TAXATION IN A LLP

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Great things in business are never done by one person. They are done by a team of people. - Steve Jobs

INTRODUCTION-

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.[1] In order to constitute a partnership, the parties must enter into a contract to make the partnership valid. There are five essential elements to constitute a partnership. They are-

1. Contract- partnerships do not arise out of inheritance, operation of law or status of parties but is an outcome of a contract. A contract becomes the most basic and foundation step in formation of a partnership no matter whether it is either express or implied or can be made in oral or in writing. 'Relation of partnership arises from contract and not from status.'[2]
2. Association of two or more persons-in order to construe a valid contract, it is necessary that at least two people are into it. As partnership is the outcome of a contract, it becomes necessary that two or people are involved in it. In a partnership firm, there is no limit for the maximum number of partners but in a company, there must be a maximum of 10 partners in a banking business and 20 in any other business[3] and the involvement of more partners than the specified number, the business will be considered illegal.
3. Carrying on of business- the parties in a partnership must agree to carry on a business and mere charitable work does not amount to business and there will be no partnership.

[1] Section 4 of the Indian Partnership Act, 1932.
[2] Section 5 of the Indian Partnership Act, 1932.
[3] Section 11of the Companies Act, 1956.

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Moreover, even if the members decide to divide their income or the goods among themselves, there will not be any partnership as there is no carrying of any business. As seen in the case of Govind Nair v. Maga[4], the owners of a tea shop shared the money equally and purchased the required utensils and pottery for their job and then rented that shop which was shared by them equally. The court held that they were mere co-owners and not partners as there was no carrying of any business. Therefore, carrying of any business means that there should be repetition or continuity of acts, and an isolated single transaction between the parties does not amount to carrying of a business.

4. Sharing of profits-in a partnership, the members must carry on a business with an object to share their profits among the partners only. There can be no partnership, if only one partner is making profit for the whole business. However, sharing of loses does not constitute to any ground for partnership. This could be seen in the case of Raghunandan v. Harmajee[5].
5. Mutual Agency-another essential element to constitute a valid partnership is mutual agency. The partners act as both principal and agent for themselves as well as for the other partners. The acts done by the partners can bind the other partners and the decisions and acts by other partners binds an individual partner in a course of partnership business. Thus, every partner can carry on a business on behalf of other partners.

From the above we can note that there is no single element to test the validity of a partnership. Sometimes, in one case, there can be sharing of profits among the partners but may not be any business; in other case there may be a business but no sharing of profits and even if there is both sharing of profits between the partners and also carrying of a business, there might not be a principal and agent relationship among the partners. Thus, there would be no partnership if either of the case if present. Hence, there should be all the elements present, in order to constitute a legally valid partnership. "In determining whether a group of persons is or is not a firm or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all the relevant facts taken together."[6]

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[4]AIR (1948) Mad. 343.
[5] AIR (1927) Bom. 187.
[6] Section 6 of the Indian Partnership Act, 1932.

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In a partnership, each and every partner has certain rights which he can legally enforce. They are- "

1. Right to take part in the conduct of business
2. Right to be consulted
3. Right to access to books and records and accounts of the business
4. Right to share profits
5. Right to interest on capital
6. Right to interest on advances
7. Right to indemnity."[7]

Given with these rights, partners are also entitled to agree upon duties which they must fulfill. The duties of partners are classified under two ways-

1. Absolute duties- these duties are mandatory in nature and are imposed by law. These duties are not subject to variation as per the agreement by the partners and are applicable to all partnerships. Following are the types of absolute duties of the partners-
   - Duty to carry on the business to the greatest common advantage
   - Duty to be just and faithful inter-se
   - Duty to render true accounts
   - Duty to provide full information
   - Duty to indemnify for loss caused by fraud
   - Duty to be liable jointly and severally
   - Duty not to assign his interest.
2. Qualified duties-the partners can make their own agreements whether expressed or implied and if there is absence of any contract, the parties must obey the duties prescribed to them in the Partnership Act, which are[8]-

[7] http://www.yourarticlelibrary.com/accounting/partnership-account/partnership-definition-rights-and-duties-of-partner/54055/

[8] http://www.yourarticlelibrary.com/accounting/partnership-account/partnership-definition-rights-and-duties-of-partner/54055/

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- Duty to attend diligently to his duties
- Duty to work without remuneration
- Duty to contribute to the losses
- Duty to indemnify for willful neglect
- Duty to use firm's property exclusively for the firm
- Duty to account for personal profits derived
- Duty not to compete with the business of the firm.

LIMITED LIABILITY PARTNERSHIP-

According to law, a 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 member the flexibility for organizing their internal structure as a partnership."[9] It is also known as an alternate corporate vehicle which seeks to attain principal benefits of both forms of business organizations- partnership and companies.[10] When placed in a historical perspective, the development in the field of LLP can be seen as more evolutionary than revolutionary.[11] The concept of LLP surfaced in US after the energy price crisis and real estate crisis in the 1980s. Before the introduction of the concept of a LLP, the liabilities of partners in a company were unlimited and they were held liable for acts which did not have any relation with them. To overcome the problems faced by the partners, the first legislation was passed on LLP as the Texas House Bull 278 in US. After this legislation other states started following it.

Soon the concept of LLP was brought in India where the cabinet approved the Limited Liability Partnership Bill, 2006. This bill was then introduced in the Rajya Sabha and later referred to the Standing Committee on Finance for examination. After the reports given by the committee, the Limited Liability Partnership Act, 2008 was passed.

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[9] http://www.charteredclub.com/what-is-a-limited-liability-partnership-llp/
[10] Amit M. Sachdeva & Sachin Sachdeva, The Indian LLP Law: some Concerns for Lawyers and Chartered Accountants, SEBI& Corporate Law, Vol. 92 No. 6, 2009, 1 available at http://ssrn.com/abstract=1423766 (Last seen on 19 February 2016).
[11]Robert W. Hillman, Limited Liability in historical perspective, Washington and Lee Law Review, Vol. 54, Issue 2.

To understand the concept of LLP, the differences of LLP with other forms of businesses must be understood.

Limited liability partnership and Company-

Company is governed by the Companies Act, 2013 and various other rules made there under while the Limited Liability Partnership Act, 2008 is the governing law for a limited liability partnership. In a company, the members can be held liable according to the shares they hold while in limited liability partnership, the partner's liability is limited to their contribution in capital. However, if a partner acts intentionally to commit a fraudulent act, he is held personally liable. In case of a private company, the company has to pay a minimum capital of Rs. 1 Lakhs and in case of a public company, a minimum of Rs. 5 Lakhs is required. But in case of a limited liability partnership, there are no such requirements of any minimum capital deposits.

Limited liability partnership and Partnership Firm-

A partnership firm is governed by the Partnership Act, 1932 and the Limited liability partnership under the Limited Liability Act, 2008 and is not bound by the Partnership Act, 1932. In limited liability partnership, the partner's liability is limited to their contribution in capital. However, if a partner acts intentionally to commit a fraudulent act, he is held personally liable. While there is a unlimited partnership in a partnership firm. According the Limited Liability Act, the accounts of a LLP should be annually audited expect for LLP's having a turnover of less than Rs. 40 Lakhs contribution in any financial year. While in a partnership firm, the accounts are audited as per the provisions prescribed by the Income Tax Act.

ADVANTAGES OF A LLP-

1. Easy to form- the process to form an LLP is easy and does not involve much formality as compared to companies which requires a lot of formalities. Moreover, the minimum fee for incorporation of a LLP is Rs. 800 and maximum is Rs. 5600.

2. Body corporate- a LLP is a corporate body, which implies that it has its own independent existence as company and partnerships. LLP will be known by its name; and the LLP and its partners will be treated as a separate entity in the eyes of law.
3. No minimum contribution required- the capital requirement of a LLP is not very high. For a private LLP, the minimum capital required is Rs. 1, 00,000 and for a public LLP, it is Rs. 5, 00,000.
4. Compulsory audits not required- it is necessary for all the limited companies, whether public or private to get there accounts audited. However, a LLP only needs to get the audit done if either the LLP's contribution exceeds Rs. 25 Lakhs or the turnover of the LLP exceeds Rs. 40 Lakhs.[12]
5. Lower compliance burden- while a private limited company has to file 8-10 regulatory compliances and formalities, a LLP has its benefit as it has to file only 2 compliances which are the Statement of Account & Solvency and Annual Return.
6. Non applicability of Dividend Distribution Tax- if an owner in a company withdraws any profit from the company, then an additional tax liability of DDT @ 15% is payable by the company while, in the case of a LLP, profits can be easily withdrawn by the partners and no tax is payable.

DISADVANTAGES OF LLP

1. As the LLPs are being benefitted in terms of taxes and also their tricky working, they are not allowed by many states to operate in their regions. LLP's are more oftenly not recognized as a legal business.
2. While some states do not recognize LLPs, majority of states impose large tax limits on LLPs.
3. Foreign direct investment is not permissible in LLP through automatic route. It is only allowed through government route. Essentially, an individual or a foreign company can invest in a LLP by the prior approval of the government.

[12] https://www.indiafilings.com/learn/llp-advantages/ (last visited on 3rd March 2016)

4. Many of the LLPs are not considered as credible business by many clients and consumers. Comparatively, companies and partnership firms gain more success and respect than a LLP.
5. External Commercial Borrowing (ECB) is not allowed in a LLP. That is, a LLP cannot take commercial loans from its foreign partners, FII's (Foreign Institutional Investors), banks from outside India, any financial institution outside India or any other entity outside India.[13]
6. For transferring of ownership of any one of the partner, he has to take consent of all other partners. Moreover, a single person cannot form a LLP. People who are not residents of India cannot form a LLP, unless one of the partners of the LLP is a resident of India. Also, once the partners have contributed their assets or cash to LLP, it cannot be returned unless there is any provision in the agreement.

TAXATION IN A LLP-

A Limited liability partnership is given the status of a corporate and hence it is not taxed separately from its members. The members in a LLP are treated as if they are partners in a partnership firm and serve for the purposes of corporation tax, income tax and capital gains tax. Hence, the members of a LLP are benefitted of limited liability as they retain the tax advantages of a partnership. Also, as the taxation of a LLP is treated as the same way as that of a partnership firm, the income tax on LLPs are also levied the same as on the income tax on partnership firms.

However, the tax structure of a LLP being same as that of a partnership firm, there is one section, i.e. section 44AD of the Income Tax Act, 1961, whose benefits cannot be claimed by a LLP and this section is only applied to the partnership firms. The individual who takes up this scheme is not liable to pay the advance tax for their business. Section 44AD is known as the Presumptive Taxation Scheme and was incorporated by the Income Tax law to provide assistance

[13] http://www.marketexpress.in/2013/04/limitations-disadvantages-llp.html (last visited on 3rd March 2016).

and relief to small assesses in a business. According to this section, the taxpayer can assume his income to be 8% of the total turnover and pay tax on the income so computed.[14]

The provisions of section 44AD are applicable to such resident assesses who is an individual, Hindu Undivided Family and Partnership firm but not Limited Liability Partnership.[15] This scheme is not applicable for any profession prescribed under section 44AA or any business which is earning its income through brokerage or commission or any business of agency and according to section 44AD only the particular categories of small assesses in business can opt while there is no prescription of how this scheme can be opted by a LLP which is not an agency business, not earning its income through brokerage or commission and also does not come under the prescription of section 44AA of Income Tax Act.

CONCLUSION

The presumptive taxation is only applied only to firms if their turnout is below 1 crore, however, if a LLP has a turnout of below 1 crore, thus scheme cannot be applied and it becomes difficult for a new LLP with a lower turnout to get benefits on taxes. This way the newly entered LLP members are discouraged in opening up their businesses as they cannot be given presumptive taxation scheme as it is only applicable for the partnership firms. Thus to overcome this problems faced by the members of the LLP, there must be amendment in the Limited Liability Partnership Act, 2008 to make provision to facilitate and give assistance to small businesses.

[14] http://www.charterclub.com/section-44ad/ (last visited on 21 february 2016).
[15] http://taxguru.in/income-tax/advance-learning-section-44ad-theory.html