

Structuring and mergers using LLPs

High level concepts

27 May 2017

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Contents

What is an LLP

What is an LLP

- Limited Liability Partnership (LLP) means a partnership formed and registered under the Limited Liability Partnership Act, 2008 (LLP Act)
- LLP is constituted through an LLP Agreement
 - The LLP Agreement is a charter of the LLP which denotes its scope of operation and rights and duties of the partners vis-à-vis LLP
- LLP is managed by Designated partners and partners
 - At least 2 designated partners and at least one of them should be a resident in India

Why LLP?

Why look for an alternate form of entity

Shortcomings of Partnership firm

- › Unlimited liability of the partners
- › Maximum 20 partners (10 - in banking business)
- › Not found favor when it comes to foreign investments (not under automatic route)
- › No perpetual succession

Shortcomings of Company

- › Dividend Distribution Tax
- › Minimum Alternate Tax
- › Buy back tax
- › Onerous compliance requirements



LLP blend of benefits of Partnership firm and Company

- › Limited liability of the partners
- › No limit on maximum partners
- › No Dividend Distribution Tax / Minimum Alternate Tax
- › Cost effective to incorporate
- › Few administrative compliance
- › Perpetual succession

LLP is aimed to

- Provide a vehicle to SME and professional firms (CS, CA, CWS, Advocates, etc.) to conduct their business / profession efficiently with lesser administrative compliances
- Boost growth of services sector

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Tax considerations

Taxation of LLP

Particulars	Implications
Tax status	<ul style="list-style-type: none">• LLP to be treated at par with a partnership firm<ul style="list-style-type: none">– Income liable to tax @ 30%• Not liable to DDT• Liable to Alternate Minimum Tax (“AMT”) on tax profits before considering deductions under Chapter VI-A and under Section 10AA• Option of presumptive taxation not available
Deduction for interest & remuneration to partners	<ul style="list-style-type: none">• Maximum interest deduction ~ 12% simple interest p.a.• Remuneration payable to working partners deductible, subject to limits applicable to partnership firms
Recovery of tax	<ul style="list-style-type: none">• LLP liable to pay taxes• Where tax cannot be recovered from LLP, all partners jointly & severally liable for payment of tax, subject to certain exceptions
Share of LLP profit	<ul style="list-style-type: none">• Exempt
Interest & remuneration from LLP	<ul style="list-style-type: none">• Taxable as business income
Contribution of assets to LLP	<ul style="list-style-type: none">• Shall be liable to capital gains tax
Recovery of tax liability of LLP	<ul style="list-style-type: none">• Joint & several liability where tax cannot be recovered from the LLP, except where partner proves that non recovery of tax cannot be attributed to his gross neglect, misfeasance or breach of duty on his part

Tax implications on conversion of company to LLP

Conversion of small private company / unlisted public company to be tax neutral subject to satisfaction of certain conditions

- Conditions at the time of conversion
 - Sales, turnover or gross receipts of ***business*** in any of the 3 preceding years not to exceed Rs. 6 million
 - All assets and liabilities to continue
 - All the shareholders to become partners
 - Capital contribution and profit sharing ratio to be in the same proportion as their shareholding in the company
 - No other consideration except by way of share of profit and capital contribution in the LLP
 - Total value of assets as appearing in the books of accounts of company in any of the 3 preceding years does not exceed Rs. 50 million
- Conditions having future implications
 - Aggregate profit sharing ratio of the shareholders to be a minimum of 50% for 5 years
 - No amount to be paid to any partner out of the balance of accumulated profit of the company for a period of 3 years
- Violation of conditions triggers tax for LLP in the year of violation
- Other implications
 - Continuity benefits available:
 - business loss and unabsorbed depreciation
 - cost of acquisition of capital assets
 - amortization of VRS expenditure
 - Depreciation allowance to be apportioned on the basis of actual number of days
 - MAT credit cannot be carried forward

LLP

Structuring options

Reorganization provisions in the LLP Act

- LLP Act has provisions dealing with the following:
 - Hiving off or separation (demerger) of undertaking, property or liabilities of LLP
 - Compromise, arrangement or reconstruction between LLP and creditors
 - Compromise, arrangement or reconstruction between LLP and its partners
 - Amalgamation of two LLPs
 - Voluntary involuntary winding up / dissolution of LLP

The Income tax Act, 1961 contains no specific provisions with respect to the above reorganizations except for dissolution of LLP

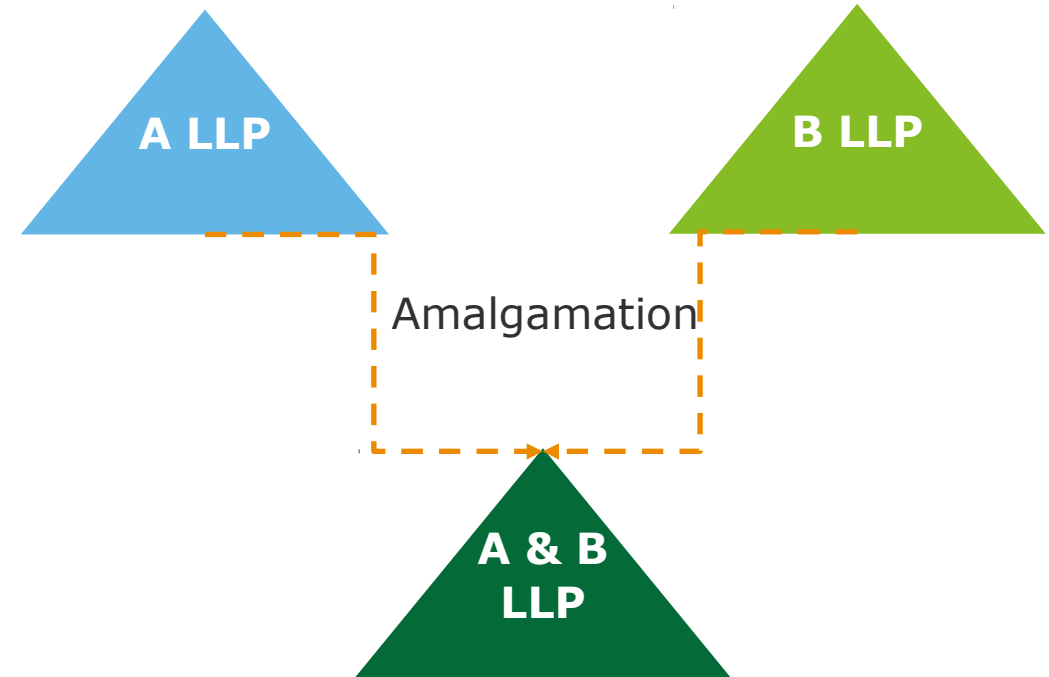
Option #1 – Amalgamation of LLP

Option #1A – Amalgamation of two LLPs

Scenario 1: Amalgamation of one LLP with another



Scenario 2: Two LLPs to merge together to form a new LLP

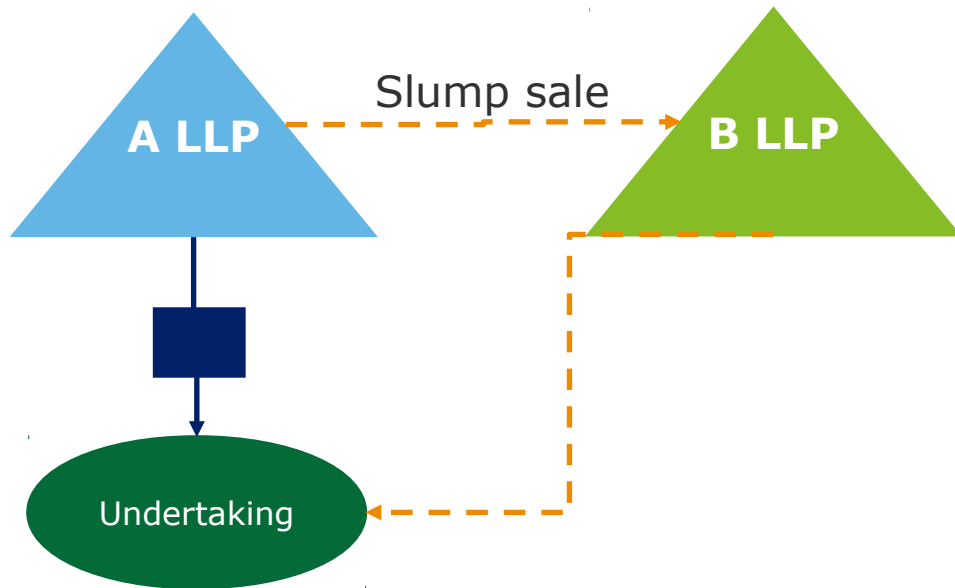


In absence of any specific provisions in the Income tax Act, 1961, there is no clarity on the tax implications that will arise in the above scenarios

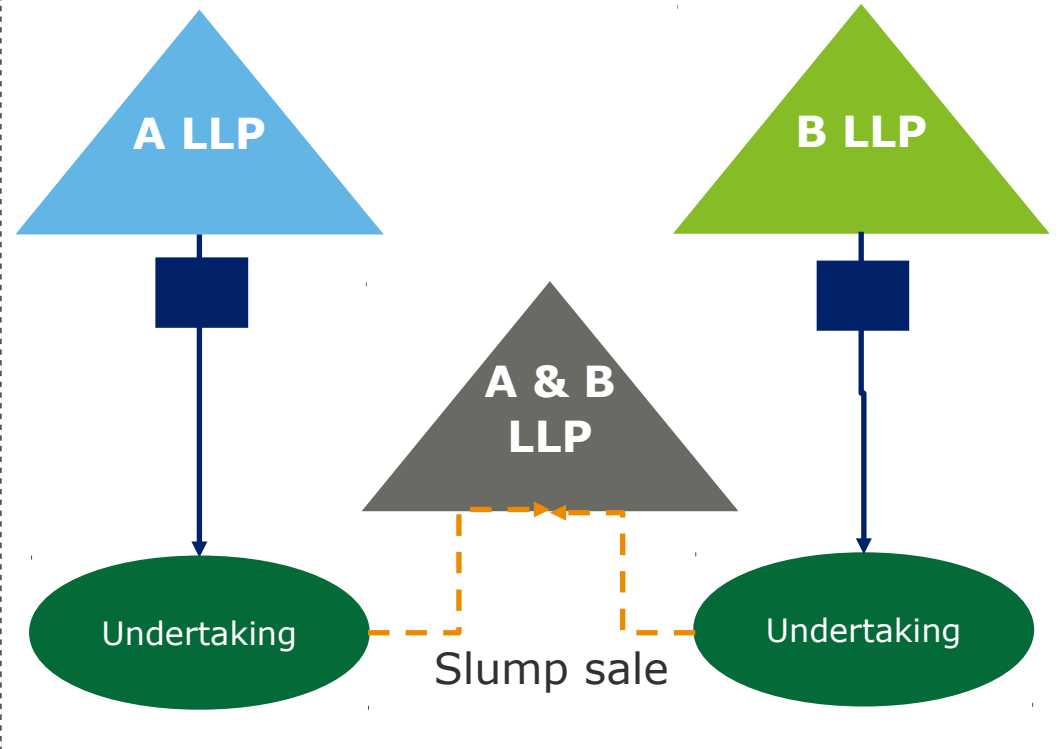
Could the amalgamations be structured in a manner that will achieve the same objectives but with more clarity on the tax implications?

Option #1B- Amalgamation of two LLPs

Slump sale of business undertaking from one LLP to another



Slump sale of business undertaking by the two LLPs to a new LLP

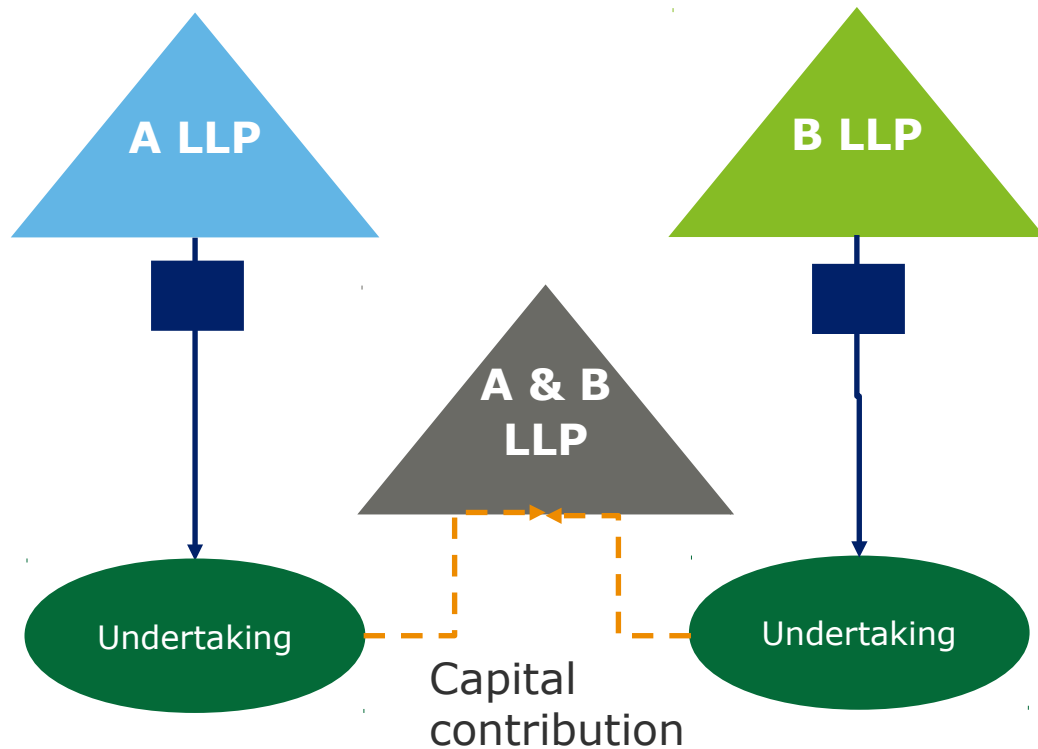


A slump sale at “net worth” (as defined in section 50B) of the undertakings could be explored to achieve the desired objectives in a tax neutral manner

Can GAAR be invoked?

Option #1C– Amalgamation of two LLPs

Contribution of business undertaking as capital contribution in another LLP



Any contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to the limited liability partnership. Such contribution shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government

(Sec 32 of LLP Act, 2008 read with Rule 23 of LLP Rules, 2009)

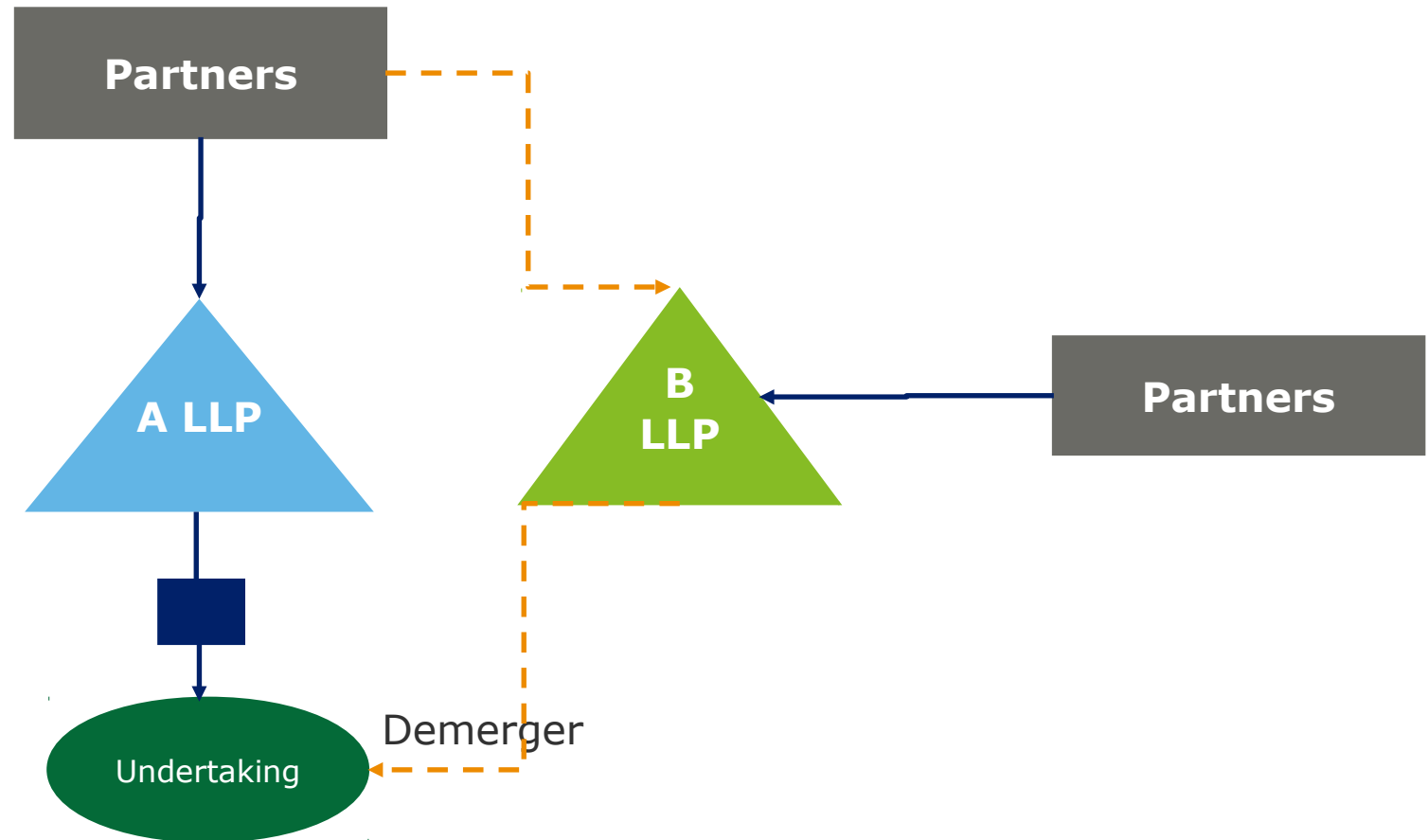
Capital contribution in form of business undertakings could be explored to achieve the desired objectives of consolidation

Can GAAR be invoked?

Option #2 – Demerger

Option #2 – Demerger of LLP

Demerger of business undertaking from one LLP to another



What will be the implications from a tax perspective if the demerger is not as defined in section 2(19AA)?

Option #3 – Conversion (Mitigation DDT / MAT)

Option #3 – Conversion of small private co. /unlisted public co.

Scenario 1: Operating company - Distributes PAT by declaring dividends

Particulars	Company	
Profit after tax / distributable cash profit	100.00	
Less: DDT @ 20.36%	20.36	Dividends entails DDT at an effective tax rate of 20.36% resulting in lower distributions to the shareholders
Distributions to shareholders	79.64	

Scenario 2: Holding company - Pays MAT on book profits

Particulars	Company	
Taxable profits	Nil	
Exempt LTCG on sale of listed equity share	100.00	
MAT @ 21.342%	21.34	MAT at 21.34% is payable on book profits even though there are no taxable profits

Could structuring these companies as LLPs assist in mitigating the DDT / MAT cost?

Option #3 – Conversion of small private co. /unlisted public co.

Scenario 1: Operating company: Distributes PAT by declaring dividends

Particulars	Company	LLP	
Profit after tax / distributable cash profit	100.00	100.00	No DDT on LLP, effectively resulting in approx. 20% higher distributions
Less: DDT @ 20.36%	20.36	NA	
Distributions to shareholders / partners	79.64	100.00	

Scenario 2: Holding company: Pays MAT on book profits

Particulars	Company	LLP	
Taxable profits	Nil	Nil	No MAT on LLP, effectively resulting in savings of approx. 20%
Exempt LTCG on sale of listed equity share	100.00	100.00	
MAT @ 21.342%	21.34	NA	

LLP appears to be a more tax efficient form of doing business vis-à-vis a company (subject to analyzing specific facts of each case)

Option #4 Conversion (Sales exceed Rs. 6 mn) / (Assets more than Rs. 50 mn)

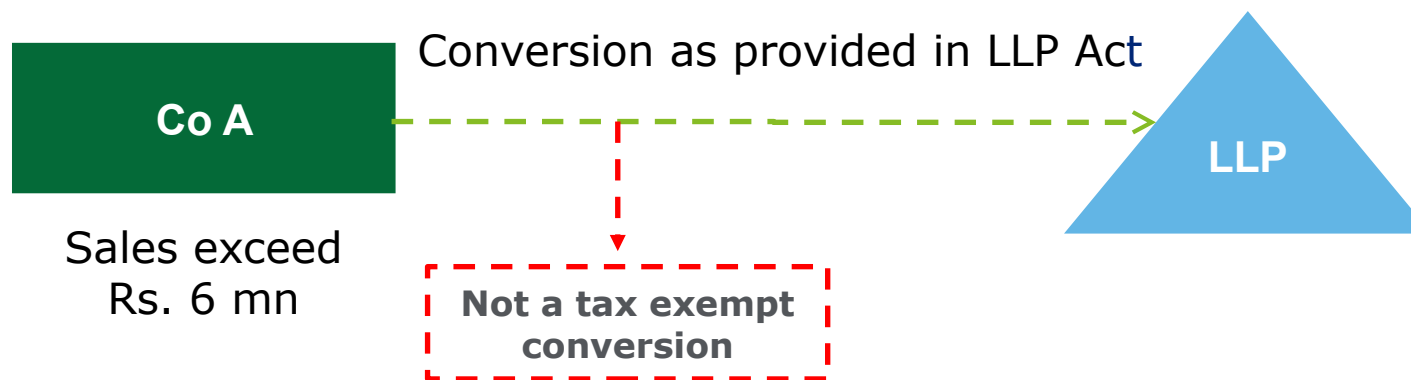
Option #4 – Conversion of small private co. /unlisted public co.

One of the critical condition for a Co. for tax neutrality on conversion to LLP is

Sales, turnover or gross receipts of business in any of the 3 preceding years not to exceed Rs. 6 mn

Query

If the aforesaid condition is not met by a company, can a tax neutral conversion to an LLP be achieved?

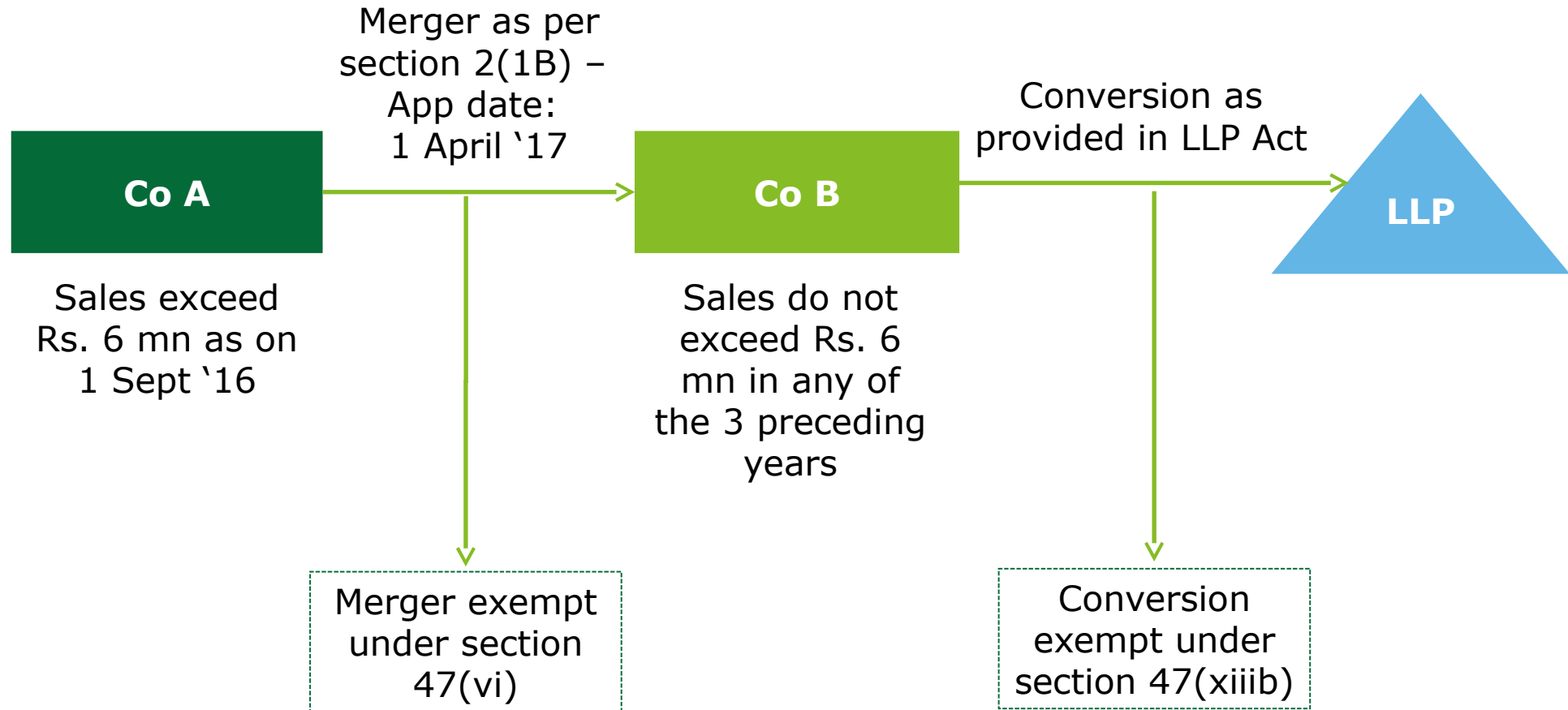


Conversion of a partnership firm into a company is tax neutral whether conditions under Income tax Act, 1961 are satisfied or not – Bombay High Court

Can same analogy be drawn for conversion of a company into LLP whether conditions prescribed under Income Tax Act, 1961 are complied or not

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Option #4 – Conversion of small private co. /unlisted public co.



Can the Tax Authorities deny exemption to a genuine merger between two companies followed by a conversion to an LLP?

Can GAAR be invoked?

Option #5 – Funding LLP

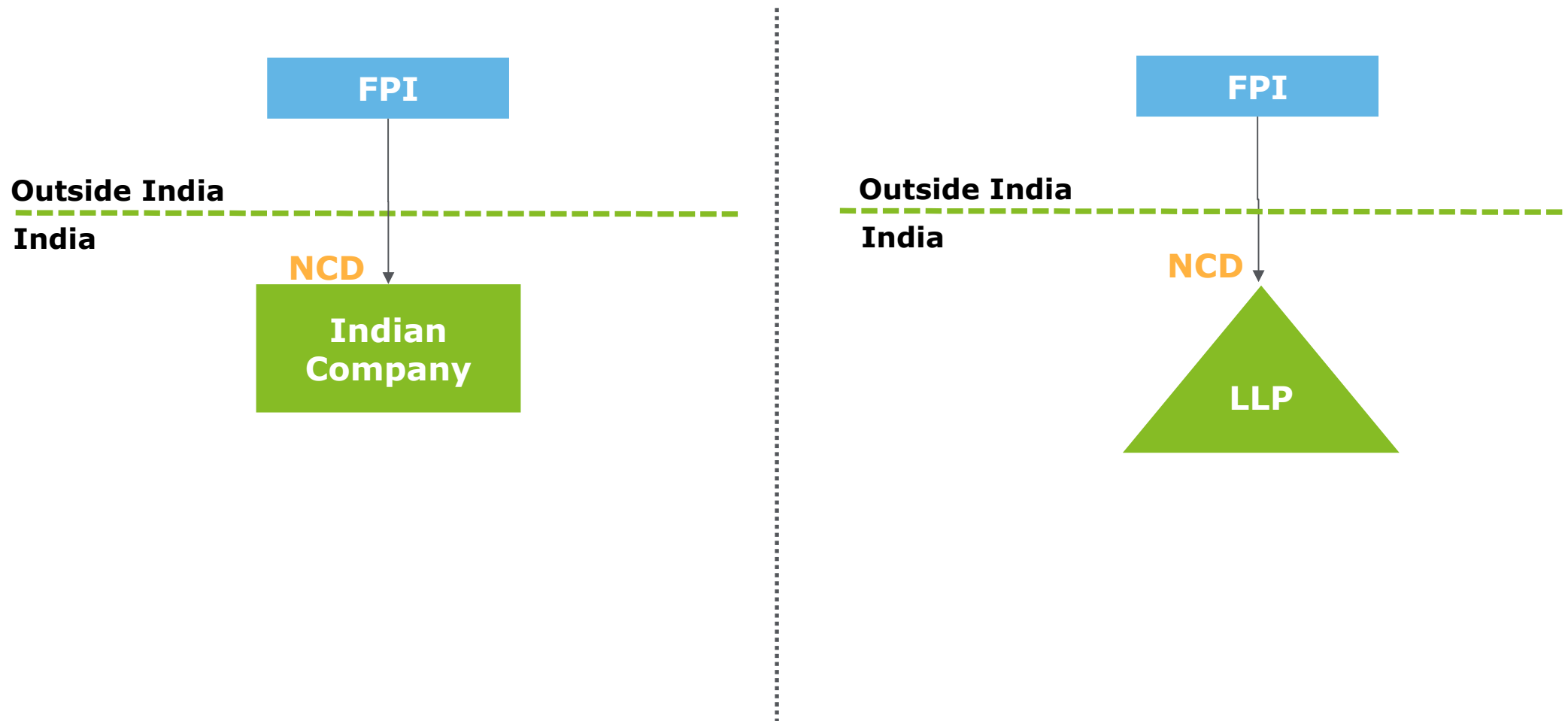
Background

- LLP Act enacted in 2009
- Created substantial anxiety and enthusiasm in the business community due to its advantages over corporate form
- FDI in LLPs approved by the Cabinet Committee on Economic Affairs of the Government of India on 11 May 2011
- FDI policy amended vide Press Note No. 1 (2011 Series) issued by the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India
- Recently, RBI through a notification issued in March 2017, liberalized FDI regulations relating to LLP

Amendments in brief

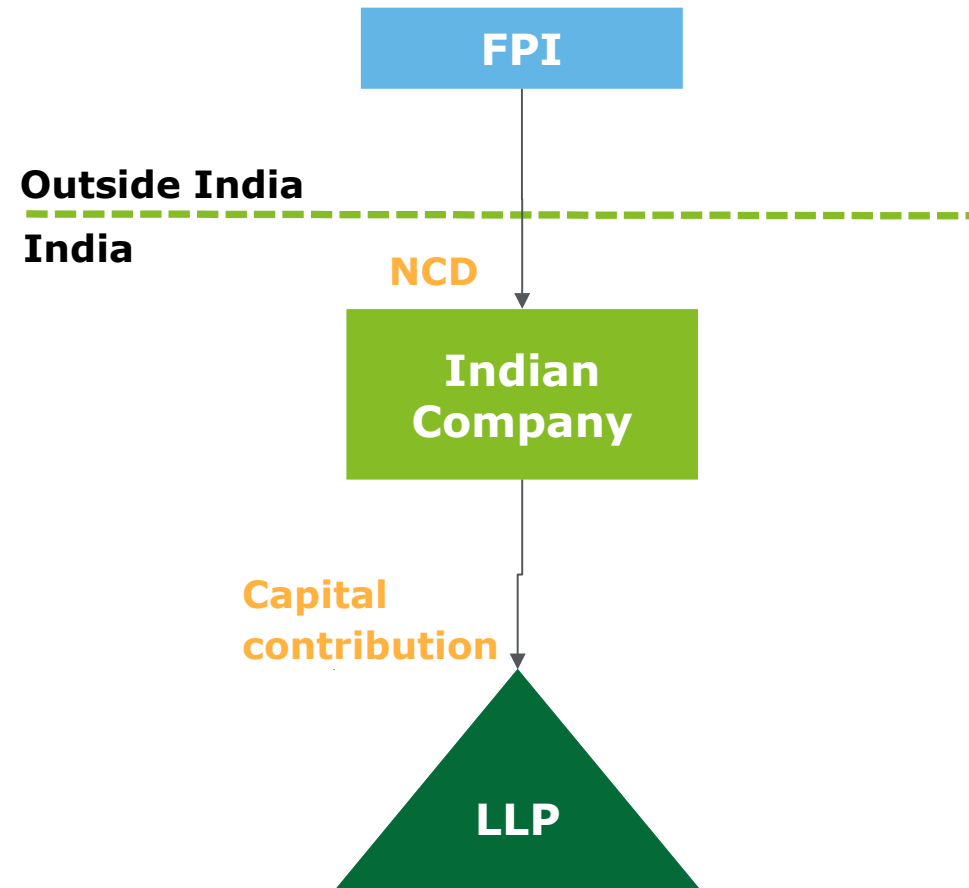
- FDI in LLP allowed subject to following conditions
 - FDI in LLP allowed only in sectors/activities where 100% FDI is allowed under automatic route and there are no FDI-linked performance related conditions
 - LLPs with FDI not allowed to operate in agricultural/plantation activity, print media or real estate business
 - Indian company or an LLP with FDI is permitted to make downstream investment in another company or LLP, only if the company and LLP both are operating in sectors/activities where 100% FDI is allowed under automatic route and there are no FDI-linked performance related conditions
 - Foreign Capital participation in LLPs allowed only by way of cash consideration received by inward remittance through normal banking channels or by debit to NRE/FCNR account of the person concerned
 - FIIs and FVCIs not permitted to invest in LLPs
 - Company with FDI can be converted into LLP under automatic route only if it is engaged in a sector where FDI upto 100% is allowed under automatic route and there are no FDI-linked performance related conditions

Option #5 – Funding LLP – NCDs



Can an LLP raise funds from outside India via NCDs?

Option #5 – Funding LLP – NCDs



Whether such kind of structuring could be explored?

Option #6 – Project specific SPVs

Option #6 – Project Specific SPVs

Facts of the case

- Co VLF is engaged in real estate development
- It proposes to enter into an agreement with certain individuals who owns land parcels for development of a residential project
- As per the agreement, Co VLF will provide its development expertise and the individuals will contribute the land parcels to the joint venture
- Residential units will be sold to independent third parties
- Profits from the sale of residential plots will be shared in the ratio as agreed between the JV partners, viz Co VLF and the group of individuals
- Post distribution of profits, the partners will exit from the project or may decide to jointly commence a new project
- In case of exit, the joint venture partners desire to have the maximum flexibility in appropriately utilizing / up streaming the funds

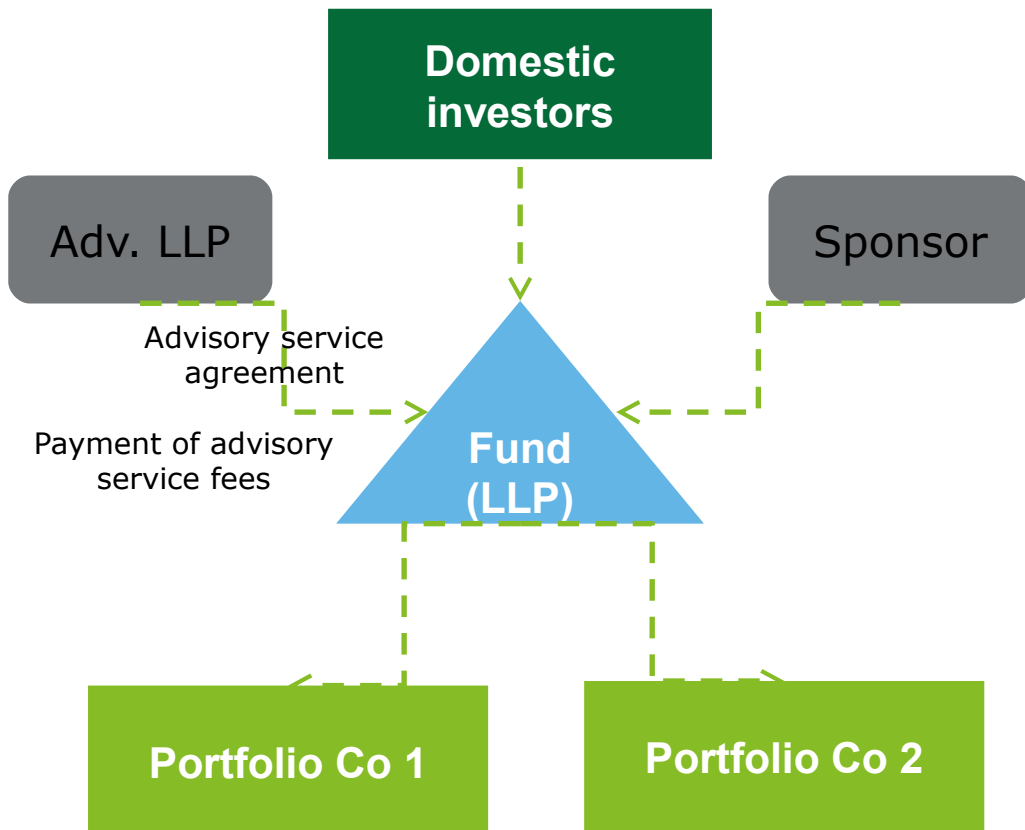
Considering the facts of the case, ascertain whether a joint venture company or LLP should be formed for such project specific SPVs?

Option #6 – Project Specific SPVs

Joint Venture Company	LLP
1. Any distribution of profits during the operational stage of the project will entail DDT	1. No DDT cost. Up streaming of profits is relatively easier
2. Grant of loans / advances to any group companies could trigger deemed dividend provisions	2. Deemed dividend provisions are not applicable to LLPs
3. Stringent requirements under corporate law to be met for any loans / advances to group companies	3. Corporate law requirements not applicable to LLPs
4. At the end of the project, due to the above constraints, funds could get locked in the joint venture company	4. LLPs provide greater flexibility to utilize funds
5. Merger, a court approval process, with parent / group company may have to be undertaken to effectively close the company	5. Dissolution and winding of LLPs could be relatively easier

Option #7 – Fund structuring

Option #7 – Fund structuring

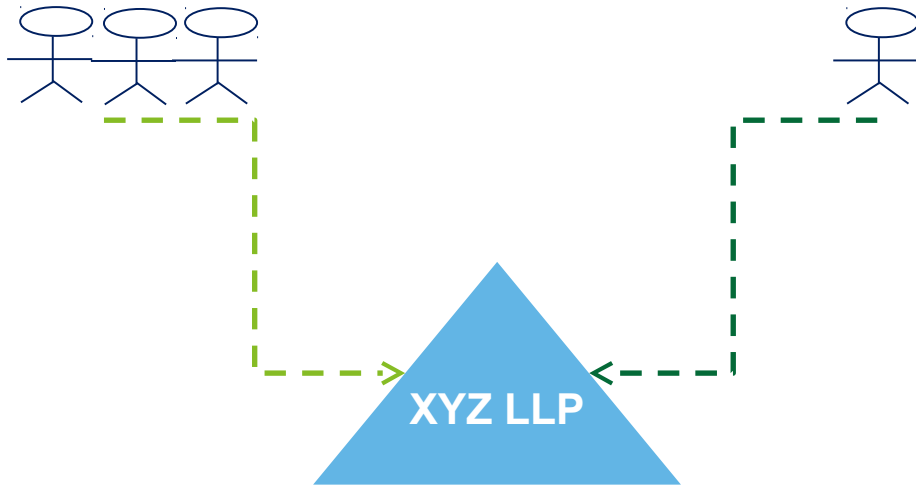


- Fund would be set up as a LLP
- Sponsors would act as designated partners
 - Other domestic investors in the LLP would act as limited partners
- Fund would enter into advisory service agreement with the Fund Manager (Adv. LLP)
 - Role of the Adv. LLP – Identify and advice on various investment opportunities
- Income earned by Fund would be distributed to the investors as per the

LLPs could be structured as a tax efficient fund pooling vehicle as well as advisor to the fund

Option #8 – Exiting LLP

Option #8 – Exiting LLP



- Individuals A B C are partners in XYZ LLP
- XYZ LLP is a profit making LLP since its incorporation in 2011
- Individual A now wishes to transfer his partnership rights in XYZ LLP to Individual D
 - Transfer to be in accordance with the LLP agreement
- Tax authorities are likely to contend that Individual A should pay capital gains tax on such transfer of partnership rights

Can Individual A have a tax efficient exit from the LLP?

Option #8 – Exiting LLP

- Individual A could consider ceasing to be a partner in XYZ LLP and withdrawing the following amounts from XYZ LLP:
 - His original capital contribution; and
 - His share in the profits of the LLP

- Withdrawal of the aforesaid amounts from XYZ LLP should not trigger any tax consequences for Individual A or XYZ LLP

- Individual D, the new partner, to contribute an amount equivalent to the amount withdrawn by Individual A to XYZ LLP for a partnership interest equivalent to Individual A's earlier interest

- Capital contribution by Individual D should not trigger any tax consequences for Individual D or XYZ LLP

Questions?

Thank you