

# TAXATION OF LIMITED LIABILITY PARTNERSHIP

Seminar on LLP on 14<sup>th</sup> February 2015  
CA. S. V. Shanbhag

# LIMITED LIABILITY PARTNESHIP

- ❖ TAX ADVANTAGES
- ❖ BASIC TAXATION ISSUES
- ❖ ISSUES ON CAPITAL GAINS
- ❖ CONVERSION

# TAX ADVANTAGES OF LLP OVER A COMPANY:

- ❑ DDT not applicable to LLP
- ❑ Deemed Dividend provisions [2 (22) (e)]
- ❑ Interest on Capital allowed as Expenses
- ❑ Carry forward & Set off Loss - less stringent provisions
- ❑ Wealth tax is not applicable
- ❑ No capital gain tax on conversion to LLP

# BASIC ISSUES ON TAXATION OF LLP

# STATUS OF LLP FOR TAX PURPOSE

## ■ LLP to be taxed as a 'FIRM'

Section 2(23) Definition of 'Firm' (Amendments by Finance Act (2) 2009)

- ❖ 'Firm' to include LLP.
- ❖ 'Partnership' to include LLP.
- ❖ 'Partner' to include 'Partner of LLP'.

## □ Scheme of Taxation of LLP

Single point Taxation/Share of Profit Exempt u/s 10(2A)

# RESIDENTIAL STATUS

<b>SR.NO</b>	<b>CONTROL AND MANAGEMENT</b>	<b>STATUS</b>
<b>1</b>	Situated fully in India	Resident
<b>2</b>	Situated partly in India	Resident
<b>3</b>	Wholly situated outside India	Non-resident

# RATE OF TAX

Sr. No.	Particulars	Rate	Surcharge	EC+SHEC	Effective Rate
1	General rate	30%	NIL	3%	30.9%
2	Short Term Capital Gain u/s 111A	15%	NIL	3%	15.45%
3	Long term capital Gain	20%	NIL	3%	20.6%

# Wealth Tax-Applicability to LLP

## ■ Section 3(2) of Wealth Tax Act

Wealth Tax is applicable on Net wealth of Individuals, HUF and Company excluding Rs.30 Lakhs .

## ■ Section 2(h) of Wealth Tax Act

1. Company as defined under section 2(17) of Income Tax Act
2. Sec.2(17) does not include LLP



# Foreign LLP -How Taxed in India

- ❖ What is Foreign LLP ?
- ❖ Is it a 'FIRM' or a 'Company' ?
  - Definition of LLP under LLP Act includes only Indian LLPs 2(1)(n)
  - Definition of 'Company' under IT Act includes Body Corporate incorporated outside India 2(17)
  - Foreign LLP is a Body Corporate under LLP Act 2(1)(d)

## Accounts & Audit of LLP

- Maintenance of Books is Compulsory
- Cash or Accrual Basis is permitted
- Double Entry system of accounts

### Issues:

- Can a LLP maintain books on Accrual basis under LLP Act & Cash basis for IT ACT ?
- What is the limit of turnover for getting the accounts audited
- Whether LLP can offer Income to tax on Presumptive basis u/s 44AD

# Due Date for Filing Return of Income tax

## Sec.139(1)

1	If accounts are required to be audited under the act or any other law	30 <sup>th</sup> September
2	If accounts are Not required to be Audited under any Law	30 <sup>th</sup> July

## Issues:

- Who can sign the Return of Income of LLP ?
- What is the limit of turnover for getting accounts audited ?

# ASSESSMENT OF LLP

(sec.184)

1. An LLP may be Assessed as 'Firm' if
  - i. LLP is evidenced by an instrument.
  - ii. Individual share of Partners specified.
  - iii. Duly signed copy of LLP agreement should be submitted incase of ITR .

Circular 3/2009/21.5.2009

LLP agreement deemed to have been submitted in case of online filing .

# ALLOWABILITY OF REMUNERATION TO PARTNER

## Conditions u/s 40(b)

- ❖ Remuneration only to working Partners.
- ❖ Remuneration should be authorized by and in accordance with Terms of Partnership Deed
- ❖ Remuneration should not pertain to period prior to Deed of Partnership.
- ❖ Remuneration not to exceed permissible limits.

<b>BOOK PROFIT</b>	<b>REMUNERATION</b>
First Rs.3 Lakhs	Rs. 1.5 Lakhs or 90% of Book Profit whichever is higher
Balance Amount	60% of Book Profit

# Remuneration to Partner

## Issues:

- ❖ Is it necessary to quantify remuneration payable to each Partner ?

**CBDT Circular no. 739/25.3.96**

**{CIT VS Anil Hardware Stores [2010] 323 ITR 368 (HP)}**

- I. Amount of remuneration payable to each partner be specified OR
  - II. Manner of Quantification of remuneration be specified.
- ❖ Whether Remuneration paid can be disallowed u/s 40A(2) as excessive ?

# INTEREST TO PARTNERS CONDITIONS

[Sec.40 (b)]

Payment of interest should be

- a) Authorised by deed of LLP
- b) Interest should not pertain to the period prior to Deed of Partnership
- c) Interest should not exceed 12%.

# INTEREST TO PARTNERS

## ISSUE:

Whether ceiling of 12% is applicable in following cases

- Interest on loan taken from a Partner
- Interest paid to a partner in a representative capacity.

*Eg: X represents a HUF which is a Partner in a LLP.  
Whether Interest @ 14% paid to X is allowed ?*

- Interest paid to Partner for loan taken from his Minor child.
- TDS on interest applicable ? **194A(1)(iv)**



## Share of Profit From LLP

- Share be calculated as per the LLP agreement .
- Post Tax Profit of LLP is exempt in the hands of LLP Partner u/s 10(2A)

## Issues

- Whether Share of profit from Foreign LLP is exempt u/s 10(2A) ?
- Whether a company which is a partner in LLP can claim exemption u/s 10(2A) ?

- Whether share of profit from LLP is included for calculation of Book profit u/s 115JB.
- Whether benefit u/s 10(2A) is admissible to minor partner of LLP.
- Applicability of clubbing provisions u/s 64(1A) for minor's share of Profit
- Applicability of Sec.14A to share of Profit?  
DJ Mehta (2007) 104 ITD 527 ITAT(MUM)  
Sudhir Dattaram Patil vs DCIT 2005 2SOT 678 (MUM)

# Set off/Carry Forward of Losses of LLP (sec.78(1))

[As compared to sec.79 applicable to company]

- Change in Constitution of a **firm**.  
Death/Retirement/Resignation
- Retired/Deceased Partner's share of loss cannot be carried forward u/s Sec.78(1).
- Share of loss of continuing partners is allowed to be carried forward.
- Change in the Profit sharing Ratio does not amount to change in Constitution.

## ISSUES

Whether benefit of Sec.78(1) is available to LLP

# Recovery of Tax

## sec.167C

- ❖ Partners are jointly and severally responsible for payment of tax liability of LLP unless he proves that the non recovery cannot be attributed to gross neglect , misfeasance or breach of duty.
- ❖ Partners are jointly and severally responsible for the payment of tax liability even if LLP gets converted into a company

### Issue

Is it fair to make every LLP partner liable for recovery of tax ? (refer sec.179 applicable to co.)

# Whether a Minor can be admitted as Partner ?

1. Provisions in General Partnership Act [sec.30(1)]
2. Provision in LLP Act (sec.5)
3. No express prohibition for Minor
4. Any implied prohibition ?
  - i. Notice of change should be signed by incoming Partner [25(3)(C)]
  - ii. Partner needs to sign the LLP agreement 2(1)(9)

## ISSUE

Minor is a Partner in General Partnership .  
Firm is converted to LLP. Whether Minor  
can continue as a partner in LLP ?

### Para 11/Sch.2 LLP Act

For every Agreement to which firm is a  
party, LLP would become party after  
conversion.

ISSUES RELATED  
TO  
CAPITAL GAINS IN LLP

# Contribution of a Capital Asset by a Partner

[Sec.43(3) of IT Act]

## ■ Sec.32 of LLP Act (contribution)

Partner may contribute movable , immovable tangible , intangible , cash, property and service contracts as Capital.

## ■ Rule 23 of LLP Rules 2004

Contribution be valued by a practicing Chartered Accountant or Cost Accountant or by an approved valuer.



- ❖ Profits and Gains arising from transfer of a Capital Asset as Contribution by partner is chargeable in his hands as Capital Gains.
- ❖ Amount credited to Capital Account of Partner is contributed as full value of consideration.

## ISSUES

Whether Section.50C overrides Section.45(3)

Carton Hotels Private Ltd vs ACIT (2008) 122 TTJ ITAT Lucknow

# REALIGNMENT OF PROFIT SHARING RATIO IN LLP

- ❖ What is realignment of PSR ?
- ❖ Whether Realignment of Profit sharing ratio amounts to transfer u/s 2(47) ?
- ❖ Whether Section 45(4) covers the cases of realignment of profit sharing ratio distribution of capital asset in the cases of dissolution

# Revaluation of Capital Asset by LLP

- Revaluation of Capital assets and crediting Difference to Capital accounts is not a 'Transfer' u/s 2(47).
- Whether Interest @ 12% is a allowable on enhanced Capital due to Revaluation  
**ACIT vs Sant Shoe Stores(2004) 88 ITD 254 (ITAT Chd)**

# Assignment of Interest in LLP

(Sec .42 of LLP Act)

- Whether Transferee or Assignee of 'Interest in LLP' gets benefit of 10(2A) ?

*No, Assignee is not a partner.*

- Whether Gift of 'Interest in LLP' liable to be taxed in the hands of Donee ?

*No. Sec 56(2)(vii) which give exhaustive list of 'Properties' to which that section applies does not include interest in LLP .*



# CONVERSION OF LLP

Sr. No	Type of Conversion	Section/Schedule of LLP
1	PARTNERSHIP to LLP	Sec.55 LLP Act & Schedule II
2	PRIVATE LIMITED COMPANY to LLP	Sec.56 & 57 LLP Act & Schedule III & IV
3	UNLISTED PUBLIC LIMITED Co. to LLP	Sec.56 & 57 LLP Act & Schedule III & IV

# Conversion of Firm to LLP:

## 1. Provisions in LLP Act

- ❖ All partners of Firm to become partners of LLP.
- ❖ All the Assets and Liabilities of Firm are transferred to LLP .

## 2. Provisions under Income Tax Act

- ❖ No provision for taxation in case of conversion of General partnership to LLP.
- ❖ Finance Act (no.2) or Finance Act 2010 has not even made any amendment in Sec.2(47) or Sec.47

- ❖ Conversion of firm cannot be treated as 'Transfer'

### Explanatory memorandum to Finance act 2009

Conversion has no tax implication if

- Rights and obligations of partners remains same after conversion.
  - No transfer of any Asset or Liability takes place after conversion.
- ❖ Transferor and Transferee are not different
  - ❖ No amendment is made in definition of 'Transfer' (u/s 2(47) or deemed transfer u/s 45

CIT vs Taxpin Engg & Mfg works (2003) 263 ITR 345



## Conversion of Company to LLP:

### Conversion not Taxable:

- ❖ New provision u/s 47 (xiiib) from AY 2011-12.
- ❖ Transfer of Capital Assets or Intangible Assets or transfer of share or Shares on conversion to LLP is not regarded as transfer for Capital Gains purpose subject to six conditions.

### Taxable on violation of conditions:

- ❖ Where any conditions u/s 47(xiiib) are not complied, capital gains arising from transfer of such capital assets deemed to be taxable capital gains of successor LLP or predecessor company in the previous year in which non-compliance takes place . (sec.47A(4))

## SIX CONDITIONS PRESCRIBED u/s 47(xiiib)

1	Eligibility Criteria	Average annual total sales/turnover/gross receipts of the company does not exceed Rs.60 Lakhs in any 3 preceding previous years
2	Conditions at conversion stage	<p>I. All shareholders of the company before conversion become partners of the LLP and capital /profit sharing ratio in the LLP should be in same proportion as their shareholding in the company</p> <p>II. Shareholders of the company receive no consideration other than shares in contribution and PSR in the LLP</p> <p>III. All assets and liabilities of the company are transferred to LLP</p>
3	Conditions after Conversion	<p>I. Erstwhile Shareholders of the company to retain atleast 50% PSR for 5 years from date of conversion</p> <p>II. No distribution of accumulated profits of the company as on the date of conversion for 3 years from date of conversion</p>

## Condition:1

❖ *The Total Sales, Turnover or Gross Receipts in business of the company do not exceed Rs.60 Lakhs in any of the three previous years preceding the previous year in which conversion takes place .*

### Issues:

- Total Sales/Turnover/Gross receipts not defined
- Turnover qua year ; not average turnover.
- If Company is in existence for less than three years ?
- Turnover to exclude material supplied by party in contract business .(Circ.684/10.6.94)
- More than one Business

## Condition :2

- ❖ *All the shareholders of the company immediately before the conversion become partners of the LLP. Their capital contribution and profit sharing ratio should be in the same proportion as their shareholding in their shareholding in the company as on the date of conversion.*
- ❖ Issues:
  - I. Includes Preference Shareholders ?
  - II. Registered Shareholders or beneficial shareholder?
  - III. Minor Shareholders of Company
  - IV. Suitable clause in LLP agreement to bind partners continue for five years to avoid Tax liability.

## Condition:3

❖ *All assets & liabilities of the Company immediately before the conversion become the assets and liabilities of the LLP*

### Objective:

1. Conversion be a total conversion so that all assets & liabilities are vested in LLP
2. No part of asset be transferred to any partner on conversion

## Condition :4

- ❖ *The shareholder of the company do not receive any consideration or benefit other than share in profit and capital contribution in the LLP*
- ❑ The words consideration or benefit be read as in connection with 'Conversion'

## Condition:5

❖ *PSR shall not be less than 50% for a period of five years from the date of conversion*

## Example:

Date of Conversion 01.04.2014

Partner	PSR 31.03.2014	01.04.2014 to 31.03.2019			
		Partner	PSR	Partner	PSR
A	50	A	25	A	20
B	50	B	25	B	25
		C	30	C	30
		D	20	D	25
		<u>Permitted</u>		<u>Not Permitted</u>	

## Condition :6

- ❖ *No payment to any partner out of accumulated Profits of Company for 3 years*

### Objective:

1. Conversion should not be used as a medium to avoid paying DDT by Company.
2. Funds be utilized for Business.

### Planning:

1. Issue Bonus Shares & avoid possible dispute from New LLP partners claim on accumulated profit.
2. Capital account balance in LLP will enhanced & higher interest on Capital can be claimed.



# Unabsorbed Loss/Depreciation:

- **Sec.72A (6) Finance Act, 2010: Unabsorbed Loss/Depreciation of Predecessor company will be allowed to successor LLP if Condition in 47 (xiiib) satisfied**
- When allowed: It will be allowed in the previous year which conversion took place
- When denied: If conditions are violated benefit of loss allowed to LLP is withdrawn & tax charged in the year of violation.
- Accumulated Loss: includes 'Business Loss' only; not Speculation loss.

## Depreciation Apportionment between Predecessor Company & Successor LLP:

- Annual depreciation apportioned in the ratio of No. of days assets used by Predecessor Company & Successor LLP.
- Apportionment Rule applies only if conditions in 47 (xiiib) complied.

Knowledge Speaks  
But  
Wisdom listens

THANK YOU