



DIRECT TAX REFRESHER COURSE

Taxation of LLP – Including reorganization

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Overview of LLP



Indian LLP: Meaning and Features

- ▶ LLP means a partnership formed and registered under LLP Act, 2008

Key attributes of an Indian LLP:

- ▶ Two or more persons associated for carrying on a lawful business with a view to earn profit
- ▶ Legal entity and personality distinct from that of its partners, having perpetual existence
- ▶ Change in partners not to affect existence, rights or liabilities of LLP
- ▶ Partners' liability limited to contribution except in event of fraud, wrongful acts, etc.

Indian LLP: A Snapshot

- ▶ Mutual rights and duties governed by LLP Agreement
 - ▶ Different asset sharing ratio and profit sharing ratio permissible?
 - ▶ Partner in profits only?

Partner of an LLP

- ▶ Can be an Individual, Indian/foreign company or LLP
 - ▶ Minimum 2 partners
 - ▶ Can a Trust/HUF or Firm become a partner in LLP? (MCA instruction)
- ▶ Is an agent of LLP for the purpose of business of LLP, but not of other partners
- ▶ Not personally liable for LLP obligation unless his own wrongful act or omission

Contribution by partner

- ▶ Can be tangible, movable or immovable or intangible property or other benefit to the LLP(e.g. know-how, development project)
- ▶ Can be contracts for services performed or to be performed
 - ▶ Eg. Partner bringing business/contracts for LLP as capital contribution

Indian LLP: A Snapshot

Designated partner (DP)

- ▶ Requires minimum two 'individual' DP, one of whom has to be an Indian Resident
- ▶ Where LLP consists of only 'body corporate' partners, nominees of such bodies corporate shall act as DP
- ▶ Meaning and purport to be derived from LLP Act

A DP is responsible for:

- ▶ Compliance obligations including:
 - ▶ Filing of documents, return, statement and like
 - ▶ Verifying Statement of Account and Solvency, etc.
 - ▶ Additionally, matters specified in the LLP Agreement
- ▶ Tax return to be signed by DP (S. 140 of IT Act)
- ▶ DP will be personally liable in case of fraudulent acts, subject thereto, limited liability

Indian LLP: A Snapshot

- ▶ Partner's right to share of profit and losses of LLP and to receive distributions can be transferred either wholly or in part
- ▶ Assignee not entitled to participate in management or conduct of the activities of LLP or access information relating to transactions of LLP

Commercial advantages and disadvantages of LLP

Commercial advantages

- ▶ Limited liability of partners
- ▶ Flexibility of organizing internal management by mutual agreement
- ▶ Fewer compliance requirements as compared to body corporate

Commercial disadvantages

- ▶ LLP not able to get itself listed without further reorganization
- ▶ Unlike in case of a company, cross border merger of a foreign entity with an Indian LLP is not feasible
- ▶ LLP not permitted to avail External Commercial Borrowings (ECBs)

Tax Analysis – LLP in general



LLP Taxation

- ▶ Definition of ‘Firm’, ‘Partner’ and ‘Partnership’ amended to incorporate LLP taxation
 - ▶ ‘Firm’ definition amended to include an LLP
 - ▶ ‘Partner’ definition now includes a partner of LLP
 - ▶ ‘Partnership’ includes LLP
- ▶ Definition not relevant to non tax purposes : For example, s. 14 of Partnership Act
- ▶ LLP taxed as a “general partnership” (firm)
 - ▶ Entity level taxation of LLP: partners not taxed again irrespective of their residential status and tax treaty residence [Refer S. 10(2A), refer MAT exclusion]
 - ▶ Possibility of deduction for remuneration paid to “individual” working partner if authorised by LLP Agreement
 - ▶ Simple interest permitted upto 12% p.a. on capital contribution by firm if authorised by LLP Agreement
 - ▶ Ensure compliance with S.184/185 of ITA

LLP Taxation

- ▶ LLP resident in India even if part of the control and management is in India
- ▶ Contribution to LLP may trigger capital gains in the hands of contributing partner with respect to value at which transfer is recorded [S. 45(3)]
 - ▶ Interplay of S.32 r.w. R 23(2) of LLP regime
 - ▶ Interplay of S.56(2)(viiia) if contribution is in form of shares
- ▶ S. 45(4) implications in case of distribution of property by LLP at the time of its dissolution
- ▶ Assignment of interest by a partner likely to trigger capital gains tax
 - ▶ Is cost of acquisition of transferred asset ascertainable ?
- ▶ Revaluation of asset of LLP - a tax neutral event?
- ▶ Cessation of interest akin to retirement of partner not triggering tax implications?

Advantages of being assessed as a 'firm'

- ▶ No tax on cash distribution during the life of or on winding up of LLP
 - ▶ Indian company pays 20.36% tax as dividend distribution tax (DDT)

Particulars	Company	LLP
Profit before tax	100	100
Less: Tax @ 30%	(30)	(30)
Profit after tax	70	70
Less: DDT @ 20.36%	(14.25)	-
Profit available for shareholders/ partners	55.75	70

- ▶ Impact of internal change in partners on carry forward of loss
 - ▶ Admission may not, but retirement does impact carry forward of loss component
- ▶ No MAT/AMT in respect of income exempt under Chapter III (other than S. 10AA) including STT paid LTCG

Advantages of being assessed as a 'firm'

- ▶ Loan to a partner or to the concerns in which partner holds beneficial interest do not trigger deemed dividend – Sec 2(22)(e)
- ▶ Deemed income provisions of Sec 2(24)(iv) does not apply in respect of transaction with partners
- ▶ Artifice of Sec 73 does not apply to convert delivery based share trading loss to speculation loss
- ▶ S. 56(2)(viia) limited in its application to shares of a company

Disadvantages of being assessed as a 'firm'

- ▶ May not qualify for tax holiday/ incentive provisions when restricted to company (E.g. S. 80-IA)
- ▶ Certain presumptive tax provisions available only to foreign company (E.g. S. 44BBB)
- ▶ Certain deductions available only to company – e.g.
 - ▶ Section 35(2AB) of IT Act - Weighted deduction for scientific research
 - ▶ Section 35D of IT Act- Deduction for preliminary / pre-operative expenses
- ▶ Tax neutrality for merger /demerger apply only when companies are parties to the reorganization

Comparison: AMT(LLP) and MAT(Company)

AMT	MAT
<ul style="list-style-type: none">▶ Linked to total income as adjusted for deductions u/s 10AA, 35AD and under Ch. VI-A▶ Full depreciation as per IT Act▶ Incomes exempt u/s 10 beyond purview of AMT▶ Quantum of set off of carried forward losses restricted to total income	<ul style="list-style-type: none">▶ Linked to 'Book Profit' as modified for specified downward / upward adjustments▶ Depreciation as per books▶ STT paid LTCG subject to MAT despite exemption u/s 10(38)▶ Restrictive set off of book losses of earlier years – lower of brought forward loss or unabsorbed depreciation as per books

Tax Analysis - Conversion of Firm into LLP



Conversion of firm into LLP



- ▶ Pre-conditions for conversion
 - ▶ Firm as defined in Indian Partnership Act may convert
 - ▶ Partners of LLP into which the firm is to be converted should comprise of all the partners of the firm and no one else
- ▶ In terms of S. 58(4) of the LLP Act:
 - ▶ LLP comes into being from the date of registration
 - ▶ Firm shall be deemed to be dissolved and removed from the records of the ROF
- ▶ No tax implications on conversion of firm into LLP since firm and LLP are treated as equivalent under the IT Act – CBDT Circular 5/2010
 - ▶ Transition of AMT credit?
- ▶ No specific amendment in S. 47 of the IT Act for conversion of firm into LLP

Tax Analysis - Conversion of Company into LLP



Conversion of Private/ Unlisted company to LLP

Conditions for tax neutral conversion of company into LLP

- ▶ All assets and liabilities of company to become that of LLP
- ▶ All shareholders to become partners in LLP with capital contribution and profit sharing ratio in the proportion of shareholding
- ▶ Shareholders not to receive any consideration or benefit, directly/indirectly, in any form except by way of share in profit and capital contribution in LLP
- ▶ Aggregate of profit sharing ratio of the shareholders of company in LLP > 50% for a period of 5 years
- ▶ Sales, turnover or gross receipts in business of company in any of preceding 3 years < INR 6 million
- ▶ No direct / indirect payment to any partner out of accumulated profits of company for a period of 3 years post conversion date

Conversion of company to LLP

- ▶ All assets and liabilities of company immediately before conversion to become that of LLP
 - ▶ Wholesale conversion; akin to amalgamation
 - ▶ Suppose, some asset is not to be taken over?
 - ▶ Constraint of transition of unabsorbed MAT credit
- ▶ Shareholders not to receive any consideration or benefit, directly/indirectly, in any form except by way of share in profit and capital contribution in LLP
 - ▶ Consideration or benefit in the capacity as shareholder, in lieu of transfer, at the time of conversion or later.
 - ▶ Avoid diversion in form of loan to shareholders
 - ▶ Payment of remuneration or interest after the date of conversion?

Conversion of company to LLP

- ▶ All the shareholders to become partners of LLP with their capital contribution and profit sharing ratio in the proportion of shareholding as on the date of conversion
 - ▶ Capital as also profit sharing ratio in LLP to be aligned to shareholding ratio
 - ▶ Position of minor shareholders?
 - ▶ Treatment of preference shareholders?
 - ▶ Reorganization amongst the shareholders prior to the date of conversion, subject to impact of S. 79
 - ▶ No lock in for the period upto which erstwhile shareholder continues to be a partner, so long as condition of aggregate of 50% of profit sharing ratio fulfilled

Conversion of company to LLP

- ▶ Aggregate profit sharing ratio of the shareholders of the company in LLP > 50% for a period of 5 years
 - ▶ Involuntary transfers beyond the control of the assessee (such as death etc.) arguably not covered
 - ▶ Admission of new partners upto 50% is permissible
 - ▶ Condition to be tested on aggregate basis; internal change permissible

Conversion of company to LLP

- ▶ No direct / indirect payment to any partner out of accumulated profits of company for a period of 3 years post conversion date
 - ▶ No bar on payment from current profits of the LLP (e.g. normal business profit or gain from sale of acquired assets)
 - ▶ Avoid loans given to related parties – an attempt to divert accumulated profits
 - ▶ What constitutes accumulated profits? (Refer next slide)

Conversion of company to LLP

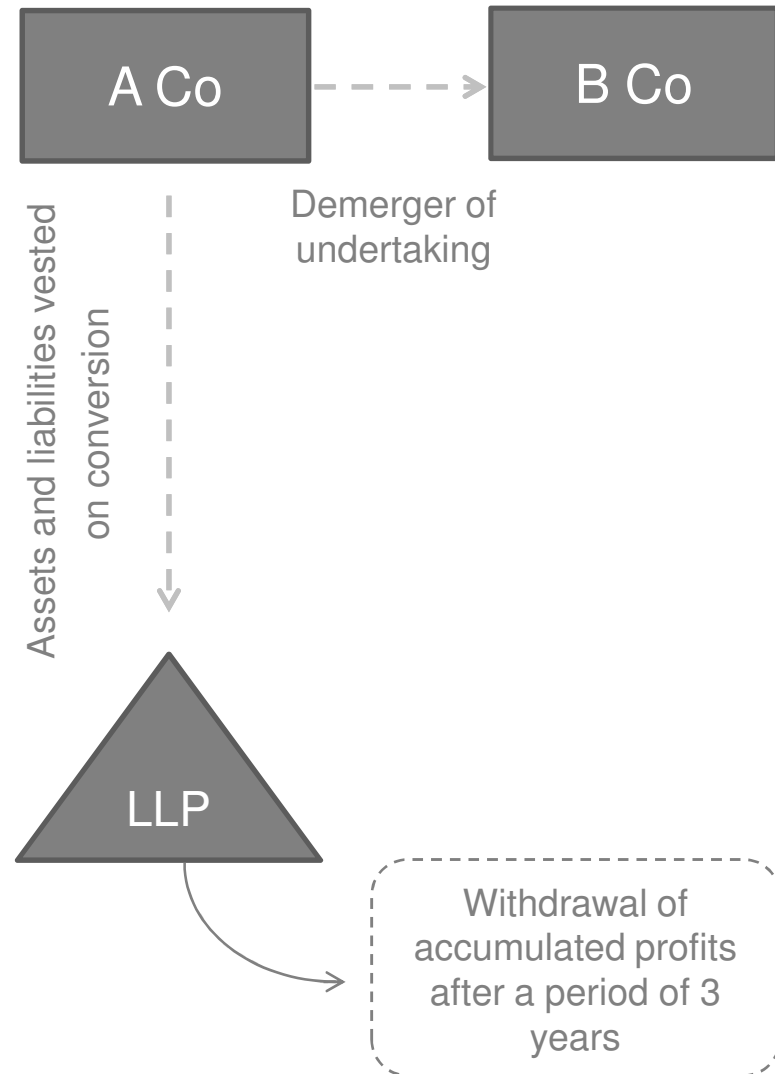
Balance sheet of company

Liabilities	INR	Assets	INR
Share capital	1000	Fixed Assets	3000
Bonus shares	500	Sundry Assets	1000
<u>Reserves & Surplus</u>			
Amalgamation reserve	200		
Securities Premium	500		
Revaluation reserve	200		
CRR	100		
P&L A/c	1500		
Total	4000	Total	4000

Balance sheet of LLP post conversion

Liabilities	INR	Assets	INR
Capital contribution	1500	Fixed Assets	3000
Reserves & Surplus carried forward from company	2500	Sundry Assets	1000
Total	4000	Total	4000

Conversion of company to LLP



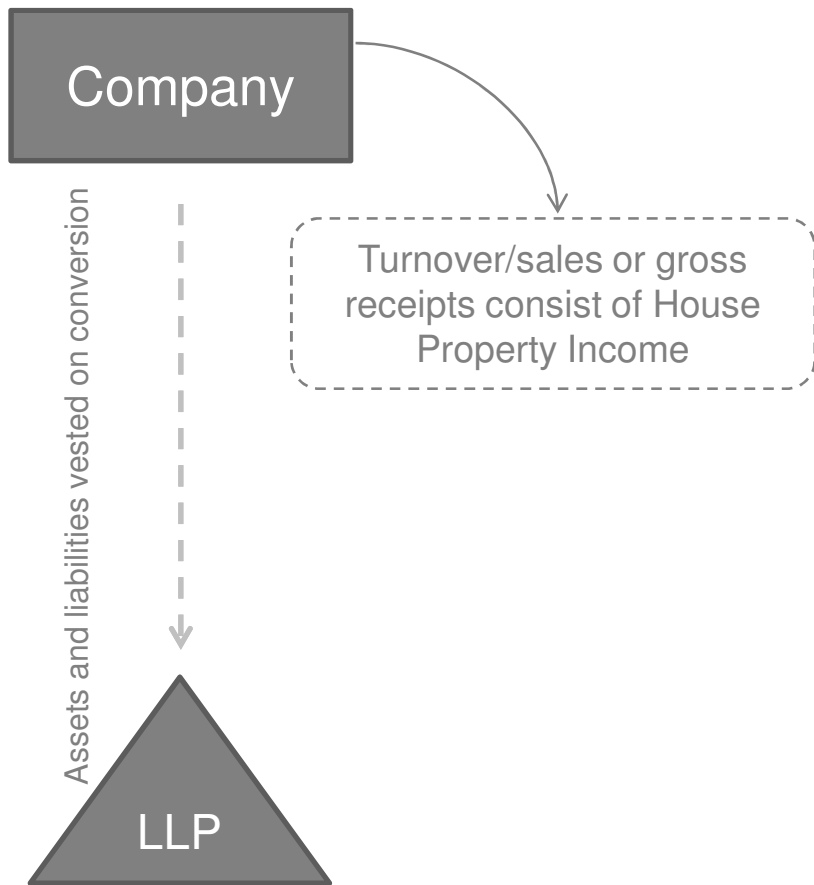
Facts

- ▶ A Co's turnover exceeds Rs. 60 lakhs in preceding 3 years
- ▶ A Co holds huge reserves
- ▶ A Co demerges its business undertaking in B Co., a newly formed entity
- ▶ A Co converts into LLP after a period of 3 years, turnover less than 60 lakhs in preceding 3 years
- ▶ Partners withdraw out of accumulated profits of A Co. post 3 years of conversion

Issue

- ▶ Is conversion of A Co into LLP S. 47(xiii b) compliant?

Conversion of company to LLP



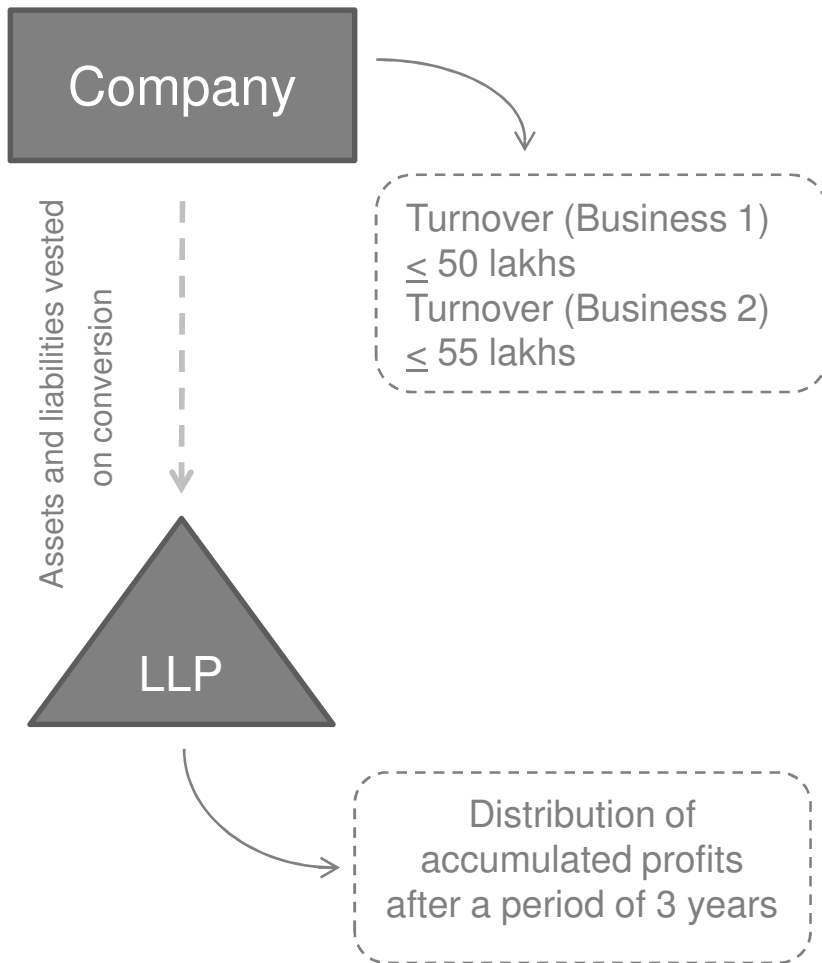
Facts

- ▶ Company is engaged in the business of acquiring and holding and letting out properties
- ▶ Turnover for the preceding 3 years is:
 - ▶ House Property Income: 75 lakhs

Issues

- ▶ In terms of S. 47(xiiib), what shall be construed as 'turnover' for the purposes of computing 60 lakhs limit? (Refer Circular No. 1/2011)
- ▶ Refer SC ruling in the case of Chennai Properties and Investments Ltd. (Civil Appeal No. 4494/2004)

Conversion of company to LLP



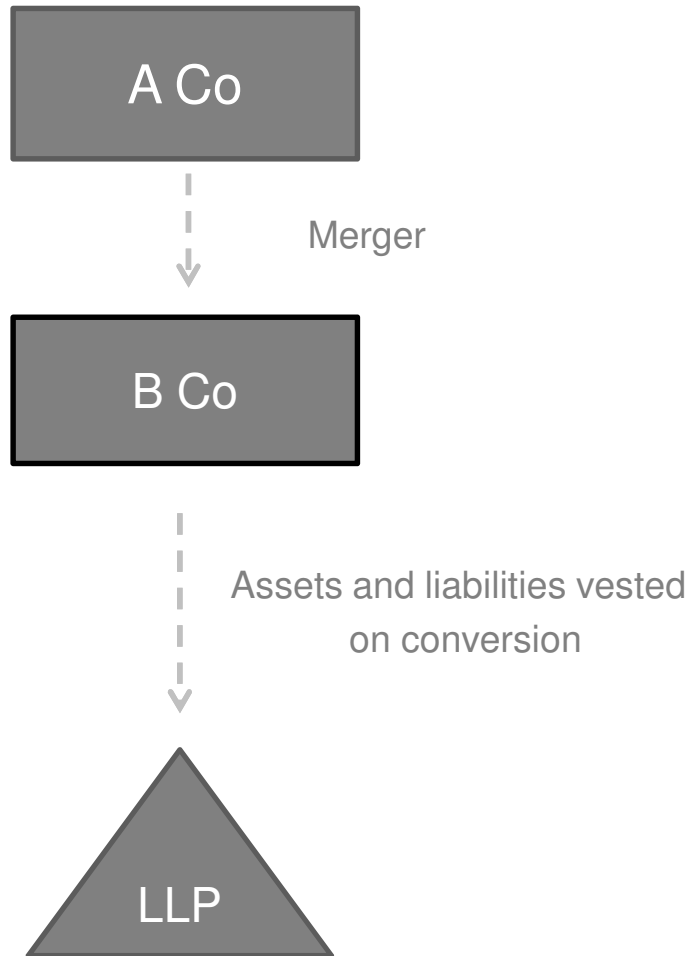
Facts

- ▶ Turnover of the company for all the preceding 3 years is as follows:
 - ▶ Business 1 \leq 50 lakhs
 - ▶ Business 2 \leq 55 lakhs
- ▶ Accumulated profits as on the date of conversion – 400 lakhs
- ▶ LLP distributes accumulated profits after a period of 3 years from the date of conversion

Issue

- ▶ Independently, turnover of business 1 and business 2 is less than 60 lakhs.
- ▶ Is conversion S. 47(xiii b) compliant?
- ▶ Does turnover include service tax, sales tax etc.?

Conversion of company to LLP



Facts

- ▶ A Co's turnover exceeds Rs. 60 lakhs in preceding 3 years
- ▶ A Co merges with B Co., a newly formed entity whose turnover is less than Rs. 60 lakhs
- ▶ Post merger, B Co. immediately converts into LLP

Issue

- ▶ Is conversion of B Co into LLP S. 47(xiiib) compliant?

Conversion of company to LLP: Other tax implications

- ▶ DDT:
 - ▶ S. 2(22)(a): Any distribution by company to shareholders?
 - ▶ S. 2(22)(c): Any distribution by company to shareholders?
- ▶ S.2(24)(iv): Implications for shareholders: Any benefit passed on by the company?
- ▶ S. 56(2)(viia): Company transfers its investment in shares to LLP upon conversion

Conversion of company to LLP: Other tax implications

- ▶ Company and LLP are separate persons;
 - ▶ Company to file return of income upto the date of conversion
 - ▶ LLP to file return for the period from date of conversion till year end
- ▶ Separate Permanent Account Number (PAN) and Tax deduction Account Number (TAN)
- ▶ No specific amendments made to permit continuation of tax holiday or incentives in the name of LLP
- ▶ Predecessor to be assessed in the name of successor

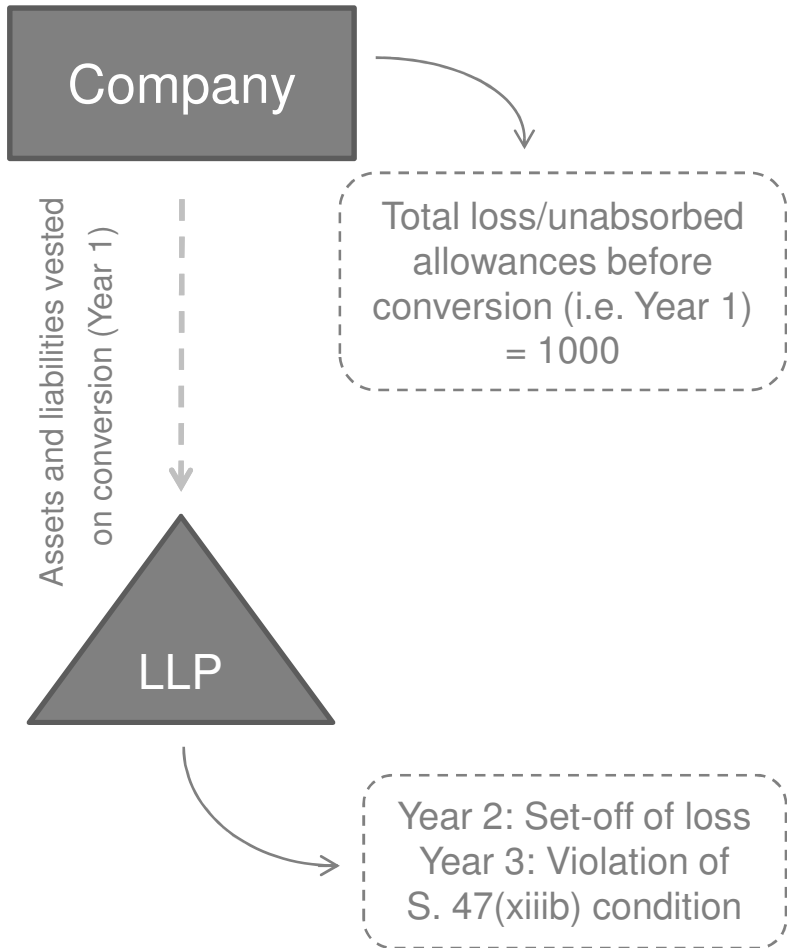
S. 47(xiiib) compliant conversion: Back up provisions

Section	Brief Particulars
5th proviso to Section 32	In the year of conversion, aggregate of depreciation to LLP and company not to exceed depreciation as would have been allowable to the company without such conversion
Explanation 2C to section 43(6)	WDV of block of assets of company to be WDV of LLP
Section 32AD	Where new asset is transferred by the company to LLP, condition of retaining the new asset for a period of 5 years from the date of its installation shall apply to LLP
Section 35DDA(4)	Amortisation in respect of residual VRS payment by company available to LLP
Explanation 13 to Section 43(1)	Actual cost of capital asset for which investment linked deduction is granted u/s. 35AD to the company to be NIL in the hands of LLP
Section 49(1)(iii)(e)	Actual cost of capital asset of company to be the actual cost to LLP

S. 47(xiiib) compliant conversion: Back up provisions

Section	Brief Particulars
Section 49(2AAA)	Cost of shares in company would represent cost of LLP interest for partner
Section 72A(6A)	LLP can carry forward unabsorbed business losses / unabsorbed depreciation of the company [Arguably, fresh lease of time period available] (Refer next slide)
Section 115JAA(7)	No carry forward of MAT credit to LLP (Refer next slide)
Section 47A(4) and Section 72A(6A)]	Also, S. 47(xiiib) breach leads to LLP paying tax in the year of violation on: <ul style="list-style-type: none">▶ Capital Gains exempted in the hands of company and the shareholders▶ Forfeiture of loss claimed by LLP [Proviso to section 72A(6A)]

S. 72A(6A) – Carry forward of loss



Facts

- ▶ Company has various losses/ unabsorbed allowances as under:

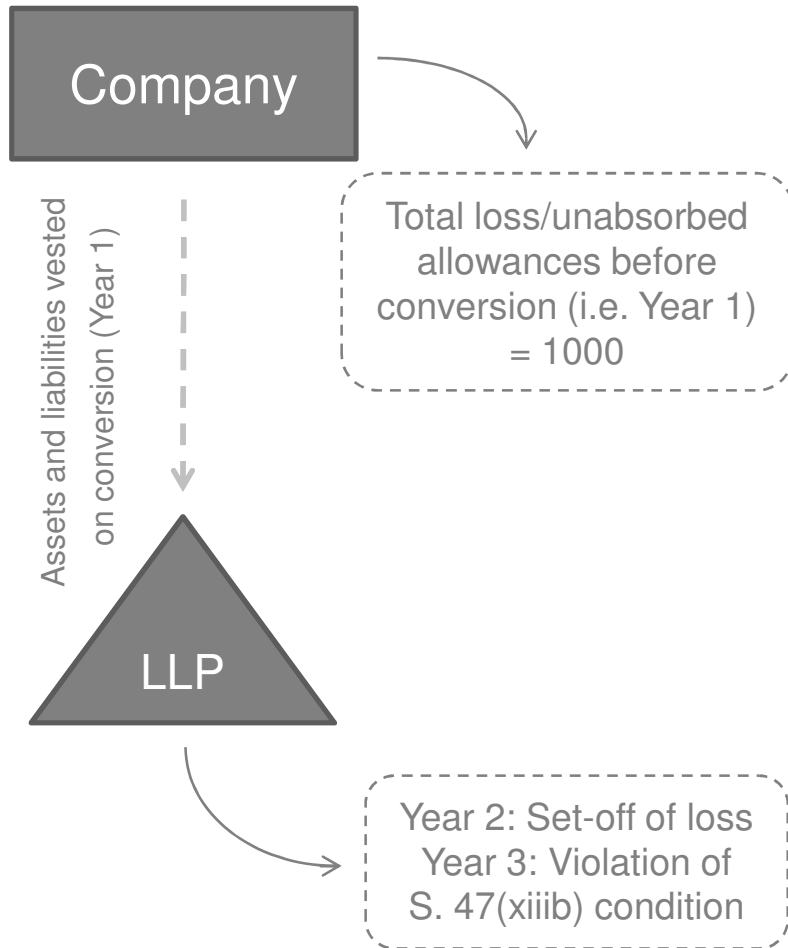
Particulars	Rs.
Business loss	400
Speculation loss	100
Capital loss	100
Unabsorbed depreciation	50
Unabsorbed expenditure on scientific research	150
Loss incurred in S. 35AD activity	200
Total	1000

- ▶ Company converted into LLP (say Year 1)

Issue

- ▶ What shall be included to calculate accumulated loss and unabsorbed depreciation available for carry forward and set off in the hands of LLP u/s 72A(6A)?

S. 72A(6A) – Carry forward of loss



Facts

- ▶ In Year 2, LLP claimed set off of loss carried forward from company
- ▶ Violation of S. 47(xiiiib) condition in Year 3.

Issue

- ▶ Will violation of S. 47(xiiiib) condition in Year 3 lead to reversal of loss which is set off in Year 2?
- ▶ Tax liability to be discharged by partners in the year of reversal.

Taxation of LLP: Non-compliant conversion



Non-compliant conversion: Implications for company

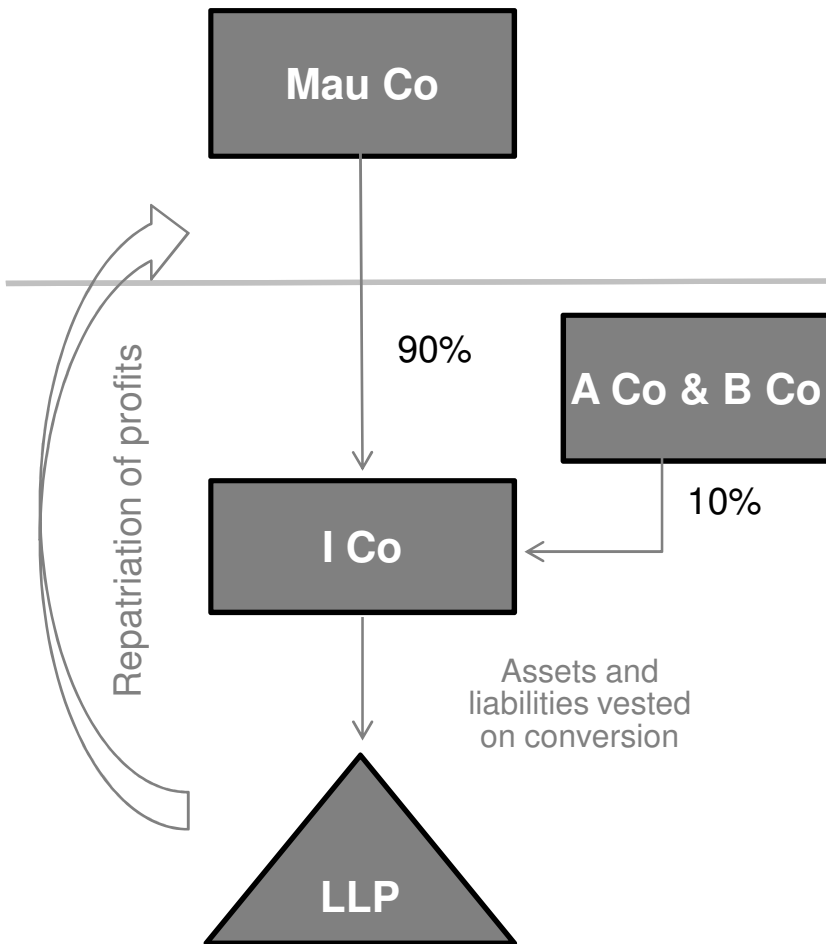
- ▶ Incorrect to suggest; absent S.47(xiiib) exemption, charge is, per se, attracted
- ▶ No consideration accruing to the company; company is statutorily dissolved
 - ▶ Principle, as equally relevant to stock-in-trade
- ▶ Akin to case of amalgamating company transferring assets to amalgamated company

Upgrade unabsorbed depreciation in computation of
WDV Of assets of LLP?

Non-compliant conversion: Implications for shareholders

- ▶ Exemption provision is not, in itself, indicator of an effective charge
- ▶ Extinguishment of shares against receipt of LLP interest
- ▶ Partner's interest in LLP is not capable of being ascertained (Beware S. 50D)
- ▶ In terms of S. 58(4) of LLP Act, the sequence of steps is:
 - ▶ Registration of LLP
 - ▶ Vesting of assets
 - ▶ Dissolution of company
- ▶ No consideration becomes due as a result of extinguishment
- ▶ Cases of vesting do not envisage any enrichment
- ▶ No real income capable of attracting charge to tax

Non-compliant conversion: Implications for shareholders



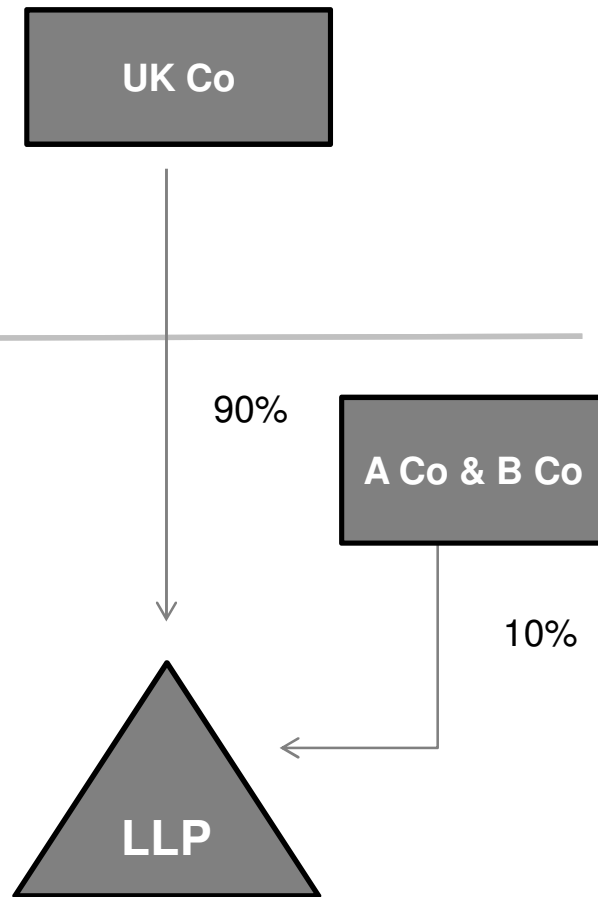
Facts

- ▶ I Co's shareholding pattern is as under:
 - ▶ Mau Co. 90%
 - ▶ A Co. & B Co. 10%(Indian promoters)
- ▶ I Co proposes to convert itself into LLP; turnover for preceding 3 years exceeds 60 lakhs
- ▶ Post conversion, profits of LLP are repatriated to Mau Co

Issue

- ▶ Tax implications in the hands of Mau Co?

PE exposure



Facts

▶ Capital as also profit sharing ratio in LLP is as under:

- ▶ UK Co. 90%
- ▶ A Co. & B Co. 10%

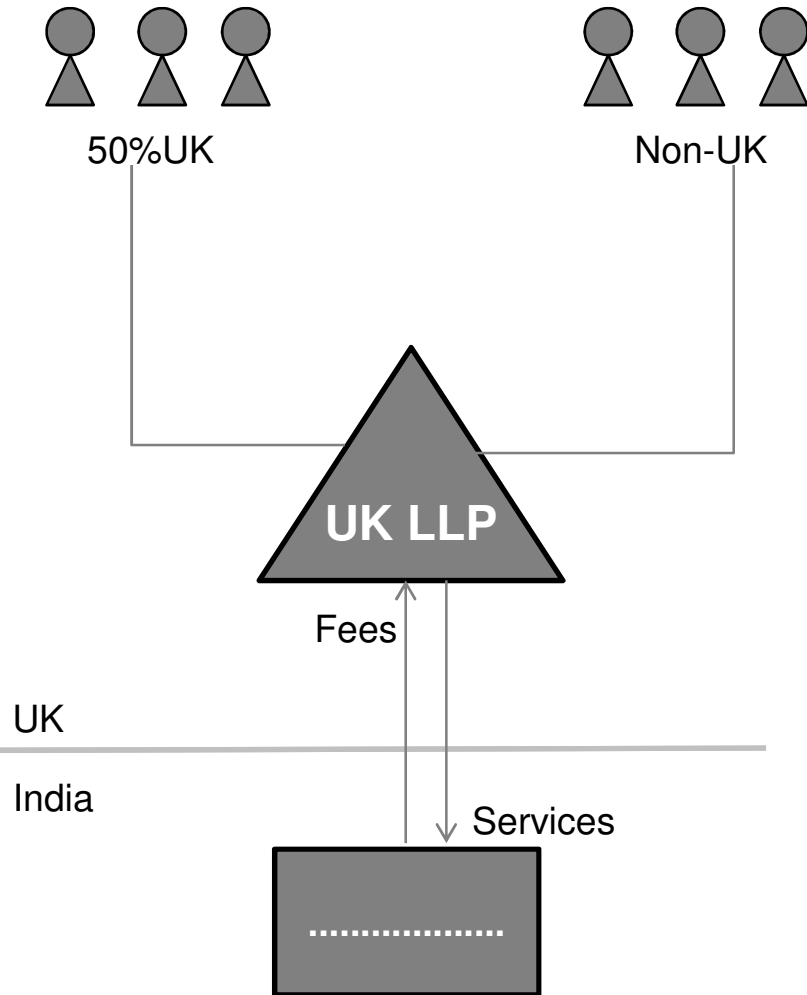
▶ UK Co. actively participates in the business of LLP

▶ LLP pays interest on capital to partners

Issue

▶ Whether payment by LLP could be characterized as interest income under India-UK DTAA or is it PE connected profit of UK Co, or none?

Treaty Entitlement



Facts

- ▶ UK LLP is comprised of UK and non-UK partners
- ▶ UK LLP has sourced income in India and claims DTAA relief
- ▶ UK LLP is taxed transparently at partner level

Questions

- ▶ Is UK LLP a body corporate or partnership?
- ▶ Is UK LLP a person liable to tax?
- ▶ Can UK Partner claim treaty relief in his own right?
- ▶ Can UK LLP seek DTAA relief as respects partial income?

Thank You

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