firm, for the amount of tax, penalty or other sum payable by the firm on its assessment.

However S 188A is not applicable to the LLP. S.167C has been proposed to be introduced on the lines of S. 179; i.e., liability of directors of private limited company. As per the proposed provision, where any tax is due from a LLP in respect of any income of any previous year or from any other person in respect of any previous year during which such other person was a LLP cannot be recovered, then, every person who was a partner of the LLP at any time during the relevant previous year shall be jointly and severally be liable for the payment of such tax 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 LLP.

Thus tax liability of the LLP shall devolve upon partner only if such tax etc. cannot be recovered from LLP. Further even though said tax could not be recovered from the firm, liability would not devolve upon partner if he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of LLP. This is in demarcation with liability of the partners in general partnership firm, which is joint and several with the firm.

Signatory to return

S. 140 provides for person who is competent to sign and verify the return of tax. New clause (cd) is proposed to be introduced, specifying person competent to sign return of income on behalf of LLP. It is proposed that return of income shall be signed by the designated partner. If such designated partner, due to unavoidable reasons is unable to sign the return or if there is no designated partner, it may be signed by any other partner.

Remuneration to partners from firm

S 40(b)(v) allows deduction for payment of salary, bonus, commission or remuneration to the working partners in the hands of firm. Current set of rules provides different perimeter for the remuneration paid by the professional and non-professional firms. Now identical set of rules and perimeter for allowability of salary, remuneration to the working partners of all types of firms has been proposed w.e.f. A.Y. 2010-11. Comparative of existing and proposed new limits are as under:

Existing Provisions				Proposed provisions	
Professional firms		Non-professional firms		Professional and Non-professional firms	
In case of loss or first Rs. 100,000 of book profit	Higher of Rs. 50,000 or 90% of book profit	In case of loss or first Rs. 75,000 of book profit	Higher of Rs. 50,000 or 90% of book profit	In case of loss or first Rs. 300,000 of book profit	Higher of Rs. 1,50,000 or 90% of book profits
Next Rs. 100,000 of book-profit	60% of book profit	Next Rs. 75,000 of book-profit	60% of book profit	On the balance book-profit	60% of book profit
On the balance book profit	40% of book profit	On the balance book profit	40% of book profit		

Above remuneration is allowable only if it is provided in the partnership deed. Hence existing partnership deeds need to be modified incorporating revised proposed limits.

Initially when salary, remuneration provisions were first introduced it was provided by way proviso to 40(b)(v) that for the A.Y. 1993-94 partnership deeds may be suitably modified with respect to the remuneration payment and appointment of the working partner/s, any time during the financial year 1992-93.

Further Circular No. 739, dated 25-3-1996 clarified that for the assessment years, subsequent to the assessment year 1996-97, no deduction under S. 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration. Current amendment providing higher remuneration shall come into force on the day President's assent is received to the Finance Bill.

Hence there may be practical difficulty in computing remuneration for A.Y. 2010-11, since partnership deeds may be modified during the middle of year.

Way forward

While finalising the tax code, the Finance Minister may provide that LLPs should be given the freedom to choose between taxation at the LLP level or at the partner level, depending on their internal structure. Similar provisions currently exists in some of the countries like US.

Further CBDT may appropriately clarify the allowability of interest, remuneration in the hands of LLP and remuneration in the hands of general partnership firm for whole of financial year 2009-10, even in respect of deeds of partnership / LLP modified after 1-4-2009.