

LIMITED LIABILITY

PARTNERSHIPS

– Act and Agreement

**By,
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LLP – What do our regulators think of it?

“An LLP is a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership”



Statistics

- Number of LLPs incorporated in India:

- 2019 (Q1) - 5421
- 2018 - 32934
- 2017 - 29723
- 2016 - 22934
- 2015 - 21389
- 2014 – 11616
- 2013 – 6783
- 2012 – 108205
- 2011 – 4218
- 2010 – 181
- 2009 – 559

- Number of LLPs incorporated in India:
 - As on 30th June 2018 – 114694
 - 82% have capital contribution < 5 lakhs
 - 3.18% have capital contribution > 1 crore
 - Economic Sector wise:
 - 87,659 LLPs are in Service Sector
 - 24,887 are in Industrial sector
 - Economic Activity Wise:
 - Business Services – 41%
 - Trading – 12%
 - Manufacturing – 12%

LLP ACT 2008

A BASIC UNDERSTANDING

LLP Act, 2008: Key Definitions

- LLP Act is applicable to whole of India.
- S.2(1)(d) – Def. of “Body Corporate” –
 - Reference to S.3 of Companies Act, 1956.
 - Has been defined in exhaustive manner containing inclusion and exclusions:
 - Inclusions :
 - Company – Incorporated in India and Outside India,
 - LLP - Incorporated in India and Outside India.
 - Exclusions similar to Def. under Companies Act.

Key Definitions continued...

- S.2(1)(j) – Designated Partner (DP)
- MEANS-
 - Partner designated under Sec.7.
- According to S.7 – Atleast 1 DP to be RESIDENT in India.
- Resident – Similar to Resident under FEMA
 - Stay should be in India for > or = 182 days
- Compliance with S.7 – **Insertion in Audit Checklist** and must be ensured for every year.

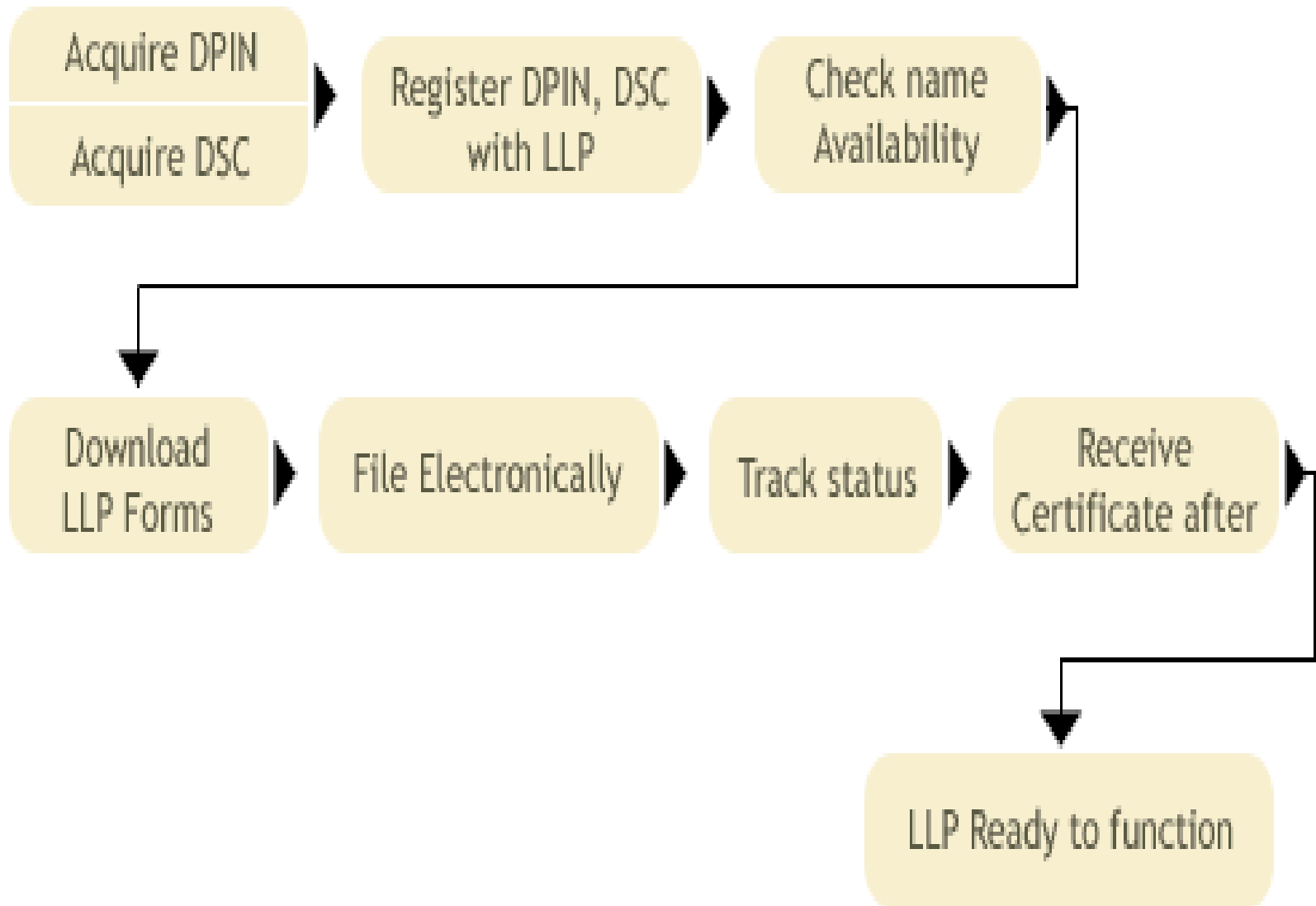
Other Definitions

- S.2(1)(m) defines foreign LLP
- S.2(1)(n) Defines LLP
- S.2(1)(o) defines LLP Agreement
- S.2(1)(l) defines Financial Year
 - Financial Year to be 12 months from April – March.
 - Option to increase 1st FY by 6 months (max) if incorporated after 30th September. I.e. till 31st March of the year next following the year.

Other Basic Provisions

- S. 6 & 7– Number of Partners and DPs – Consequence of not having required strength

FAQ: HOW TO FORM NEW LLP?



FAQ: HOW TO FORM NEW LLP?

- Create User ID.
- File eForm DIR 3 to Obtain DPIN.
- Obtain and register DSC with MCA.
- File Form 1 to reserve the proposed name of the LLP. (Similar to Form 1A) (Issues)
- File Form 2 - incorporation document and statements (Similar to Form 1)
- File Form 4 for appointment of partners / designated partners along with consent to act as DP in Form No. 9 for each DP. (Similar to Form 32)

FAQ: HOW TO FORM NEW LLP?

- Partners / DPs have to prepare LLP Agreement, ratify the same after incorporation and thereafter file **Form 3** for submitting details of LLP Agreement. (Optional Attachment of LLP Agreement) (*Issues*)
- Pay stamp duty on LLP Agreement as per rates prescribed in relevant stamp act.
- Upon Approval of LLP by ROC obtain Certificate of Registration in **Form 16**.*

FAQ: HOW TO CONVERT FROM FIRM / COMPANY TO LLP?

- File Form 7 for obtaining DPIN (DIN),
- Obtain DSC, and thereafter,
- File Form 1 for Reservation of Name.

- **ELIGIBILITY TO CONVERT: 2nd Schedule to S.55 r.w. Rule 38**
- **ONLY IF** – All partner / shareholders of firm / company are the partners of the LLP, and
- There are no secured borrowing in the books of company. **(Not applicable for conversion of firms)**

FAQ: HOW TO CONVERT FROM FIRM / COMPANY TO LLP?

- **IN CASE OF REGISTERED FIRMS:**

- Obtain statement from all partners appearing in the registered partnership deed along with firm name and firm registration number.
- Obtain List of Creditors and obtain consent from all creditors for conversion.
- Submit both along with Form 17 **AND** Form 2.

- **IN CASE OF UNREGISTERED FIRMS:**

- Not clear whether unregistered firms can convert to LLP.
- Procedure same as above.

- **IN CASE OF CONVERSION FROM COMPANY:**

- Procedure same as above.
- Require Form 18 instead of Form 17.

FORM 4: NOTICE OF APPOINTMENT / CHANGES IN PARTNERS/ DESIGNATED PARTNER— **RULE - 8, 10(8), 22(2) AND 22(3)**

- Filing is compulsory at the time of incorporation or within 30 days of appointment / resignation / death / cessation / change in classification.
- Details of DP to be given – DIN, address, e-mail id etc.
- If the appointee is a nominee of any Body Corporate, resolution is to be obtained.
- **Consent of partners given in Form 9 to be attached in case of appointment.**
- Verification by CA/ CS/CWA/Adv
- Upload the form and make payment online.
- Similar to that of Form 32 under the Companies Act, 1956.

FORM 3: INFORMATION WITH REGARD TO LLP AGREEMENT AND CHANGES –**RULE 21**

- Within 30 days from the date of incorporation or changes.
- Details of LLPIN, name, business, DP etc. to be given.
- Following details from LLP agreement required:
 1. DP responsible for compliance of the Act.
 2. Matters where consent of all the partners is required
 3. Obligation of the partner to contribute and total thereof
 4. Powers, duties and authorities of each partner.
 5. Mutual rights and duties of partners
 6. Mutual rights and duties of LLP and its partners.
 7. Restrictions of partners' authorities
 8. Indemnity, admission, retirement, cessation, expulsion and resignation.
- Attach the digital signature of DP and get it certified by CA / CS / CWA in practice.

FORM 17 - CONVERSION OF A FIRM INTO LLP **RULE 38(1) r.w.** **SCHEDULE II**

- Provide the details of the firm to be converted, partnership agreement and registration thereof and partners.
- Give the proposed name of the firm.
- On conversion of Firm only addition of the word “LLP” in existing name of the Firm is allowed.
- **Consent of all partners for conversion to be obtained and attached.**
- Provide details of IT Returns filings, details of any pending proceedings, conviction, ruling etc. subsisting in favour of against the firm.
- **Consent of all the creditors to be obtained and attached.**

FORM 17 - CONVERSION OF A FIRM INTO LLP cont.

RULE 38(1) r.w. SCHEDULE II

- The statement of assets and liabilities of the firm duly certified as true and correct by a Chartered Accountant in practice and made up to a date not preceding 30 days of the date of filing the application for conversion to be filed.
- Further attachments:
 - Statement of partners of the Firm as per prescribed Format B of the Form
 - Incorporation Document & Statement in **Form 2**
- To be digitally signed by the DP and CA/ CS / CWA in practice.

FORM 18: CONVERSION OF A PRIVATE COMPANY/UNLISTED PUBLIC COMPANY INTO LLP: RULE 39(1) & 40(1) R. W. SCHEDULE III:

- Enter CIN and date of incorporation of the co.
- Provide the details of Shareholders.
- Enter the name of LLP.
- On conversion of only deletion of words “private Limited”/ “Limited and addition of the word “ LLP” in existing name of the company is allowed.
- Provide regd. off. Address, details of partners, consent of shareholders
- Confirm whether all partners comprise all the shareholders of the company.
- Confirm whether any subsisting security interest in the assets of the company

FORM 18: CONVERSION OF A PRIVATE COMPANY/UNLISTED PUBLIC COMPANY INTO LLP: RULE 39(1) & 40(1) R. W. SCHEDULE III:

- Provide details of income tax filing, proceedings, conviction, any subsisting order in favour of or against the company,
- Give written consent of all unsecured creditors of the company.
- Provide status of filing of Annual Return with ROC.
- Provide Statement of Assets and Liabilities of the company duly certified as true and correct by the auditor.
- To be digitally signed by DP and certified by CA / CS / CWA.

PERIODIC RETURNS: FORM 8 - STATEMENT OF ACCOUNT & SOLVENCY – **RULE 24:**

- Must be filed within 30 days from end of 6 months after Financial Year end.
- **Audit not compulsory in case of turnover less than or equal to Rs.40 lacs in any financial year or contribution less than or equal to Rs.25 lacs.**
- Statement of Accounts and Solvency to be signed by ALL the DPs. **Presumption as to approval by all DP.**
- Statement of Solvency in prescribed format to be given. **(Issues)**
- Relaxation on disclosure norms as applicable to companies available to LLPs also.

PERIODIC RETURNS: FORM 8 - STATEMENT OF ACCOUNT & SOLVENCY – **RULE 24:**

- A certificate has to be issued by DP (in case of no audit) or by auditor (in case audit is applicable) – True and Fair view of the statement of accounts and solvency including statement of assets and liability.
- Appendix to Form 8 covers the creation, modification and satisfaction of charge details.
- Includes possibility of creation of charge outside India.
- Have to provide details of acquisition of property which may be subject to charge – also have to give details of any existing charge of the property to be acquired.
- Annual Return must be filed in **Form 11** within 60 days of **closure** of financial year of LLP – Must be accompanied by certificate from Practicing CS.

WHO IS A WHISTLE BLOWER? S.31

- If during any investigation or inspection any partner or employee:
 - Assists the investigation by providing useful information of such LLP or,
 - Provides information (need not be during investigation) which leads to LLP or any partner or any employee being convicted under LLP Act or any other Act, THEN
 - Such a partner or employee may be awarded reduced penalty or penalty may be waived.
- It also enables the Tribunal to offer security to such a Whistle Blower.

HOW TO ASSIGN SHARE OF LLP BY PARTNER? S.42

- Assignment NOT= Transfer.
- Only gives the assignee right to share in profits and losses of LLP and to receive distributions.
- Does not imply disassociation of partner or dissolution of LLP. Hence Rights and Liabilities remain vested with Partner.
- Assignee cannot participate in management.
- No form Filing with ROC required – NOT YET!

WHAT ARE THE REQUIREMENTS TOWARDS ACCOUNTS AND AUDIT: S.34

- Maintenance of books of accounts as may be prescribed.
- Can be on cash basis or accrual basis.
- Double entry book keeping must be followed.
- Within 6 months from the end of FY prepare Statement of Account and Solvency.
- Must be signed by all DPs.
- Similar to Schedule VI, **Form 8** is the prescribed form for preparation of Statement of Accounts and Solvency.
- Failure to maintain books of accounts – LLP will have to pay fine of 25K-500K and DP of 10K-100K
- Preference of uncodified requirements over clear guidelines seen under Companies Act. (**Issues**)

WHAT ARE THE REQUIREMENTS TOWARDS ACCOUNTS AND AUDIT: S.34

- Power given to Central Govt. to give exemptions to LLPs from mandatory audit requirement.
- **Rule 24 and Form 8** exempts LLPs with t/0<40Lacs or Contribution <25 Lacs in any financial year
- Exemption from Applicability of Accounting Standards Rules, 2006 is available to LLPs also which are SMCs. **S.2(f) of ASR, 2006.**
- As per S.40 of the Act, if the LLP or partners fail to file any returns or do not comply with requirements of ROC within 14 days of being asked to comply – ROC can approach Tribunal / CLB and LLP can be ordered to comply. Failure to comply can then be held as **contempt of court.**
- Disclosures as per **S.22 of MSME Act** apply.

Closing Down a LLP

- Any LLP can close down its business by adopting any of the following two ways:
 - Declaring the LLP as Defunct
 - In operation for 1 year or more
 - Application to RoC in eForm 24 (Rule 37)
 - Suo-Moto by RoC (Principle of Natural Justice to be followed)
 - Winding up of LLP
 - Section 63, 64 to be referred
 - Voluntary & Compulsory winding up

HOW TO WIND UP / DISSOLVE A LLP:

- **S.51** applies.
- Can be wound up under the foll. Circumstances:
 - Under report from Inspector u/s 49.
 - Matters covered under investigation carried out u/s 43 and it is found that business is carried out to:
 - Defraud its creditors, partners, any other person.
 - Oppress or be unfair to any partner(s)
 - Affairs of LLP are not in accordance with the Act.
- Central Govt will direct any person to file petition with the Tribunal if it feels it is just and equitable to expedite winding up.
- Principle of *Ejusdem Generis* applies.

HOW TO WIND UP / DISSOLVE A LLP:

S.64

- Winding up by the Tribunal possible if:
 - LLP decides that Tribunal wind up the LLP
 - If number of partners are less 2 for > 6 months
 - LLP is unable to pay its debts
 - LLP has acted against the sovereignty and integrity of India, security and public order.
 - Default in filing Form 8 for Statement Of Accounts And Solvency or Form 11 for Annual Return for 5 consecutive years.
 - If it is found to be just and equitable to do so.

LLP Agreement

LLP Agreement governs the mutual rights and duties of the partners and the LLP –
Sec 23

Definition of LLP Agreement

- **S.2(1)(o):** *“limited liability partnership agreement” means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership”*

Essentials to drafting

- Any Agreement must have the following basic essentials:
 - Simplicity
 - Clarity / Precision
 - Flexibility
 - Comprehensive

KEY FEATURES OF LLP AGREEMENT

- In case no LLP Agreement is prepared at the time of incorporation, SCHEDULE I to LLP Act will apply.
- Items covered in Schedule I must form part of LLP Agreement – Else – Unspecified matters Schedule I will be applicable.

First Schedule

- The First Schedule lays down provisions regarding matters relating to mutual rights and duties of partners and LLP in the absence of an agreement
- All the partners are entitled to share equally in the capital, profits and losses of LLP.
- LLP shall indemnify each partner in respect of payments made and personal liability incurred by him in the ordinary course of business of LLP.

First Schedule

- Every partner can take part in the management of LLP
- No partner shall be entitled to remuneration for managing and conducting business of LLP
- No person may be introduced as a partner without the consent of the existing partners
- All matters shall be decided by a resolution passed by a majority in number of the partners and for this purpose each partner shall have one vote

Inputs from Partners

- Key points to remember while drafting an LLP Agreement:
 - Purpose
 - Ownership
 - Management
 - Liquidation
 - Conflict Resolution

Basic Clauses of LLP Agreement

- Main Features of the Agreement
- Objective
- Definition and interpretation Clause
- Commencement of business of LLP
- Having a Common Seal and affixing common seal
- Manner and Mechanism for purchase of assets, especially immovable property
- Appointment of Lawyers and establishing banking relationships
- Flexibility to carry on other businesses by partners

KEY FEATURES OF LLP AGREEMENT

- Registered Office Clause: depends on:
 - Location of Dominant Partner
 - Location of maintenance of books of accounts
 - RoC's location
 - Use of Correspondence Address or Care off address?
 - Multiple entities at same address? Concerns?
- Capital clause:
 - One of the most important clauses – Clearly defined
 - Option to increase the same should be kept
 - Manner of receiving Capital contribution from time to time should be mentioned

KEY FEATURES OF LLP AGREEMENT

- **Admission of New Partners: Method and Manner must be provided for:**
 - Admission on death of an existing partner
 - Admission on retirement of existing partner
 - Approval of Partners - Majority vs All
 - Introduction of Family Members
 - Goodwill at the time of admission
 - Form of contribution by a new partner
- **Cessation from Partnership: Method and Manner must be provided for:**
 - Cessation by way of Retirement of a partner
 - Cessation by way of Death of a partner
 - Gross Negligence by a partner
 - Grounds / Circumstances for Removal from Partnership
 - Goodwill at the time of cessation

KEY FEATURES OF LLP AGREEMENT

- Appointment of DP and Cessation from DP
 - Maximum Number of DPs permitted
 - Representation by 2 parties
- Remuneration to Partners and DP
 - Fixed Remuneration
 - Bonus
- Role and Responsibility of Partners, especially Sleeping Partners.

KEY FEATURES OF LLP AGREEMENT

- Defining Rights & Duties of Partners:
 - Rights of DPs vs Partners vs Sleeping / Dormant Partners
 - Rights in all the assets vs selective rights
 - Right to access information and records
 - Exclusivity and NOC towards other partners
 - Indemnity of each partner to the LLP and to each other
 - Employ or dismiss key employees
 - Pledging, assigning, mortgaging any assets of the LLP – for benefit of the business

KEY FEATURES OF LLP AGREEMENT

- **Term of LLP:**
 - Indefinite / Perpetuity
 - Can it Dissolve on completion of project / object
 - Mechanism for Winding up should be prescribed
- **Committees and Meetings:**
 - Creation of Committees / Board of Advisors – Roles and Responsibilities
 - Organizing Meetings – Quorum, Chairman, Proxy, Manner of Voting, Casting Vote, Circulation Resolution,
 - Recording to Minutes of Meetings
 - Place of keeping records, books and minutes

Other Aspects in LLP Agreement

- Manner of transfer of share of Outgoing partner.
- Method of Valuation of Intangibles.
- Non-Compete Clause
- Arbitration Clause
- Accounts and Audit Clause covering Preparation of Accounting Statements, Reserve Fund, etc.
- Costs of Formation
- Indemnity Clause
- Assignment of Share
- Borrowing Powers

ISSUES IN LLP



ISSUES – WHO CAN BE A PARTNER??

- CAN A CORPORATION BE A PARTNER?
- CAN A HUF BE A PARTNER?
- CAN A TRUST BE A PARTNER?
- CAN A FOREIGN PARTNERSHIP / LLC / OTHER FOREIGN ENTITY OTHER THAN FOREIGN LLP BE A PARTNER?
- CAN A MINOR BE A PARTNER?

ISSUES – DESIGNATED PARTNER

- A Designated Partner has to be a partner, unlike in a company, where a director need not be a shareholder – **CONCEPT OF PROFESSIONAL / INDEPENDENT DIRECTOR NOT KEPT** – Not good from Corporate Governance stand point.
- Every LLP must have atleast 2 DPs, of whom atleast 1 must be Resident –
 - Resident is similar to FEMA Regulations (182 days during immediate prev. year.)
 - Sec. 7 of LLP Act states that compliance of residential status is a must – **ADD TO AUDIT CHECKLIST for EVERY YEAR.**

ISSUES CONT....

- The Statement of Accounts and Solvency needs to be signed by ALL DPs – **Presumption as to approval by all DPs**
- Debts owned by firm to be subordinated to others & loans to partners is not subordinated.
- Solvency Certificate not filed – liable to be wound up – **S.60(c)**
- Solvency Certificate does not give assurance of Going Concern

ISSUES CONT....

- No specific form for Creation of Charge / Modification of Charge / Satisfaction of Charge – Has to be done through Annual Return – **Does this mean Interim Filing cannot be made ??**
- Annual Return must be filed within 60 days of CLOSURE of financial year of LLP – Defn. Of “CLOSURE” not given?? What does one assume??

ISSUES Cont...

- In every financial statement, mandatory to create provision towards judgements and creditors!
- Claw Back Mechanism – IF INTRODUCED – Present in LLP legislation in Singapore.
- Authority given to CG to apply any section(s) of Companies Act – **BY WAY OF NOTIFICATION!!!**

ISSUES Cont...

- Charitable Organisations and Section 25 companies – CAN THEY FORM LLP?
- In case of a partner earning profits from a competing business- he/she must bring entire profit to LLP if no prior consent obtained – WHAT WILL HAPPEN FOR CA FIRMS HAVING NON-EXCLUSIVE PARTNERSHIPS.

ISSUES Cont...

- No partner can be removed by majority unless it is stipulated in the LLP Agreement
- In case of non-provision of information and documents by DP to ROC during Investigation or otherwise – only fine + possible winding up of LLP. But no provision like Companies Act, which prohibits such a Director to be a director in any other company for 5 years.

ISSUES Cont...

- What is a Defunct LLP – Not Defined?
- How to strike off a Defunct LLP not provided!!

- **TENANCY CLAIMS** & Applicability of 1 crore ceiling on LLP?

- Removal of Auditor can happen as per procedure laid down in LLP Agreement
 - THIS IS IN CONTRADICTION WITH PROCEDURE UNDER CA ACT.
 - NO MECHANISM FOR UNJUST REMOVAL – REDRESSAL as seen in Companies Act seen!!!
 - **WHAT IS OUR PROTECTION???**

ISSUES Cont...

- CA to certify solvency in FORM 8-
 - Provide Disclosures
 - Conditions
 - Guidance Note??
- Fair Valuation Concept and implication in case capital contribution is made in kind – IFRS reporting issues

CA NEEL MAJITHIA

