

# Legislative Brief

## The Limited Liability Partnership Bill, 2006

The Bill was introduced in the Rajya Sabha on 15th December, 2006 and referred to the Standing Committee on Finance (Chairperson: Ananth Kumar).

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### Highlights of the Bill

- ◆ The Limited Liability Partnership Bill, 2006, permits the creation of a new type of corporate entity, the limited liability partnership (LLP).
- ◆ An LLP shall have a minimum of two partners. At least two will be designated partners, one of whom is resident in India.
- ◆ Unlike in partnerships, the liability of partners of an LLP is limited to their share in the LLP. In the case of deliberate fraud, the limited liability shield may be removed.
- ◆ The concept of whistleblower has been introduced. The penalties against a partner or employee may be reduced or waived if he provides information that is useful during investigation, or leads to conviction.
- ◆ Partnerships, private limited companies and unlisted public limited companies may convert into LLPs. The Bill also permits foreign LLPs to function in India.

### Key Issues and Analysis

- ◆ Limited companies are taxed on their incomes, and the income they distribute to their shareholders is also taxed. In partnerships and proprietorships only the income attributed to the partners is taxed. It is not specified how LLPs will be taxed.
- ◆ The maximum number of partners in a partnership is limited to 20 by the Companies Act, 1956. It is unclear if this limit will also apply to LLPs.
- ◆ The Bill does not specify whether capital gains tax or stamp duty will be payable when a partnership or a company converts into an LLP.
- ◆ For companies, partnerships and proposed LLPs, the minimum number of members or partners is two. Even after this Bill there is no legislation under which a single-member entity can function with limited liability in India.
- ◆ If a person ceases to be a designated partner, the LLP has to appoint another person, resident in India, as a designated partner. This seems to apply even if the LLP has the minimum required two designated partners, one of whom is resident in India.

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## PART A: HIGHLIGHTS OF THE BILL<sup>1</sup>

### Context

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Indian businesses and enterprises are of four broad types: proprietorships, partnerships, public limited and private limited companies. In limited companies, if the company is unable to meet its financial obligations, the owners (shareholders) are only liable to the extent that they have invested in the company. That is, if the company is wound up, neither will it pay out any funds to the shareholders nor will they need to pay any further amount to the company or its creditors. In contrast, in proprietary and partnership firms, the owners can be held personally responsible for all liabilities incurred by the firm. That is, their personal assets beyond those invested in the company can be seized to pay the debts of the firm that it is unable to pay on time. The tax treatment also differs. In the case of limited companies, the income of the company is taxed, as well as the income distributed to shareholders. In proprietorships and partnerships, only the income of the individual is taxed, not that of the firm. The Limited Liability Partnership Bill will permit the creation of a new type of partnership, the LLP, in which the liability of its partners will be limited to only the amount they have invested into the firm, except in certain circumstances.

### Key Features

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The Bill permits the creation of Limited Liability Partnership firms in India. It defines the characteristics of an LLP, its method of incorporation, the rights and obligations of the LLP and its partners, and lists penalties for infractions.

### LLP

- An LLP is a body corporate that has to have a minimum of two partners who can be any individual or body corporate.<sup>2</sup> There have to be at least two “designated partners”, one of them resident in India. An LLP shall have the words “Limited Liability Partnership” or “LLP” as the last part of its name.
- Designated partners are responsible for management duties and for filing required documentation. They will be liable for compliance-related penalties imposed on the LLP. If at any time there is only one designated partner, all the other partners will be treated as designated partners and held similarly responsible. Every designated partner shall obtain a Partner Identification Number (PIN), which is similar to the Director Identification Number (DIN) required for directors of companies.
- Every LLP has to be registered with the Registrar of Companies (RoC). The RoC shall register the LLP within 14 days of filing the required documents. LLPs shall maintain books of accounts that shall be audited, and file annual accounts with the RoC. LLPs shall also file a statement of account and solvency with the RoC within six months of the end of the financial year. Both the annual return and statement of account and solvency shall be accessible from the RoC on the payment of a fee.
- Partnerships, private companies and unlisted public companies may convert into LLPs. The central government shall make rules for foreign LLPs to conduct business in India.

### Partners

- Relations among the partners (including addition of new partners) will be regulated by an LLP agreement. If there is no such agreement, the rules stated in the First Schedule of the LLP Act will apply. These state that all partners may take part in the management of the LLP and the consent of all partners is required to introduce a new partner. The First Schedule also states that issues will be passed by a majority vote with one vote per person except if the LLP is to change its nature of business, in which case the consent of all partners is required.
- A person may cease to be a partner in the LLP by any procedure laid out in the initial agreement. If there is no such agreement the partner is required to give 30 days notice to the other partners before resigning. A partner shall also cease to be a member of the LLP in case of death or the dissolution of the firm. All changes in the status of partners in the LLP have to be notified to the RoC within 30 days.

### Liability

- The debts of the LLP shall be repaid out of the assets of the LLP. No partner shall be held personally liable for any act of the LLP or any of the other partners for the sole reason of being a partner of the LLP. A partner will only be personally liable in the case of a wrongful action of commission or omission, or in the case of deliberate fraud. In the case of a wrong act of omission or commission, only the specific partner(s) will be held personally responsible. In the event of deliberate fraud the liability of the partner(s) involved in the fraud shall be unlimited. The liability of the LLP will also be unlimited unless the LLP can prove that the action was carried out without the knowledge or authority of the LLP.

- The Bill introduces the concept of a “whistleblower”. Any applicable penalties against a partner or employee who provides useful information may be reduced or waived. The whistleblower may not be penalised by the LLP for providing such information.

## Winding Up

- An LLP may be wound up voluntarily. It can also be wound up by order of the National Company Law Tribunal (established under the Companies Act, 1956), in case of insolvency of the LLP, if the number of partners falls below two, if the LLP requests it, or if it fails to file accounts for five consecutive years.

## PART B: KEY ISSUES AND ANALYSIS

**Table 1: Comparison between Partnerships, LLPs and Private Limited Companies**

	Partnerships	LLPs	Private Limited Companies
<b>Number of Members</b>	2 to 20.	Minimum 2 partners.	2 to 50 shareholders.
<b>Liability</b>	Unlimited. Partners severally and jointly liable for actions of other partners.	Limited, except in case of intentional fraud or wrongful act of omission or commission.	Limited.
<b>Registration</b>	Registration with RoC optional.	Registration with RoC required.	Registration with RoC required.
<b>Documents to be Filed</b>	None required, unless registered. If registered, annual accounts mandatory.	Designated partners have to file annual accounts, and submit an annual statement on solvency.	Annual statement of accounts, minutes of Board meetings, share register, register of charges.
<b>Dissolution</b>	By agreement, mutual consent, insolvency, certain contingencies, and by court order.	By agreement or by order of National Company Law Tribunal.	By court order once the affairs of the company have been wound up or court’s discretion.
<b>Transfer / Inheritance of share</b>	Not transferable. In case of death the legal heir receives the financial value of share.	Transferable, but transferee may not have management rights.	Transferable (with the consent of Board of Directors).
<b>Taxation</b>	Income of partners taxed, not of partnership.	Unspecified.	Income of company is taxed, income distributed to shareholders is also taxed.

Sources: LLP Bill, Indian Partnership Act, 1932, Indian Companies Act, 1956, PRS

**Table 2: Comparison of key provisions with LLP Acts in the US & UK**

	US	UK	India
<b>History</b>	Introduced in 1991 in Texas. Incorporated into commercial law in most states by Uniform Partnership Act, 1996.	Formed under the Limited Liability Partnerships Act 2000.	Proposed under the Limited Liability Partnership Bill, 2006.
<b>Membership</b>	Any two or more people can form an LLP. Some states restrict membership to specific professions only.	Any two or more people can form an LLP for the conduct of any form of business.	Any two or more people can form an LLP for the conduct of any form of business.
<b>Liability of Partners</b>	Liability limited to investment in LLP, except in the case of deliberate fraud.	Liability limited to investment in LLP, except in the case of deliberate fraud.	Liability limited to investment in LLP, except in the case of deliberate fraud.
<b>Taxation</b>	Profits distributed among members, and taxed as individual income. The LLP does not pay taxes.	Profits distributed among members, and taxed as individual income. The LLP does not pay taxes.	Unspecified.

Sources: US Uniform Partnership Act (1997), UK Limited Liability Partnerships Act 2000, LLP Bill, PRS

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## Taxation

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The LLP Bill does not specify how LLPs will be taxed. Private limited companies are taxed on their incomes, and the income they distribute to their shareholders is taxed again. Partnerships and proprietorships are not taxed separately; the income is attributed to the partners and is taxed as personal income. In the US and the UK, LLPs are treated like partnerships for tax purposes.

## Capital Gains Tax and Stamp Duty

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In the case of a partnership or a proprietorship converting into a company the transfer of assets is not treated as capital gains (section 47 (xiii) and (xiv) of the Income Tax Act, 1961). The Bill does not specify whether the capital gains tax will be waived in the conversion of a partnership or limited company into an LLP.

Also the Bill does not specify whether stamp duty would be applicable in such a case. In the UK LLP Act 2000, stamp duty is waived on any property that is transferred in the process of a partnership being converted to an LLP during a period of twelve months after its incorporation.

## Number of Partners

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The LLP Bill does not mention a maximum number of partners. The Indian Partnership Act, 1932, also only states a minimum number. The maximum number of partners in a partnership is governed by the Clause 11(2) of the Companies Act, 1956, that stipulates that no company, association or partnership consisting of more than twenty persons shall be formed for profit unless it is registered as a company under that Act. It is not clear whether this limit will apply to LLPs. However, it appears that the Ministry of Company Affairs does not intend to set an upper limit to the number of partners in an LLP.<sup>3</sup>

Similar to the Companies Act, 1956, and the Indian Partnership Act, 1932, the LLP Bill sets a minimum number of two partners. Even after this Bill, there is no legislation under which a single-member entity might conduct business with limited liability.

## Replacement of Designated Partners

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Every LLP is required to appoint a designated partner, who is resident in India, within 30 days of a person ceasing to be a designated partner in the LLP. This raises two issues. First, an LLP would need to replace a designated partner with another even if it continues to have the minimum required two designated partners. Second, the replacement of a non-resident designated partner is required to be a resident one.

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### Notes

1. This Brief has been written on the basis of the Limited Liability Partnership Bill, 2006 introduced in the Rajya Sabha on 15th December, 2006 and referred to the Standing Committee on Finance (Chairperson: Ananth Kumar).
2. A body corporate refers to any company as defined in section 3 of the Companies Act, 1956, an LLP under the LLP Act, any LLP incorporated outside India, and a company incorporated outside India. It does not include a corporation sole, a co-operative society or any other body corporate not covered by section 3 of the Companies Act, 1956.
3. FAQ on the LLP Bill, 2006, Ministry of Company Affairs (F. No. 17/57/2007-CL. V).

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