Taxation of LLP vis-à-vis Firm

by

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BASIC TAXATION

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LLP Taxable as Firm

The Finance (No. 2) Act 2009 provided for taxation of LLP on same lines as that of traditional Partnership firms

Firm	Partner	Partnership Firm
"**firm**" shall **include a Limited Liability Partnership** as defined in the LLP Act, 2008	"**partner**" shall **include**,— **a partner of a LLP** as defined in the LLP Act, 2008;	"**partnership**" shall **include a Limited Liability Partnership** as defined in the LLP Act, 2008 [Sec 2(23))

Other taxation aspects

- LLP assessable as Firm (184)
- Residential Status of LLP (6)
- Tax Rates of LLP
- Minimum Alternative Tax (MAT)
- Dividend Distribution Tax (DDT)
- Presumptive Taxation under section 44AD
- Presumptive Taxation under section 44AE
- Signing of return by designated partner (in absence of designated partner by any partner) (140)

Partner's Remuneration

- It should not be disallowed u/s 37(1)
- It should not be disallowed u/s 40(a)(i)
- Should be paid to a working partner who is an individual.
- Such remuneration is authorised by and is in accordance with LLP Agreement
- It is related to period falling on or after the date of such LLP Agreement
- The LLP should comply with conditions u/s 184
- It should be within the limits specified in sub-clause (v) of clause (b) of section 40

Partner's Interest

- It should not be disallowed u/s 36(1) (iii)
- It should not be disallowed u/s 40(a)(i)
- It should not be disallowed u/s 40(b) i.e.:
  - Such interest is authorised by and is in accordance with LLP Agreement
  - It is related to period falling on or after the date of such LLP Agreement
  - It should be within the limits specified in clause (iv) of section 40b which is currently 12% p.a. simple interest.
- The LLP should comply with conditions u/s 184

OTHER ISSUES

- Book Profit
- Deemed Dividend
- Deposits
- Taxability of amounts received by partners from LLP
- Liability of partners for tax dues of LLP (167C)
- Applicability of Accounting Standards
- Carry forward and set off of losses
- Wealth Tax

CONVERSIONS

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CONVERSION - FIRM

- No specific provisions carved out for conversion of firms to LLPs.
- Though the memorandum to Finance (No.2) Act 2009 stated that conversion of firms to LLPs will have no tax implications:
  - If the rights and obligations of the partners remain the same post conversion; **and**
  - If there is no transfer of any asset or liability after conversion

CONVERSION - COMPANY

- *Sec 47(xiiib)* – Conversion of a Private Ltd company or a unlisted Public Ltd Company into a LLP exempt from capital gains if:
  - All A & L of the co become the A & L of the LLP;
  - The shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;
  - No consideration other than share in profit and capital contribution in the LLP arises to partners;
  - The erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for 5 years from the date of conversion;
  - Turnover do not exceed Rs. 60 Lacs in any of 3 preceding yrs;
  - No amount is paid, either directly or indirectly, to any partner out of the accumulated profits of the company for a period of 3 years from the date of conversion.

CONVERSION - COMPANY

- *Fifth Proviso to Sec 32(1)* - Aggregate **depreciation** allowable to the predecessor company and successor LLP shall not exceed, the depreciation allowable as if the conversion had not taken place.
- *Explanation 13 to Sec 43 (1)* - The actual cost of the block of assets in the case of the successor LLP shall be the NIL in case the predecessor company has been allowed deduction for capital asset u/s 35AD
- *Explanation 2C to Sec 43 (6)* - The actual cost of the block of assets in the case of the successor LLP shall be the WDV of the block of assets as in the case of the predecessor company on the date of conversion.
- *Sec 47A(4)* - If the conditions in section 47(xiiib) are not complied with, the benefit availed by the company shall be **deemed to be the profit** of the successor LLP in the previous year in which the requirements not complied.

CONVERSION - COMPANY

- *Sec 49 (1)(iii)(e)* - The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it.
- *Sec 35DDA* – In case of conversion, amortization of expense on VRS shall continue in the hands of the converted LLP as if there was no conversion.
- *Sec 72A(6A)* - Carry forward and set-off of business loss/unabsorbed depreciation allowed to the successor LLP which fulfills the conditions u/s 47(xiiib) – fresh 8 yrs
- *Sec 115JAA* - The tax credit u/s 115JAA shall not be allowed to the successor LLP.

CASE STUDIES

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Share of Assignee

Facts

- A & B are partners in AB LLP
- A & B earns share of profit from AB LLP of Rs 2 Lacs each
- B assigns his rights to share profits in the LLP to C

Total	A	C
Accounting profit: Rs. 4 Lacs	2 Lacs	2 Lacs

- **What is the taxability of Rs. 2 Lacs in the hands of B ?**
- **What is the taxability of Rs. 2 Lacs in the hands of C ?**
- **What rights does C have in AB LLP?**

CAPITAL CONTRIBUTION

Facts

- A & B are partners in AB LLP
- C joins and contributes capital in the form of plant & machinery and land

Particulars	Cost of C	Value LLP	FMV
Plant & Machinery	50 L	100 L	300 L
Land	10 L	50 L	400 L

- What is the taxability for C on transfer of Plant & Machinery?
- What is the taxability for C on transfer of land?
- What is the relevance of valuation report prescribed under the LLP Rules?

Partner's Retirement

Retirement of partner

A & B

Facts of the case

- A & B are partners in the LLP in equal profit sharing ratio
- C & D are introduced as partners
- Revaluation of assets is carried out on reconstitution which is credited to capital accounts of A & B
- Partners A & B retire after a year from the LLP
- Their capital account is credited with their share in the LLP

- **What is the taxability of A & B on receiving their share in the LLP?**

Conversion of Firm to LLP

Facts

- A & B are partners in AB LLP
- Partnership is converted to a LLP
- Partners and the profit sharing ratio remains the same
- Partnership has accumulated losses of Rs. 10 Cr.

- **Whether conversion would be regarded as a taxable event?**
- **Whether the LLP can carry forward the losses?**

CONVERSION OF COMPANY TO LLP

Facts

- A & B are shareholders in AB P. Ltd.
- **AB Company is eligible for 10A benefits**
- Company is converted to a LLP
- Assets are transferred at their respective fair values
- Conditions for section 47 exemption are met

- **What are the implications on conversion for AB P. Ltd.? Can ABLLP avail 10A benefits?**
- **What are the tax implications for shareholders who become partners?**

CONVERSION OF COMPANY TO LLP

- Deduction u/s 10A is undertaking specific.
  - Change in Ownership does not impact the allowability of deduction
    - Tech Books Electronics Services (P) Ltd vs Addl CIT (2006) 104 TTJ (Del) 306
    - Income Tax Officer vs Hindustan Petroleum Corpn Ltd (1986) 16 ITD 574 (Mum)
    - Shah Granites (P) Limited vs ITO (1987) 21 ITD 282 (Mum)
- Can 2(22)(c) provisions on deemed dividend be attracted?
  - (22) "dividend" includes—

    (*c*) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the **accumulated profits** of the company immediately before its liquidation, whether capitalised or not

COMPARISONS

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Partnership vs. LLP

	Partnership	*LLP*
Legal Entity	Not Separate	Separate
Perpetual succession	No	Yes
No. of members	Min. 2 Max. 20	Min2 Max NA
Instrument Requirements	Deed on Stamp paper, even if change in Const.	LLPA to be reg. at ROC, Fees for filing all doc.
Governing law	Indian Partnership Act	LLP Act & Companies Act

Partnership vs. LLP

	Partnership	*LLP*
Capital Requirement	Nil, However Stamp paper as per capital	Contribution as per LLPA
Partner's Identity	No legal requirement	DP to obtain DPIN
Liability	Unlimited	Limited to contribution
Names	No regulation	Regulated
Audit	Only if turnover exceeds 40L – 44AB	Only if turnover exceeds 40L or contribution 25 L

Partnership vs. LLP

	Partnership	*LLP*
Financials	Secret	Statement of accounts to be filed
Penalties	Nil	As per LLP Act
Capital withdrawal	Flexible	As per LLPA
Loans – 269SS/T	Partner's capital – cash /trf allowed	Apart from contribution, loans may be covered
Most preferred by	Small businesses and professionals	Professionals

Partnership vs. LLP

	Partnership	*LLP*
Tax Rates	Flat 30% + cess No surcharge	Flat 30% + cess. No surcharge
44 AD	Available	Not available
44 AE	Available	Seems to be available
Liability of partners for tax dues	Every partner is jointly & severally liable (S. 188A)	J & S liable unless proves non-recovery cannot be attributed to his *gross neglect, misfeasance or breach of duty* (S. 167C)

Company vs. LLP

	Company	*LLP*
Legal Entity	Separate	Separate
Perpetual succession	Yes	Yes
No. of members	Pvt-Min2 Max 50 Pub-Min3 Max NA	Min2 Max NA
Instrument Requirements	MA to be reg. at ROC, Fees for filing all doc.	LLPA to be reg. at ROC, Fees for filing all doc. – Filing fee Less than company.

Company vs. LLP

	Company	*LLP*
Capital Requirement	1 Lac for Pvt. & 5 Lacs for Public Ltd. Cos.	Contribution as per LLPA
Directors Identity	All directors to obtain DIN	Only DP to obtain DPIN
Names	Regulation	Regulated - other partnership names cannot be kept
Flexibility of business	Regulated by MA & AA	Regulated by LLPA

Company vs. LLP

	Company	*LLP*
Deposits	Regulated by section 58A	No regulation yet
Listing	Possible	Not possible
Audit	Compulsory	Only if turnover exceeds 40L or contribution 25 L
Shareholders	No consent required	Partners consent required
Meetings	Regulated by Companies Act	Not mandatory

Company vs. LLP

	Company	*LLP*
Suffix	'Limited' or 'Private Limited'	'Limited Liability Partnership' or 'LLP'
Common Seal	Compulsory	Optional
Authority in conduct of business	Individual director or member do not have any authority	Every partner has authority, unless the LLPA provides otherwise
Financials	B/s, P/L to be filed with ROC	Statement of A/cs and Solvency

Company vs. LLP

	Company	*LLP*
Rate of Tax	30% + 3% cesses. Surcharge 10% if income > Rs. 1 Cr.	Flat 30% plus 3% cesses. No surcharge
MAT	Applicable @ 15%	Not applicable
DDT	15% is payable u/s 115 O	Not applicable
Method of Accounting	Accrual only	Cash or Accrual
Remuneration & Interest	No Limits	Limits u/s 40b

Thank You

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