

LIMITED LIABILITY

PARTNERSHIPS

- Act and Agreement

By,
CA Neel Majithia

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”



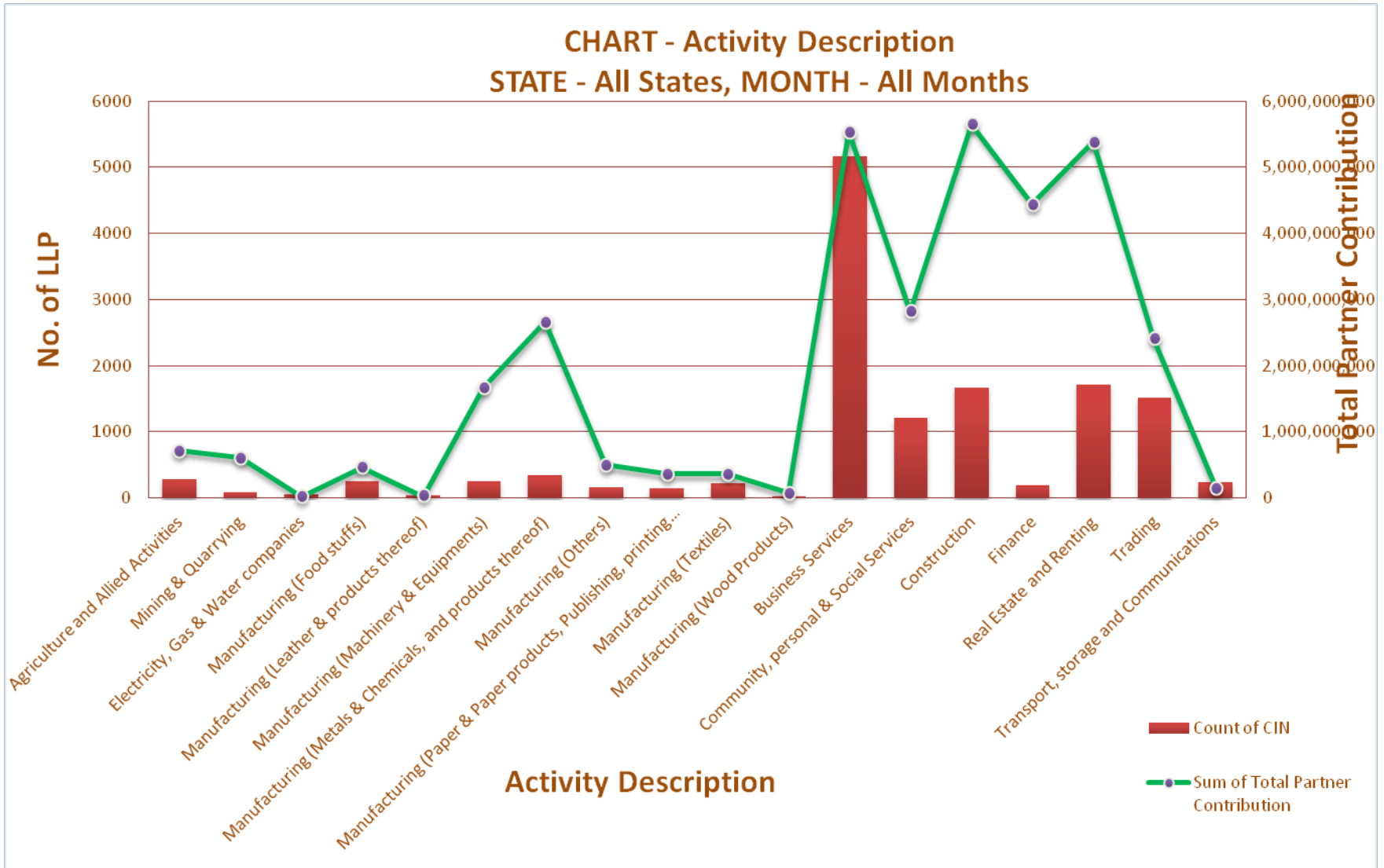
Statistics

- Number of LLPs incorporated in India:
 - 2015 - 20980
 - 2014 – 11616
 - 2013 – 6783
 - 2012 – 5633
 - 2011 – 4218
 - 2010 – 181
 - 2009 – 559
 - **TOTAL No. of LLPs as on 30/11/15: 50290**
- **More than 5800 companies have converted into LLPs as on 30th November 2015**
- **There is a decreasing trend in number of new LLPs being registered. Averaging 1074 per month as on 30th November 2015**

Statistics

Obligation of Contribution Range	No. of LLPs	Obligation of Contribution (in Rs Lakhs)
Up to 1 lakh	21,334	16,652.30
Above 1 lakh to 5 lakh	3,797	13,060.06
Above 5 lakh to 10 lakh	1,961	18,267.39
Above 10 lakh to 25 lakh	1,124	20,899.66
Above 25 lakh to 50 lakh	701	28,553.77
Above 50 lakh to 1 crore	612	53,246.49
Above 1 crore to 2 crore	284	43,970.59
Above 2 crore to 5 crore	328	112,823.89
Above 5 crore to 10 crore	144	112,367.51
Above 10 crore to 25 crore	92	156,464.78
Above 25 crore to 100 crore	89	473,839.31
Above 100 crore to 500 crore	12	272,898.12
Above 500 crore to 1000 crore		
Above 1000 crore		
Grand Total	30,478	1,323,043.89

Statistics



A BASIC UNERSTANDING

LLP ACT 2008

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.

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.

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

LLP AGREEMENT

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

FAQ: WHAT ARE THE KEY FEATURES OF 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

Partner

Majithia & Associates

