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REVISITING THE MENTAL PICTURE OF CONVERSION OF COMPANY INTO LIMITED LIABILITY PARTNERSHIP

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ABSTRACT

The ever-changing business arena in which we dwell urges for transformation and enhancements. To survive in the competition and continue the growth in business, the selection of business structure is very essential along keeping in mind the parameters minimum imposition of regulation and government intervention. Before adopting a business structure, it is pertinent to rightly weigh the adversities and favourable conditions attached to the business structure. The unique feature of LLP is that it combines the characteristics of private companies as well as the partnership firms. Therefore, it is relevant choice for the corporate looking for venturing into business or conversion from an existing structure like companies and partnership firms. The practical field and process of conversion experience range of hurdles and it is high time where authorities are required to eradicate any such issues. The procedural problems and substantive issues with LLPs have overshadowed the advantages offered by it. In India many new LLPs has been formed and many companies are tending to convert into LLPs. Nevertheless, the government and authorities are in line of limiting the autonomy and flexibility of LLPs. The tax implication on conversion of a private company into LLP is a filthy area which necessitates groundwork and analysis. The present paper aims to evaluate the pros and cons attach to the conversion of private companies into LLPs. The authors embarked firstly, on the concept and evolution of LLPs in context to India. Secondly, the authors have analysed the luring benefits which LLPs offers over private companies. Thirdly, the authors attempt to dig out the pitfalls in LLP structure in the light of recent decisions of *authorities and suspected future developments. This sets the stage for further research and authors endeavour to draw determinative deductions on the present subject.*

Keywords: Private Companies, Limited Liability Partnership (LLP), Conversion, Judicial Pronouncement.

INTRODUCTION

The ever-changing business arena in which we dwell urges for transformation and enhancements. In order to combat the competition and maintain the business position it is required to adopt a business model that best suits it with minimum imposition of regulation and government intervention. Before adopting a business structure, it is pertinent to rightly weigh the adversities and favourable conditions attached to the business structure. This decision is made at different stages by the stakeholders, i.e., at entrepreneurial or during expansionary stage of business.[1] The propensity to work collectively in a business to achieve mercenary goals has a long past. Generally, the companies and partnerships are used as means to attain such a target. It is unrealistic to imagine that an individual with limited resources can solely run an enormous business. A large business yearns for more investment, resources and risk diversification; this has shifted the trend to companies and partnerships.[2]The list has recently included Limited Liability Partnership (LLP) which entices corporate world, mostly the entrepreneurs. LLP can be defined as "A corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner.[3] It is understood as "Hybrid" of a company and partnership firm."[4]

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1 *Limited Liability Partnerships in India - The Newage Business Vehicle*, RSM ASTUTE CONSULTING PVT. LTD., *available at*: https://www.rsm.global/india/insights/consulting-insights/limited-liability-partnerships-india-newage-business-vehicle (last seen on February 20, 2020).

2 *Limited Liability Partnership In India*, LEGAL SERVICE INDIA- LAW ARTICLES, (May 4, 2018), *available at:*http://www.legalservicesindia.com/law/article/963/3/Limited-Liability-Partnership-In-India (last seen on February 20, 2020).

3 *The Limited Liability Partnership Act, 2008*, MINISTRY OF CORPORATE AFFAIRS, *available at:* http://www.mca.gov.in/MinistryV2/llpact.html (last seen on February 20, 2020).

4 Abhinav, *Conversion of Company into LLP-Accounting & Tax implications*, CACLUBINDIA, (March 18, 2014), *available at:* https://www.caclubindia.com/articles/conversion-of-company-into-llp-accounting-tax-implications-20109.asp (last seen on February 22, 2020).

The advent of Limited Liability Partnership Act, 2008 intends to facilitate the business people with a novel alternative to run their business. This structure provides dual sword advantage, (a) Limitation of liability and (b) Flexibility in administration of business. It is notable that the tax benefits for LLPs are the prime reason for which the corporate are inclined to start or convert their business structure into LLP. The LLP Act enumerates the provisions which permits the Partnership firms; incorporated under Partnership Act, 1932 and unlisted public company along with private companies to convert themselves into LLPs. The relevant rules are contained in Clause 58 and Schedule II to Schedule IV of the Act.[5] There are unresolved practical issues revolving around the procedure of conversion and the eyes are on authorities to remove the eclipse of dilemmas. The procedural problems and substantive issues with LLPs have overshadowed the advantages offered by it. In India many new LLPs has been formed and many companies are tending to convert into LLPs.[6] Nevertheless, the government and authorities are in line of limiting the autonomy and flexibility of LLPs.

The unique feature of LLP is that it combines the characteristics of private companies as well as the partnership firms. Hence, it is developed as a substitute business vehicle to companies and partnership firms.[7]The tax implications on conversion of a private company into LLP are filthy area which necessitates groundwork and analysis. The present paper aims to evaluate the pros and cons attached to the conversion of private companies into LLPs. The researcher embarked *firstly*, on the concept and evolution of LLPs in context to India. *Secondly*, the researcher have analysed the luring benefits which LLPs offers over private companies. *Thirdly*, the researcher attempt to dig out the pitfalls in LLP structure in the light of recent decisions of authorities and suspected future developments. This sets the stage for further research and authors endeavour to draw determinative deductions on the present subject matter.

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5 *The Limited Liability Partnership Act, 2008*, MINISTRY OF LAW AND JUSTICE. *Available at*: http://www.mca.gov.in/Ministry/actsbills/pdf/LLP_Act_2008_15jan2009.pdf, (last seen on February 23, 2020).

6 **Ketan Dalal and Manish Desai,** *Limited liability partnership: conversion into Llp, why and how*, LIVEMINT, (December 28, 2008), *available at*: https://www.livemint.com/Companies/89Z8XQFAl0wVXFoXJg4T2L/Limited-liability-partnership-conversion-into-Llp-why-and.html, (last seen on March 14, 2020).

7 *FAQs on Limited Liability Partnership*, THE INSTITUTE OF COMPANY SECRETARIES OF INDIA, (November 2017), *available at:* https://www.icsi.edu/media/webmodules/publications/FAQs%20on%20Limited%20Liability%20Partnership.pdf (last seen on February 23, 2020).

EVOLUTION OF LLPS IN INDIA

The concept of LLPs owes its origin from United States when in 1822 the first legislation related to limited liability firms was enacted by New York.[8] Further, the statute was adopted by majority states of US on the line of model law of New York.[9]The 1980s witness the emergence of the LLP model concept after the experience of real estate and energy price crisis. The onus of the fiasco of institutions fall on the lawyers and accountants associated with it irrespective of their non-indulgence in advising. The liability extended to their personal assets as well and this triggered the necessity for introduction of LLPs. The Texas House Bill 278[10] was enforced and emerged as the first statute on the matter. The inception of 19th Century brought expansion of LLPs concept over all jurisdictions of the United States of America.[11] The concept of LLP is welcomed by different US states in divergent manner. Some states have enshrined only protection from vicarious liability while others assimilated the concept in its expansionary form by offering safety umbrella from contractual and tortious liability of partnership.[12]In United Kingdom voice was raised by people to bring LLPs with the intend to confine the liability of partners to their acts. This made the path for the amendment in UK Companies Act, 1989 which permitted the accounting firms to convert in LLPs. However, the partners were not insulated from liability arising from regular works of the firm. This could not content the businessmen and clamors were taking place to further limit the liability of the partners. Consequently, the Limited Liability Partnership Act, 2000 was enacted. The UK LLP Act is founded on three basic pillars, i.e., partnership flexibility, limited liability and corporate personality.[13]

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8 *What are Limited Liability Partnerships (LLPs)?*, Limited Liability Partnerships (LLPs), *available at:* https://corporatefinanceinstitute.com/resources/knowledge/strategy/limited-liability-partnerships-llps/, (last seen on March 16, 2020).

9 Ravi Meena and Renu Nainawat, *LLP in India: As Advantageous Business Model,* 3(10), GLOBAL JOURNAL OF MANAGEMENT AND BUSINESS STUDIES, (2013), *available at:* https://www.ripublication.com/gjmbs_spl/gjmbsv3n10_01.pdf, (last seen on March 16, 2020).

10 Texas House Bill 278 on August 26, 1991.

11 Stephen M. Bainbridge and M. Todd Henderson, LIMITED LIABILITY: A LEGAL AND ECONOMIC ANALYSIS, 36 (2016).

12 Amit Kumar Kashyap and Deepak Kashyap, *Limited Liability Partnership as Advantage ToSmall Business: Indian Scenario,* NATIONAL SEMINAR ON EMERGING ISSUES IN COMMERCE AND MANAGEMENT, (February 05-06, 2010).

13 Deep Ray, *The Emergence of Limited Liability Partnerships*, SSRN, (July 25, 2012). *Available at*: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2117240, (last seen on March 16, 2020).

The acceptance of LLPs in Indian scenario has derived the motivation from foreign countries like UK and Singapore. The legislations of these countries enumerate provisions for creation of body corporate in LLP form.[14]In India the 7th Law Commission of India report[15] had glimpses of the new structure and it proposes to acknowledge the business model in the legislation of Partnership act.[16] However, the recommendations were not welcomed, and no steps were taken to enforce them. Series of events followed this to trigger the enactment of a legislation or the regulations pertaining to LLP. The Report of the Expert Committee on Small Enterprises highlighting the advantage of LLP stated that LLP would assist in getting access to more funds and techniques. Later, in 2003 the Ministry of Finance gave a report[17] on regulation of private companies and partnerships which argued to establish LLPs in India. Also, the report explained the functioning process and working model of the new business form. It was thought that at embryonic stage the business model should be limited to be used only by lawyers, accountants, company secretaries etc. Nevertheless, the scope was left to be widened in future and the Department of Company Affairs shall notify other professions to include within the ambit.[18]The idea of enacting a separate legislation for the business model was introduced by the J.J.Irani Committee in the year 2005. This paved the way and in 2008 Limited Liability Partnership bill was enacted and was notified in the Official Gazette on 31stMarch, 2009. A concept paper was brought by the Ministry of Corporate Affairs on LLP and replies to it became the bedrock of the draft bill on LLP.[19] The bill was passed by houses without much discussion and received President's assent on January 7, 2009.The Ministry of Corporate Affairs has stated the object behind enacting the legislation.[20] The stated purpose is limiting the significance of the

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[14] Akshat Gupta, *Limited Liability Partnership* in India, *available at:*http://www.legalservicesindia.com/article/191/Limited-Liability-Partnership-in-India.html, (last seen on March 16, 2020).

[15] *Partnership Act, 1932*, LAW COMMISSION REPORT NO. 7, MINISTRY OF LAW AND JUSTICE, *available at:* http://lawcommissionofindia.nic.in/1-50/Report7.pdf, (last seen on March 16, 2020).

[16] *Id*.

[17] *Available at*: http://reports.mca.gov.in/Reports/3-Naresh%20Chandra%20committee%20report%20on%20regulation%20of%20private%20companies%20and%20partnerships,%202003.pdf.

[18] Nivedita Sen and Neha Mathen, *Decoding The New Business Vehicle Of India: The Limited Liability Partnership,* 4(4), NUJS Law Review, (2011).

[19] Bhumesh Verma, *India: LLPs In India - All You Want To Know*, MONDAQ, (December 15, 2016), *available at:* http://www.mondaq.com/india/x/552322/Corporate+Commercial+Law/Llps+In+India+All+You+Want+To+Know, (last seen on March 02, 2020).

new business model to entrepreneurs. The real practical use of LLPs structure reached way forward, beyond expectation of the authorities. Even established companies are converting into LLPs for tax perks. An LLP accommodates all the features of a corporate body like separate legal entity from its partners, perpetual succession, can own assets etc. Also, alteration in partners of LLP will not influence the rights and liabilities LLP.[21] Various legislations and rules govern the LLPs in India such as the Companies Act, 2013; The Limited Liability Partnership Act, 2008; Foreign Exchange Management Act, 1999; Income Tax Act, 1961 and other sector specific legislations.[22]

LIMITED LIABILITY PARTNERSHIP ACT: A NECESSARY LEGISLATION

India as a developing nation has a different option for business structure. It is the consensus between government, private sector and the society which are determinative factor for opting business model. The urge for economic growth in India made realize that technicality, risk capital and entrepreneurship together can boost the economy.[23]"*In this background, the need has been felt for a new corporate form that would provide an alternative to the traditional partnership, with unlimited personal liability on one hand, and statute based governance structure of the limited liability company on the other, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.*"[24]The legislation, i.e., Limited Liability Partnership Act, 2008 became effective on March 31, 2009 and turns the dream of existence of LLP into reality.[25] For a while the legislator thought to regulate the LLPs by the Companies Act, 2013 but later realized that the

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21 *FAQs on Limited Liability Partnership*, THE INSTITUTE OF COMPANY SECRETARIES OF INDIA, (November 2017), *available at:*https://www.icsi.edu/media/webmodules/publications/FAQs%20on%20Limited%20Liability%20Partnership.pdf (last seen on February 23, 2020).

22 *Limited liability partnership*, *Available at:* https://www.bcasonline.org/Referencer2015-16/Other%20Laws/limited_liability_partnership.htm, (last seen on February 23, 2020).

23 AjaiChowdhry, *Is entrepreneurship at the heart of economic growth in India?*, THE ECONOMIC TIMES, (May 13, 2015), *available at:* https://economictimes.indiatimes.com/blogs/dejaview/is-entrepreneurship-at-the-heart-of-economic-growth-in-india/, (last seen on March 14, 2020).

24 STATEMENT OF OBJECTS AND REASONS, Limited Liability Partnership Bill 2006, *available at:*https://www.prsindia.org/sites/default/files/bill_files/scr1206341536_The_Limited_Liability_Partnership_Bill__2006.pdf, (last seen on March 14, 2020).

25 ManaliSinghal, *Analysis of Limited Liability Partnership Act, Available at*:http://www.legalservicesindia.com/article/470/Analysis-of-Limited-Liability-Partnership-Act.html, (last seen on March 14, 2020).

act is not suitable to achieve the real objective which was intended to get from new corporate structure. On the suggestions put forth by the Irani Committee a need for separate legislation was observed. It was the concept paper by the Government on LLPs in 2005 which reiterated that a new entity is required which will have characteristics of both corporate and non-corporate entities.[26] The concept of partnership in India is regulated by the Indian partnership Act, 1932 and this legislation is governed by State. However, many sectors like technology, biotech, textile, automobile, pharma, etc. found the partnership structure not that adequate. The partnership structure also could not facilitate the new era business model like conglomeration of lawyers and accountants. This acted as a driving force for creation of the LLPs. Therefore, this new model is acting as a bridge between the companies and traditional partnership structure. LLPs came as a solution to meet the desires of different industry, entrepreneur, businessmen who wanted a midway to opt from features of company as well as partnership. It was viewed as a suitable vehicle for business with small capital, entrepreneurs, venture capital firms, etc.

Mainly, there are two recognized types of LLPs model, i.e., Texas model and Delaware model. In the first model the partners liability is restricted to unlawful acts of the partners and it does not extend to the cases of usual activities of the business. The latter model implies that there is no contractual or tortuous liability of the partners and wholly the LLP would be liable. It would not be incorrect to say that the Delaware model has influenced the LLP Act more.[27] Section 3 of the Act statutorily endows a separate legal entity character on LLPs. The magna carta of LLP is the LLP agreement in true sense. However, the LLP act was enacted to act as a watchman and it provides framework for investigation, power to registrar, central government in different functions. The act also enunciates several penalties for non-compliance.

TRUMPS TO CONVERT COMPANIES INTO LLPS

The rise of LLPs in India reflects the extent of advantages it offers comparatively to other business model. It combines the benefit of limitation of liability as a company and for the purpose of taxation it is considered as a partnership. Around 85,000 registered LLP existed till

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[26] Chirashree Das Gupta, *Globalisation, corporate legal liability and big business houses in India*, 34 (5), Cambridge Journal of Economics, 895 - 913, 895, (September 2010).

[27] *Critical Distinctions Between Texas and Delaware LLC Law*, CSC, *available at*: https://www.cscglobal.com/service/webinar/texas-delaware-llc-law-distinctions/, (last seen on March 18, 2020).

starting of year 2017.[28] The conversion figures are more surprising, till mid 2014 around 20,39 corporates were converted to LLPs.[29] The nature of existence of unlimited liability of partners in a partnership firm inhibit the development of entrepreneurs.[30] The Limited Liability Partnership Act, 2008 facilitates protection to partners from being liable to the extent of their personal assets.[31]When a private company converts itself into LLP, the effect of such a transformation is on the assets and the liabilities of the corporate. Without any instrument of transfer all the assets and liabilities passes to the new corporate formed. Therefore, the entity is not required to bear the burden of stamp duties. In respect of management flexibility, LLPs have won from companies as the business working is regulated by agreement created between the members. If a company wishes to have a greater number of owners, LLP is a good business structure choice for them because there is no restriction on the number of partners. The cost involved in formation of an LLP is much economical than incorporating a company.

Recently, Reserve bank of India (RBI) introduced an amendment to the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 (the Regulations)[32] which has allowed LLPs to raise External Commercial Borrowings to increase inflow of funds in the nation. Further, LLPs are also not obligated to pay the Minimum Alternate Tax which a company has to give. LLPs have been added with one more feather on its cap by permitting Foreign Direct Investment (FDI) under automatic route for them. In November, 2015 the Department of Industrial Policy and Promotion, the Ministry of Commerce & Industry, Government of India made an amendment to provide license to LLPs to accept FDI.[33] So, now LLPs are permitted to

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28 Niti Kiran, *Growth Unlimited*, BUSINESS TODAY, (April 23, 2017), *available at*:https://www.businesstoday.in/magazine/focus/growth-unlimited/story/249170.html, (last seen on March 18, 2020).

29 *Id*.

30 Evan Tarve, *Unlimited Liability*, INVESTOPEDIA (September 12, 2019), *available at*: https://www.investopedia.com/terms/u/unlimited-liability.asp, (last seen on March 18, 2020).

31 *Limited Liability Partnerships in India - The Newage Business Vehicle*, RSM ASTUTE CONSULTING PVT. LTD., *available at*: https://www.rsm.global/india/insights/consulting-insights/limited-liability-partnerships-india-newage-business-vehicle (last seen on February 20, 2020).

32 *Available at:* : https://rbidocs.rbi.org.in/rdocs/notification/PDFs/BORO17122018141D6FF9D78A4F3BBB96BC74A6C11945.PDF, (last seen on March 19, 2020).

33 *Key changes in the consolidated FDI policy of 2017*, LEXOLOGY, (August 31 2017), *available at*: https://www.lexology.com/library/detail.aspx?g=55e48344-7711-417b-aebd-5af4a082ae0b, (last seen on March 15, 2020).

accept 100 per cent FDI subject to certain conditions and approvals.[34]An LLP must undertake certain activities to go for FDI like valuation from Chartered Accountant for capital contribution, compliances to LLP Act, etc. Even downstream investment can be made in other companies without any performance requisites by LLPs, provided 100 per cent FDI is permitted for it. A company with foreign investment which is in the sector where 100 per cent foreign investment is allowed and there exists no FDI linked performance conditions can also think of converting itself into an LLP under automatic route.[35]However, the Foreign Exchange Management Act(FEMA), 1999 has mandated that an investor can only pay through cash in profit share of LLPs.[36]

Taxation aspect is the primary driving force to opt for LLPs.[37]Income tax act, 1961 provides for a minimum turnover amount and an LLP has to comply the requirement of financial audits only if it exceeds that amount.[38] The Act applies on LLPs similarly as it applies to partnership. There is no prohibition on mobility of funds of LLPs by its partners. In addition, the benefits enumerated under Section 40(b) of the act like remuneration, interest is also available to LLPs.[39]Usually, companies has to bear 30per cent corporate tax on their profits and at the time of distributing dividend around 20 per cent dividend distribution tax (DDT) which is inclusive of surcharge and educational cess. The payment of DDT is to be made within 14 days of declaration, distribution or payment of dividend as a statutory requirement. LLPs enjoy leverage in this respect. The corporate tax is necessary to be paid but for LLP no DDT is required to be paid. This implies that distribution of profits by an LLP to its partners is not taxable in India. These remarkable features of LLP give it a comparative advantage over the companies and

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34 *Review of Foreign Direct Investment (FDI) policy on various sectors*, MINISTRY OF COMMERCE INDUSTRY, DEPARTMENT OF INDUSTRIAL POLICY AND PROMOTION, GOVERNMENT OF INDIA, *available at*: https://dipp.gov.in/sites/default/files/pn12_2015%20%281%29.pdf, (last seen on March 19, 2020).

35 Kular Chirag, *FDI in LLP*, TAXGURU, (June 06, 2019), *available at*: https://taxguru.in/corporate-law/fdi-llp.html, (last seen on March 19, 2020).

36 Manish Kumar Sharma and Ankita Singh, *India: Foreign Direct Investment In Limited Liability Partnership*, MONDAQ, (August 02, 2018), *available at:*http://www.mondaq.com/india/x/724320/Inward+Foreign+Investment/Foreign+Direct+Investment+in+Limited+Liability+Partnership, (last seen on March 19, 2020).

37 *Taxation of Limited Liability Partnership (LLPS) in India*, TAX GURU, (September 09, 2009), *available at:* https://taxguru.in/income-tax/taxation-of-limited-liability-partnership-llps-in-india.html, (last seen on March 03, 2020).

38 *Conversion of Private Limited Company into LLP*, LEGALWIZ, *available at:*https://www.legalwiz.in/blog/conversion-of-private-limited-company-into-llp, (last seen on March 19, 2020).

39 *Available at*:http://www.amitadesai.com/pdf/articles/company-law/conversion-of-pvt-co-to-llp.pdf, (last seen on March 19, 2020).

attract businessmen to convert their business structure into LLPs. Moreover, this model is efficient if the business has an overseas parent. The cost plus mark-up may range between 10per cent– 20 percent (if not higher), hence cash keeps getting accumulated at India level.[40] Such accumulated profits can be furnished to the parent company. However, the Direct Tax Code Panel has recommended the government to shun the dividend distribution tax (DDT) for even companies and to provide no preferential treatment to any class of investors.[41]

As mentioned earlier LLPs are governed by Limited Liability Partnership Act, 2008 and is not within the purview of Companies Act.[42] This exempt LLPs from various compliances which a company hasto undergo like Corporate Social Responsibility (CSR), Board and General meetings, Establishment of governance mechanism, Appointment of Key Management Personnel, Restrictions on loans, guarantees and investments, etc. Precisely, LLPs have attempted to incorporate good features of private companies and in the same time providing autonomy to partners in running the business. Therefore, it can be regarded as a combination of assorted types of business.[43]

Table: Number of LLPs registered in Financial Year (2009-2019) and their obligation.[44]

Financial Year (April to March)	**Total Number of LLP Registered**	**Per cent growth over previous year**	**Total Obligation of Contribution (Rs. in. Crore)**	**Per cent growth over previous year**
2009-10	1,055	—	596.55	—
2010-11	3,261	209	2758.37	462.39

41 Ruchi Bhatia, *Abolish DDT; LTCG, STT should stay; rework personal income tax rates: Direct Tax Code Panel to Govt*, THE ECONOMIC TIMES, (August 27, 2019), *available at*: https://economictimes.indiatimes.com/markets/stocks/news/dtc-panel-for-highest-i-t-slab-at-20-seeks-removal-of-ddt/articleshow/70855997.cms?from=mdr, (last seen on March 19, 2020).

42 Ananya Das, *Limited liability partnership in India*, 1 (1), INTERNATIONAL JOURNAL FOR EMERGING RESEARCH & DEVELOPMENT, (2018).

43 *Conversion of Company into LLP*, LEGAL RAASTA, *available at*: https://www.legalraasta.com/conversion-of-company-into-llp/, (last seen on March 19, 2020).

44 *Available at*:https://www.researchgate.net/publication/333338380_A_Study_on_Growth_of_Limited_Liability_Partnerships_LLPs_in_India_-_An_Innovative_Vehicle_for_Entrepreneurial_Development.

2011-12	4,319	32	3049.73	110.56
2012-13	5,167	20	1854.50	-60.81
2013-14	7,982	54	2029.56	109.44
2014-15	14,682	84	2650.05	130.57
2015-16	22,505	49	8872.33	334.80
2016-17	29,407	34	8,420.63	94.91
2017-18	32,934	22	5,545.15	65.85
2018-19 *(Upto 30.06.2018)	5,421	—	2,670.34	—
TOTAL	1,26,733		38,447.21	

Analysis and Interpretation of Data

The above table represents the registration statistics of LLPs and its sum total obligation from 01.04.2009 to 30.06.2018. On analysing the figures, it can be seen that 1,26,733 number of LLPs have been registered which has an obligation of rupees 38,447.21 Crore. This figure of LLPs includes new formed LLPs and converted entities too. It can be observed that the financial year2010-11 experienced double increase of number from 2009-10. Also, if one observes the trend of each succeeding years a positive growth in number of LLPs can be seen except for the year 2012-13. However, the comparative growth percentage has a fluctuating trend. Similar is the case of obligation of LLPs.

FOIBLES IN OPTING LLP AS BUSINESS STRUCTURE

The LLP model was introduced in the ecosystem of corporate to bring ease of doing business in the country.[45] Since LLP came into existence its flexibility began to overshadow by various statutory requirements and practical hurdles.It is not the transaction, but existence of LLP requires statutory compliances like annual filing which even attract huge penalties on noncompliance. The decade has witness a lot of conversion of company into LLP and in pursuance to this the Ministry of Corporate Affairs is performing the groundwork to make stringent norms for the companies wanting to convert to LLP.[46]Presently, under Central Goods and Service Tax (CGST) Act, 2017 the transfer is considered as Supply of Services and it falls in 0per cent rate slab, however, it is upon the government to alter the slab rate. The flexibility norms for LLPs are catalysts to reduce control over management of company leading to less accountability and transparency in the corporate. The chunk of liability falls on the partners for all the wrong moves of the employees. Further, unlike companies the LLP does not support funding from venture capitalists or angel investors and even does not have Employee Stock Ownership Plan (ESOP).[47]The recent decision of tax authorities has aggravated the problems for entities willing to convert to limited liability partnership.

Mumbai Income Tax Appellate Tribunal made an astounding decision[48] about conversion of private company into LLP wherein, a private company converted itself into an LLP. The Tax authority in the assessment proceedings considered the conversion as a taxable transfer. According to the authority the transfer does not qualify to avail the exemption under Section 47(xiii)(b) of the Income Tax Act, 1961inserted by the Finance Act, 2010. The taxpayer argued that the in conversion all the assets and liabilities of the company is vested into the LLP and therefore, there is no transfer of capital assets. Further, the assessee contented that unabsorbed depreciation and losses of the erstwhile entity will be carried forward and set off but the tax

[45] **Gireesh Chandra Prasad**, *To improve ease of doing business, govt panel to revamp corporate regulations*, LIVEMINT, (September 18, 2019), *available at*: https://www.livemint.com/companies/news/to-improve-ease-of-doing-business-govt-panel-to-revamp-corporate-regulations-1568829975580.html, (last seen on March 2, 2020).

[46] Veena Mani, *Corporate Affairs Min may amend LLP Act to tighten noose on shell firms*, BUSINESS-STANDARD, (June 20, 2019), *available at*: https://www.business-standard.com/article/companies/corporate-affairs-min-may-amend-llp-act-to-tighten-noose-on-shell-firms-119062000055_1.html, (last seen on March 16, 2020).

[47] Anubhav Pandey, *Why Don't Venture Capitalists Like Investing in LLP?*, IPLEADER, (August 15, 2017), *available at*:https://blog.ipleaders.in/why-dont-venture-capitalists-like-investing-in-llp/, (last seen on March 16, 2020).

[48] ACIT v. Celerity Power, (ITA No. 3637/Mum/2015).

officer even does not agree on this. Later, the matter went in appeal before the tribunal. On the question of whether the conversion of a private company into an LLP is subject to capital gain tax, the tribunal answered affirmatively. The tribunal embark on legislative intend to enact the provision in Indian Tax Law which provides for exemption in certain cases. It is only when the specified conditions are complied the benefit will be given to assessee. In the present instance the said conditions are not met so, capital gain tax must be paid. The tribunal clarified that the pronouncement in TexspinEngg. and Mfg. Works[49] is not applicable as it was made in different context. The vesting of assets of the company to LLP is done at a book value which the tribunal contemplated as full value of consideration. The ultimate difference between cost of asset and full consideration is nil, hence, the question of taxation of capital gains does not arise. However, if the conversion happens by valuing the assets at higher value then the liability falls on successor LLP. This would further aggravate the problems of LLPs in India.

Another facet discussed in the pronouncement is that under Indian tax regime it is the transferor which is liable to pay tax imposed on transfer of capital assets.[50] But in the present instance the erstwhile company stood dissolved, hence, the liability to pay capital gain tax shifts to LLP. Section 72A(6) of the Act provides that in case of reorganization of business wherein a firm satisfies the conditions of Section 47(xiii) of the Act, the accumulated loss and unabsorbed depreciation of the company is transitioned to a limited liability partnership. The carrying forward of loss and unabsorbed depreciation is not permitted in the present case as the statutory conditions are not met by the taxpayer. The only relief the taxpayer got was in terms of profit linked deductions which was not claimed at the first place. Only after the refusal on carrying forward of loss and unabsorbed depreciation, the claim was made and audit report was filed. The tribunal accepted the report and remarked that it is a procedural requirement. Therefore, it can even be adhered during proceedings. The abovementioned decision was successful in setting a new trend and other decisions followed the same path. In the case of *Aravali Polymers LLP*,[51] a private company convert to LLP and also had reserves after the conversion process.[52] After the

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49 TexspinEngg. & Mfg. Works, [(2003) 263 ITR 345 (Bom)].

50 Section 170(1)(b) of Income Tax Act, 1961.

51 Aravali Polymers LLP v. Joint Commissioner of Income Tax (ITAT Kolkata), I.T.A. No. 718/ Kol. / 2014.

52 *Conversion to LLP – Capital gains to be computed on book value of assets transferred and not on market value*, TAX GURU, (July 04, 2015), *available at:*https://taxguru.in/income-tax/conversion-llp-capital-gains-computed-book-assets-transferred-market.html, (last seen on March 15, 2020).

conversion, there was selling of shares and the gain of sale was charged as capital gain tax. A free loan was made available to the partners. The assessee asserted to be exempted under Section 47(xiiib) of the Act. Nevertheless, the authority vividly mentioned that the act of providing loans to partners contravenes the said provision. Consequently, the Section 47A would be attracted and computation would occur at market value. The tribunal observed that there is no contravention of the Proviso (c) to Section 47(xiiib) of the Act. The said provision provides that except through share of profit and capital contribution in the LLP, the shareholders should not have received any benefit. It mandates the existence of company and LLP both but in the present instance company does not exist after the process of conversion so, the question of infringement does not arise. Further, the tribunal held that the act of giving interest free loan to partners is invasion of Proviso (f) of the said section. The proviso mandates non-payment out of balance of accumulated profit standing in the accounts of company. The tribunal concluded that the enumerated conditions are not complied hence, the Section 47A(4) would not give benefit to the assessee. For computation of tax, tribunal suggested to consider the book value and to adhere Section 45 of the act.

In the case of *Domino Printing Services Plc*[53]the entity is a subsidiary, situated in India, of a UK based company. The Authority for Advance Rulings determined whether the conversion is a transfer under Section 2(47) of the Act. The definition of 'transfer' is identified as inclusive one. The present case falls within the ambit of Explanation 2 of the section. The conversion has effect of dissolution of the company and the shareholding of the company is substituted by the partnership interest in the newly formed LLP. Surprisingly, in this context the authority relied on the reasoning's made in the Texspin decision. The authority *in toto* rejects the contention that for charging the capital gains transfer must take place between existing entities. A transfer is exempted only on complying the conditions of Section 47(xiiib) from capital gin tax. In this case cumulative requirements are not satisfied; therefore, the transaction is chargeable for capital gain tax. On the question circumscribing failure of computation mechanism, the authority clarified that such mechanism also incorporates a tax neutral condition. Hence, where there is no loss or gain the mechanism would not be regarded as a fail measure and Section 48 would be workable.

53 Domino Printing Services Plc (AAR No. 1290 of 2012).

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RECOMMENDATION

The researcher has identified certain measures through which the problems in the limited liability partnership (LLP) structure can be resolved and the model can proof to be efficient: -

- It is essential to identify the niche areas which are affecting the LLPs like legal, taxation and credit problems. Addressing these emerging obstacles can be beneficial.
- Transparency and inspection can eradicate hidden frauds in a corporate entity. It is important to formulate a proper method of auditing and conduct the same.
- It is generally seen that LLP structure is presumed to be suitable for the entrepreneurs but enhancing the capital sector wise can be helpful to make LLP suitable for large business.
- The expansion of LLP beyond India would be a win situation for the LLPs, hence the government should attempt to increase foreign investments.
- As the LLPs are beneficial to Indian economy, the government needs to take measures to infuse more funds in this sector.
- Trading and foreign exchange affects the growth of business and for a prosperous LLP market these pillars must be strong.
- Legislature should formulate rules and regulations to increase growth in this sector and improve economies of scale.
- The businessmen are required to understand the advantages and disadvantages attach to any business structure and meticulously opt for it.
- With regard to conversion of entities into LLPs, the legislature should take prompt steps and clarify the current position with adequate reasoning.

CONCLUSION

It would be unjust to the topic if the concluding remarks are definitive and absolute. The decision on conversion into LLP is subjective and wholly depends on foresights of stakeholders who could predict and weigh the overall benefits or losses keeping in mind the future uncertainties. The present research indicates that the progress of limited liability partnership has been remarkable. From the time of its execution on 30/06/2018, registration of LLP was 1,26,733 among which 1,14,694 were in our country.[54] This showcases the acceptability of conversion

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[54] P Govindan, *A Study on Growth of Limited Liability Partnerships (LLPs) in India – An Innovative Vehicle for Entrepreneurial Development*, Vol. XLVII, No. 4, PRAJNAN, 387 (2018-19).

into LLP by the stakeholders especially, the investors. The evolution of the concept of LLP and its registration has hiked post the execution of the Companies Act of 2013. The present research work concludes that there is no distinction among the registration of limited liability partnership pre and post the execution of goods and services tax act (GST), 2017. It is recommended by the researcher that numerous suitable and appropriate changes are to be made in the GST act, 2017 for having its impact of raising the number of registration of the LLPs. It is also concluded that LLP has raised as a most inventive model especially for the small and medium stage entrepreneurs as compared to the private and public companies in the market.

There is no doubt on the premise that LLP offers alluring features as a mode of business. Nevertheless, the recent trend and foreseeable possibilities are fly in the ointment. There are lot of scepticism regarding approaching hurdles and difficulties for the companies which are seeking to convert into LLP. Major obstacles are uncertain government policies which are likely to change for LLPs and recent decision of tax authorities burdening the conversion process with capital gain tax. The pronouncement made by the tax authorities are only binding on parties and holds persuasive value for the Indian courts. The decision blooms certain dilemmas of tax implications on conversion. The deeming fiction envisaged by the tribunal considering the book value as the full value of consideration is not rendered by the legislation. The judgment has ignored and surpassed the principles laid in Bombay High Court decision in Taxpin Engg & Mfg case.[55] In light of various judicial precedents, in the absence of consideration received by the transferor company for the transfer in the form of money or money's worth, the determination of the full value of consideration can be unworkable.[56] The tribunal has not determined the position of shareholders of company with respect to taxation.

The undefined areas may create belief in tax authorities to tax shareholders for the interest which they receive in LLP after losing the shareholding in the erstwhile company. In addition, scepticism may encircle stamp duty authorities regarding imposition of stamp duty on conversion by designating it as transfer. Filing of tax returns is another unresolved aspect which is hanging as danger on the heads of company and LLP. The decision will also have impact on pending proceedings on the subject matter of conversion. Now, the assessee will have an extra burden of proving the tax neutrality of conversion. Further, the tribunal has not scrutinized the IT Act and

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55 TexspinEngg. & Mfg. Works, [(2003) 263 ITR 345 (Bom)].

56 *Conversion of company into LLP –"Clear road" ahead?, available at*: https://taxguru.in/income-tax/conversion-company-llp-clear-road-ahead.html, (last seen on March 16, 2020).

has only referred to the memorandum to the Finance Act, 2010 in reaching the conclusion. The judgment is a blessing in disguise because it holds that if the conversion is at book value there will be no imposition of capital gain tax. Hence, it covers merely such conversions which happen at a value higher than the book value. The exclusion of capital gain tax on conversion happening at book value will have far reaching impact in structuring future transactions. The corporates seeking conversion into LLP should rethink and ponder on the risks emanating from unresolved issues. There is urgent need to reconsider the matter by higher forums or court to reach certainty on the subject.