Taxation of Limited Liability Partnership (LLP)

Seminar on LLP, WIRC, Mumbai

CA Vishal Palwe
4 March 2017

What is LLP?

Key points

- Governed by Limited Liability Partnership, Act 2008
- A mix of features of a general partnership firm and a company
- It has a separate legal existence
- It has perpetual succession
- The liability of partners is limited
- LLP is considered as ‘firm’ for taxation purposes
- Generally, no restriction on the business activity that can be carried on by an LLP (except for foreign direct investment rules)
- Minimum 2 partners; no limit on the number of partners
- Can LLP enter into a partnership?

Taxation of LLP and partners

- Tax treatment of LLPs to be same as that of 'partnership firms'
- Definition of partner, firm and partnership – section 2(23) of Income-tax Act
- Residential status as per section 6(2) of Income-tax Act
- Remuneration (salary, bonus, commission, etc.) deductible in the hands of the LLP and not taxable in the hands of the partner – subject to certain conditions / limits
  - Profit up to first 300,000 or loss → remuneration deductible 150,000 or 90% of book profit, whichever is more
  - Balance → 60% of book profit
- Interest paid to partners
  - Up to 12% per annum
- For remuneration and interest, it is important that there is specific unambiguous provision in the partnership agreement
- Remuneration paid to a working partner

Taxation of LLP and partners

- Share of profit not taxable in the hands of the partner
- Dividend Distribution Tax (DDT) not applicable
- Alternate Minimum Tax (AMT) applicable
- LLP subject to compulsory audit if turnover exceeds INR 40 lakhs or if total contribution exceeds 25 lakhs – as per LLP Act, 2008
  - Due date for filing return of income for LLP and partner
- LLP assessed as a firm if certain conditions are met (section 184 of Income-tax Act)
- Determination of book profit
- Carry forward and set-off losses restricted in case of change in constitution of partnership firm – whether applicable to LLP?

Conversion of company to LLP

- Specific provisions of the Limited Liability Partnership Act, 2008 permit conversion of a closely held company into LLP
- Certain conditions for tax neutral conversion as prescribed under the Indian income-tax law – section 47(xiiib)
- Supported by judicial precedents, it is possible to adopt a position that the conversion is tax exempt for both the shareholders and the company using the following arguments:
  - Conversion being a statutory vesting of properties in the LLP, it may not qualify as transfer under the Indian income-tax law
  - Value of the business of the company and LLP remaining the same, no capital gains would arise in the hands of the shareholders – position is however debatable

Conversion of company into LLP – key eligibility criteria for tax neutral conversion

1. **All the assets and liabilities** of the company immediately before the conversion become the assets and liabilities **of the LLP**
2. **All the shareholders** of the company immediately before the conversion become the **partners** of the LLP and their capital contribution and profit sharing ratio in the LLP are in the **same proportion** as their shareholding
3. **No consideration** or benefit in any manner (other than by way of share in profit and capital contribution) received by **shareholders**
4. The **aggregate of the profit sharing ratio** of the shareholders of the company in the LLP shall **not be less than 50 per cent**, at any time during the period of **five years** from the date of conversion
5. The **total sales / turnover / gross receipts** in business of the company in any of the **3 previous years preceding** the previous year in which the conversion takes place **does not exceed INR 6 million**
6. **No amount is paid**, either directly or indirectly, to any partner out of balance of **accumulated profit** standing in the accounts of the company on the date of conversion for a **period of three years from the date of conversion**
7. The total **value of the assets** as appearing in the books of account of the company in any of the 3 previous years preceding the previous year in which the conversion takes place does not exceed **INR 50 million**

Cumulative conditions

Tax neutral conversion of company to LLP

Conversion of company to LLP – tax benefit

Particulars		Company	LLP
A) Taxability in the hands of company / LLP			
Net taxable profit before tax / taxable profit		100.00	100.00
Less: Income-tax @ 34.61%*	(a)	34.61	34.61
Profit after tax		65.39	65.39
Cash profit available for distribution		65.39	65.39
Less: DDT @ 20.36* on amount of dividend distributed	(b)	11.06	0.00
Amount of dividend distributed		54.33	65.39
Total tax outflow (a+b)	(c)	45.67	34.61
B) Taxability in the hands of shareholder / partner			
Income in hands of shareholder / partner		54.33	65.39
Taxes on distributed profits		Nil	Nil

Tax savings

Thank You