

Critical Aspects of - FORMATION & CONVERSION OF LLP

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INDEX

- Why do we need separate form of organisation?
- What is LLP?
- Comparison of existing options
- Who can prefer LLP?
- Who can not go for LLP?
- Incorporation of LLP
- Important Concepts in LLP
- Conversion
- Critical aspects of conversion

**Why do we need
separate form of
organization ?**

Rationale - Need for a separate form of organization

- There is a need for Multi Disciplinary Professionals Firm
- There is restriction on number of partners u/s. 464
- BIG Hurdle is the liability of all partners is unlimited

Rationale - Need for a separate form of organization

- SME can not cope up with corporate financial rigidity [i.e. Dividend, capital and related party transaction]
- SME can not cope up with compliance requirements in Company
- SME sector generally do not raise money from public

What is LLP?

- Partnership Registered in this LLP Act
- Word Partnership is not defined in LLP
- Provisions of Partnership Act – not applicable
- Provisions of Companies Act [except winding up] - Not applicable
- LLP Agreement is the source [Se 23]

Comparison with existing options

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Particulars	Partnership	Limited Liability Partnership	Company
Legal Entity	No separate entity	Separate entity	Separate Legal Entity
Perpetual Succession	Not applicable	Applicable	Applicable
Liability	Unlimited	Limited	Limited

Perpetual Succession ??

- LLP has perpetual Succession
- Legal Heir does not have right to become partner [unless agreement provides]
- LLP Act + First Schedule provides consent of all Partners in certain cases

Liability under LLP

- LLP is liable, in case of wrongful act or omission by the partner in the course of business
- **LLP is not liable if outsider is aware that the partner has no authority to act**
- Partner is Agent of LLP but not of other PARTNERS
- Partner is not liable for the wrongful acts/omission of any other partner of LLP
- Partner may be personally liable [eg. Auditors liability]
- Partner to indemnify the LLP for any loss caused to it by his fraud in the conduct of the business

Comparison with existing options

Particulars	Partnership	Limited Liability Partnership	Company
Compliance level	Low	Moderate	High
Dividend Distribution Tax	Not applicable	Not Applicable	Applicable
Dispute Resolution System	Not available	Not available	Available
Making investment in shares	Not possible	Possible	Possible

Comparison with existing Options

Particulars	Partnership	Limited Liability Partnership	Company
FDI/ ODI/ ECB	Eligible	FDI – where there are no sectoral caps /conditions ODI allowed	Eligible
NBFC	Not eligible	Not eligible	Eligible
From Bankers point of view	Un favorable	Un favorable	Favorable
Information at Public Domain	NIL	Lower	Higher

Who can prefer LLP?

- **Asset Holding Companies**
- **Best for Joint Venture entities**
- **All partnerships /AOP with long term objective**
- **Any company not having bank loans**
- **Professional Firms [CA/CS/CWA]**
- **Service sector/ Real Estate**

Who can not go for LLP?

- Non profit making entities [NGO]
- Finance/ Investment entities [Till RBI recognises LLP]
- FDI is not allowed where there are sectoral caps or conditions
- FII / FVCI / QFI / FPI not allowed to invest in LLP

Incorporation

- At least two partners
- At least two individual are required as designated partners
- At least one of Designated Partners should be resident in India
- Partnership Agreement is required to be entered (By default First Schedule is applicable)

Important/ New Concepts in LLP

- Partner
- Designated Partner
- Contribution
- LLP Agreement

Partner

- Person who becomes Partner in LLP in accordance with LLP Agreement
- Any Individual or Body Corporate
- Corporation Sole and Society can not become Partner
- Partnership Firm, HUF, Trust cannot become Partner
- Partner is Agent of LLP not of other Partner
- Rights & Duties depend on LLP Agreement

Partner is Agent of LLP not of other Partners

Principles of Agency

- Agency is the relationship which subsists between the principal and the agent, who has been authorized to act for him or represent him in dealings with others
- Agent bound to conduct business on the directions of the principal
- Agent is bound to conduct business with reasonable skill and diligence
- Agent is bound to render proper accounts to its principal
- When the agent acts otherwise, is liable to make the loss good to principal
- Agent to compensate principal in case of negligence

Important concepts

- Designated Partner is a concept similar to officer in default
- Contribution is not a capital
- Contribution is similar to guarantee
- Contribution need not be the basis for voting/control
- Contribution need not be the basis for profit sharing

LLP Agreement

- Provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership.
- In the absence of provision in LLP Agreement, of First Schedule are applicable
- First Schedule = Partnership Act
- LLP Act has only 81 Sections and 4 Schedules and Rules [Not like Companies Act]
- Rights and Duties of Partner / Designated Partner will depend on LLP Agreement [No rights like member, Director or Partner]

Important features of First Schedule

- No partner shall draw remuneration
- LLP shall indemnify partner against liabilities incurred in Ordinary Course
- Each Partner shall have one vote at the meeting
- New partner can be admitted with consent of all the Partners

Important features of First Schedule

- Decision taken at Partners Meeting should be minuted within 30 days
- New business can be started with consent of all Partners
- Partner shall not compete with LLP
- Partner can not derive any benefit from LLP without consent of Partners

Imp. aspects of LLP Agreement

- Profit Sharing Pattern/ Voting/ Contribution may not be related
- Powers, Rights & Duties of DP and Partners to be specified
- Admission/ Cession of Partners / DP
- Decision making process to be defined [Meeting?]
- Exit mechanism / dispute resolution - Arbitration
- Remuneration, Interest on Capital, Profit withdrawal
- Books of Accounts, Audit, Reporting
- AOA of public co. / Partnership Deed can be the basis
- Agreements for Family business / VC Undertaking / Widely held cos will be different

Process for Incorporation

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- **Step I – Obtain DIN/ DSC**
- **Step II – Apply for Name [Form 1]**
- **Step III – Enter into LLP Agreement**
- **Step IV – Submit Form 2**
- **Step V – Obtain Certificate of Registration**
- **Step VI – Submit Form 3 within 30 days**
- **Process Time = 15 - 20 days**
- **Registration is now decentralized to the respective ROC**

Conversion of Partnership into LLP

- ▶ All the assets and liabilities of the firm would get vested in LLP
- ▶ All the Partners becomes Partners of LLP
- ▶ Partnership Firm registered with ROF stands dissolved
- ▶ Partners personally liable for liabilities incurred before conversion
- ▶ Consent of all creditors is required
- ▶ Statement of assets and liabilities by CA [≤ 30 days]
- ▶ Acknowledgement of last Income Tax rtns.

Conversion of Company to LLP

- ▶ There should not be any security interest on the assets of the Company
- ▶ All the assets and liabilities of the Company would get vested in LLP
- ▶ All the shareholders becomes Partners of LLP
- ▶ Consent of all Creditors is required
- ▶ Statement of assets and liabilities by CA [<30 days]
- ▶ Acknowledgement of last Income Tax returns
- ▶ Company stands dissolved

Process of Conversion

- Step I – Update Residential status of Designated partner by filing DIR-6/ Apply DIN
- Step II – Apply for Name [Form 1]
- Step III – Application for conversion in Form 2 and form 17 OR 18
- Step IV – Obtain Certificate of Conversion
- Step V – Enter into LLP Agreement
- Submit Form 3 within 30 days
- Step VI- Filing form 14 – in case of conv , of firm into LLP
- Process Time = 25-30 days
- Registration is now decentralized to the respective ROC

Critical Aspects of Conversion

- ▶ Treatment of Equity Capital
- ▶ Treatment of Equity Capital with Differential Voting Right
- ▶ Treatment of Preference capital
- ▶ Treatment of Shareholders Agreement
- ▶ Role of Directors/ Managing Directors
- ▶ Method of maintaining Books of Accounts
- ▶ Stamp Duty & Capital Gain Tax
- ▶ Change in licenses/ govt. registrations

Interesting Questions ?

- Whether Doctrine of Ultra Vires is applicable?
- Whether Doc. Of Indoor Mgt. is applicable?
- Can LLP issue debentures/ bonds?
- Can LLP convert into Company/ Firm?
- Can LLP have Share Capital over and above contribution?
- Can LLP list on Stock Exchange?
- Can LLP carry out investment as its incidental business?

Opportunities for CSs

- Incorporation of LLP
- Drafting of LLP Agreement [V V IMP]
- Conversion of Partnerships into LLP
- Conversion of Private or Closely held Public Ltd cos' into LLP
- Compliance services for LLP
- Gearing up for Multi Disciplinary Practice

THANK YOU

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