## Taxation of Limited Liability Partnership (LLP)

Seminar on LLP, WIRC, Mumbai

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### What is LLP?

#### <u>Key points</u>

- 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  $\rightarrow$  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

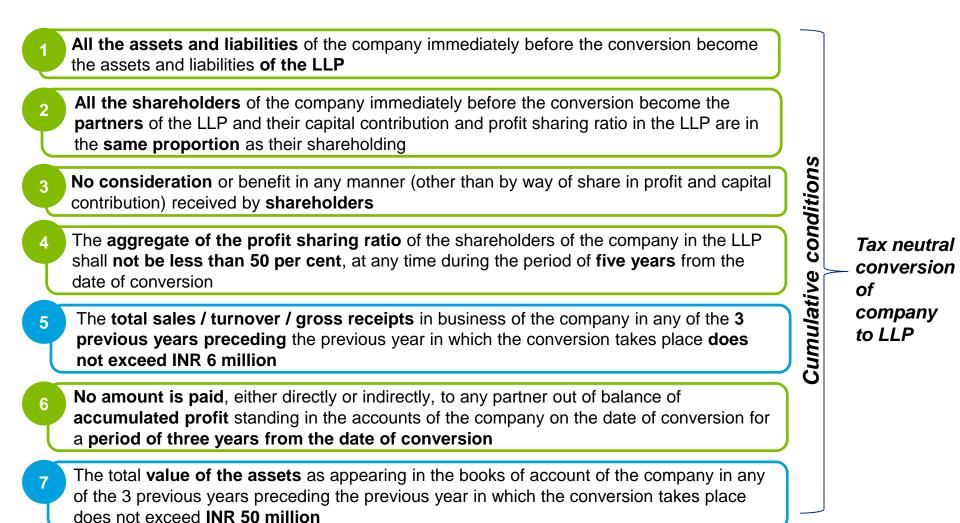
#### **Taxation of LLP and partners**

- 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 Incometax 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



#### **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