

TAXATION FOR LIMITED LIABILITY PARTNERSHIPS

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Abstract:

Introduction of limited liability partnership on the backdrop of corporate tax management is an additional tool offered, of late, in the hands of entrepreneurs and consultants. Though many tax aspects have been well settled by the government it is imperative to understand the implications at one go. The popularity of a business tools many times depends upon the clarity of provisions under the taxation laws. This paper is an endeavor to explain these tax aspects in the light of latest provisions.

Introduction

In India after the introduction of Limited Liability Partnership Act in 2008, Finance Act, 2009 had made it clear that Limited Liability Partnership should be treated at par with the firm/ association of persons established under the Indian Partnership Act, 1932. It was actually a thought then that the taxation of Limited Liability Partnership should be like a corporate assessee; however it was natural and more realistic to tax it like any other partnership firm. Historically from the assessment year 1993-94 a partnership firm is assumed as a separate entity for taxation purpose and hence was allotted separate PAN. On similar lines Limited Liability Partnership also requires separate PAN and is taxed like a partnership firm.

With this background it may be relevant to run through various taxation aspects of Limited Liability Partnership.

1. PARTNERSHIP FIRM – DEFINITION [SECTION 2(23)]

Pursuant to Section 2(23) of the Income-tax Act which defines “Firm”, “Partnership” and “Partner” provides that these terms shall have meanings assigned to them under the Indian Partnership Act, 1932.

As per amendment made by Finance (No. 2) Act, 2009, a Limited Liability Partnership (LLP) is included in the definition of ‘Firm’ ‘Partnership’ and ‘Partner’. However, LLPs incorporated outside India (foreign LLPs) shall be taxed as ‘company’.

Accordingly the provisions of Taxation applicable to a Partnership Firm constituted under Indian Partnership Act, 1932 will equally be applicable to a firm constituted under LLP Act, 2008.

2. PARTNERS

Pursuant to Section 2(23)(ii)(a) of the Act, ‘partner’ shall have meaning as assigned under Indian Partnership Act, 1932 and includes ‘any person who being a minor is admitted to benefits of partnership’.

It is clearly provided in Section 5 of LLP Act that any individual or body corporate can be partner in LLP.

3. RESIDENTIAL STATUS

To remove any doubt in respect of residential status, Section 6(2) provides that a firm is said to be resident in India if control and management of its affairs is wholly or partly situated within India during the relevant previous year.

4. RATES OF TAX A.Y. 2018-19

- Flat Rate of 30%
- Long – term capital gains shall be taxable @20%
- Short -term capital gains from shares/securities, subjected to Securities Transaction Tax @15%
- Surcharge is payable @12% in case of firms having total income above Rs.1 crore (10% for A.Y.2015-16 as given below).

However, the surcharge shall be subject to marginal relief (where income exceeds one crore rupees, the total amount payable as income-tax and surcharge shall not exceed total amount payable as income-tax on total income of one crore rupees by more than the amount of income that exceeds one crore rupees).

- Besides, Education Cess @2% and Secondary & Higher Education Cess @1% of income-tax and surcharge shall be leviable.
- Dividend Distribution Tax (DDT) u/s. 115-O is not applicable to Limited Liability firms.

5. RATES OF TAX A.Y 2018-19

Income Tax Rate	Surcharge	Education Cess
30% on whole of the income	10% surcharge will be applicable where total taxable income is over Rs.1 Crore. . However, the surcharge shall be subject to marginal relief (where income exceeds one crore rupees, the total amount payable as income-tax and surcharge shall not exceed total amount payable as income-tax on total income of one crore rupees by more than the amount of income that exceeds one crore rupees).	3% (2% of income tax and Additional Secondary & Higher Education Cess @ 1% is also levied on all assesseees).

5. TAX AUDIT

The Limited Liability Partnerships having Gross Sales, Turnover or Gross Receipts exceeding Rs. 1 crore shall require to undergo through tax audit, w.e.f. A.Y. 2013-14. Earlier the threshold was Rs. 60 lakhs.

Actually the Committee appointed for the purpose had recommended the alignment of two section viz Section 44AA and Section 44AB under the Income Tax Act. The Committee also felt that the threshold limits for getting the books of account audited, both in the case of business and profession, need upward revision. Hence it was recommended that the threshold limit may be revised from the present one crore rupees to two crore rupees for assesseees carrying on business and from the present twenty-five lakhs rupees to rupees one crore for assesseees exercising a profession.

Based on the aforesaid recommendation, section 44AA and section 44AB of the Income-tax Act, 1961 were merged into the following new section:-

Substitution of sections 44AA and 44AB In the Income-tax Act, for sections 44AA and 44AB, the following section shall be substituted with effect from the 1st day of April, 2017, namely;

"44AA (1) Every specified person shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.

(2) The specified person referred to in sub-section (1) shall get the books of account and other documents referred therein audited by an accountant before the specified date.

(3) The specified person shall, after completion of the audit, furnish by the specified date, the following statements and reports, namely:-

- (i) the statement of assets and liabilities of the specified person as on the last day of the previous year;
- (ii) the profit and loss statement or the income and expenditure statement, as the case may be, for the previous year; and
- (iii) the report of tax audit.

(4) The person referred to in sub-section (1) shall be deemed to have complied with the provisions of this section, if -

- (i) the person keeps and maintains the books of account and documents and gets such accounts and documents audited, as required by or under any other law;
- (ii) the person obtains by the specified date the report of the audit as required under such other law; and
- (iii) the person furnishes, by the specified date, the statements and report referred to in sub-section (3).

(5) The Board may, subject to the provisions of sub-section (4), prescribe the following in respect of keeping, maintaining, auditing of accounts and documents and furnishing of statements and reports:-

- (i) the books of account and documents to be kept and maintained;
- (ii) the particulars to be contained in the books of accounts and documents;
- (iii) the form and the manner in, and the place at, which the books of account and other documents shall be kept and maintained;
- (iv) the period for which the books of account and documents should be retained;
- (v) the form of the statement and reports and the manner of verification; and
- (vi) the medium in which the statements and reports is to be delivered;
- (vii) the income-tax authority, or any other person, authorized to receive the statements and reports; and
- (viii) any other matter connected therewith.

(6) For the purposes of this section,-

- (i) "accountant" shall have the same meaning as in the Explanation below sub-section (2) of section 288;

(ii) “profession” shall mean the legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as may be prescribed;

(iii) “specified date” means the due date for furnishing the return of income under sub-section (1) of section 139;

(iv) “specified person” shall mean a person carrying on business or profession in the previous year and who fulfils the following conditions, namely:-

(a) the total sales or turnover in the business exceed or exceeds two crore rupees or the gross receipts in the profession exceed one crore rupees in any one of the three years immediately preceding the previous year;

(b) the person is carrying on business or profession which is newly set up in any previous year and the total sales, turnover or gross receipts, as the case may be, in business or profession are or is likely to exceed one crore rupees in the previous year; or

(c) the profits and gains from the business or profession are deemed to be the profits and gains of such person under section 44AD or section 44AE or section 44AF or section 44AG or section 44BB or section 44BBB, as the case may be, and he has claimed such profits and gains of the business to be lower than the profits and gains so deemed in the said previous year.”.

OTHER AUDITS

- Partnership Firm – Does not require generally to undergo audit under Indian Partnership Act, 1932.
- Limited Liability Partnership under LLP Act, 2008 makes it mandatory for every LLP having turnover not less than Rs. 40 lakhs or Capital contribution not less than Rs. 25 lakhs to get its accounts audited by a Chartered Accountant.

6. DUE DATES FOR FILING OF RETURN OF INCOME [SECTION 139(1)]

Firms liable for TP Audit	30th November
Firms whose accounts are required to be audited other than TP Audit	30th September
Other Firms	31st July

With effect from A.Y. 2006-07, it is mandatory for a firm to file return of income irrespective of whether there is taxable income or not. From A.Y. 2007-08, return of income for firms which are subject to Tax Audit u/s. 44AB needs to compulsorily filed in electronic form with or without digitally signature.

7. CONDITIONS FOR ASSESSMENT AS A FIRM

- The Partnership should be evidenced by an instrument in writing and individual shares of partners should be specified therein (Sec. 184).
- A certified copy of the instrument (Partnership Deed) should be filed with the return of income of the year in which assessment is first sought. The copy of the Deed be certified by all partners in writing (Sec. 184).
- In the year in which there is a change in constitution of firm or shares of partners, a certified copy of the instrument of change of Partnership is to be filed with the return of income for the relevant previous year (Sec. 184).

- In the event there is failure on part of firm in complying with the conditions of Sec. 184 or has committed failures specified in Sec. 144, no deduction shall be allowed in respect of Interest, Salary, Bonus, Commission or Remuneration, by whatever name called. (Sec. 184, 185). However in case of income tax returns filed electronically, the return shall not be accompanied by any attachments/annexures but produced when demanded by the Assessing Officer (Refer Circular No. 3/2009/21-5-2009).
- Where, at the time of making an assessment of the firm, it is found that a change has occurred in the constitution of the firm, the assessment shall be made on such reconstituted firm.
For this purpose,
 - i. If any of partners cease to be partners or any new partner is admitted and one or more of the persons who were partners of the firm before change continue to be partner after the change, or
 - ii. Where all partners continue but there is change in shares of some or all of them, such change would constitute change in constitution of the firm (Sec. 187).
- Where a firm is succeeded by another firm (not being a change in constitution u/s.187) separate assessments shall be made on the predecessor and successor firms (Sec. 188).
- If business or profession carried on by the firm is discontinued or where a firm is dissolved, all the proceedings under the Act shall be made as if there is no discontinuance or dissolution.
- If such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against persons who were partners at the time of dissolution or discontinuation or legal representative of such person who is deceased (Sec. 189).

8. INTEREST TO PARTNERS [SECTION 40(B)]

Maximum interest allowable on capital/current accounts of partners is Simple Interest at the rate of 12% per annum. The payment of interest should be authorised by and in accordance with the instrument of partnership. Interest paid/credited to partner will be allowable as deduction to LLP and it will be taxed at the hands of partner of LLP.

9. REMUNERATION TO PARTNERS [SECTION 40(B)]

- a. Any payment of salary, bonus, commission or remuneration, by whatever name called can be paid only to a “working partner”; i.e., a partner who is actively engaged in conducting the affairs of the business or profession of the firm.
- b. Maximum permissible deduction in respect of remuneration payable collectively to all working partners has been made uniform for all Firms/LLPs engaged in business or profession with effect from A. Y. 2010-11, which is as follows:—

<i>Book Profit</i>	<i>Maximum allowable deduction</i>
Loss or book profit up to ₹ 3,00,000/-	₹ 1,50,000 or 90% of book profit whichever is higher
On balance book profit	60% of book profit

The remuneration is to be calculated on book profit of the firm; i.e., net profit as per profit and loss account (in the manner laid down in Chapter IV-D) of the firm before allowing deduction of remuneration to partners.

- c. Requirements of LLP Agreement for allowing deduction : Remuneration shall be in accordance with terms of LLP Agreement. As per CBDT circular No. 739 dated 25-3-1996, ‘In cases where neither the amount has been quantified nor even the limit of total remuneration has been specified but the

same has been left to be determined by the partners at the end of the accounting period, in such cases payment of remuneration to partners cannot be allowed as deduction in the computation of the firm's income'. Reference may be made to the judgment **M/s. Durga Dass Devki Nandan vs. ITO (HC Himachal Pradesh)**

10. PRESUMPTIVE INCOME

Benefit of presumptive taxation not available to LLP :

Presumptive taxation covered u/s 44AD specifically exclude partnership firms established as limited liability (LLP).

11. LOSSES OF THE FIRM [SECTION 78]

Unabsorbed losses of the firm shall be carried forward and set off as per provisions of sections 70, 71, 71B, 72, 73, 74 and 74A in the hands of the firm.

In case of change in constitution of firm, the loss proportionate to share of the retired or deceased partner shall not be allowed to be carried forward.

12. OTHER ISSUES OF TAXATION OF LLPS

- **Designated Partner** : An LLP shall have at least 2 designated partners. The designated partners have been defined in Sec. 7 of the LLP Act, 2008 being an individual who shall be resident in India. The designated partners are necessarily individuals and in case of body corporate individuals being nominees of such bodies corporate.
- **Signing of Income Tax Return** : Under section 140 return of income of an LLP is to be signed by a designated partner. However, if for any unavoidable reason designated partner cannot sign or where there is no designated partner, any partner may sign the return.
- **Deemed Dividend [Section 2(22)(e)]**: Any loan given by LLP to its partners out of its accumulated Profits/Reserves is not liable to be taxed as Deemed Dividend unlike in the case of closely held Companies.
- **Provision of Wealth Tax** : Not applicable to Partnership firms or Indian LLPs since Section 3 of Wealth Tax Act, 1957 provides wealth tax shall be charged in respect of Net Wealth of Individuals, HUFs and Companies only.

Conclusion:

From the discussion above, it could be concluded that limited liability partnership could be an economical and flexible business tool and it could be efficiently used for tax management, provided the entrepreneur understands the pros and cons of its direct tax structure. As the concept of partnership firm is relatively well understood already in the corporate world, similar tax treatments could be easily grasped and considered as an alternative to any business unit. However the concepts like presumptive taxation or allowable business expenses should be appropriately understood to overcome the pitfalls.

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