

An Introduction To LLPs For SMPs

The ICAI's report on Capacity Building Measures, 2004 has noted that the Sole Proprietary Firms/Small Firms having less than 4 partners constitute 93.98 per cent of the total members while firms with 4 to 10 partners and more than 10 partners constitute 5.78 per cent and 0.24 per cent of the members respectively.

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The Naresh Chandra Committee on Regulation of Private Companies and Partnerships and J.J. Irani Committee on Company Law have encouraged the formation of Limited Liability Partnerships (LLPs). The above Committees emphasised on the need of LLPs in India in view of the growing opportunity for professionals in the field of international transactions, in a WTO era and also having a suitable vehicle which has the flexibility of a partnership and at the same time limiting the professional's liability. These Committees have also recommended that a separate legislation is to be enacted for LLPs. In this regard the Ministry of Company Affairs is finalising the concept paper on LLPs, which will be released to the public in the near future for comments and discussions.

The above traditional model of the structure of the Small and Medium Practice Firms (SMPs) is not equipped to meet the multi-competency, multi-disciplinary and multi-locational requirements of the global and domestic clients in a most efficient manner. In this regard, the Firms have to acquire more resources, intellectual property, world class methodologies and requisite expertise/skills.

The above Report has, among other recommendations, recognized the formation of LLP as a suitable vehicle to strengthen and promote multi-disciplinary partnerships.

The vision document of ICAI recognizes the need for CAs to be world class advisors in an ever growing and changing business environment.

The Naresh Chandra Committee Report on Corporate Audit and Governance also observed that there is a need to change the regulatory framework that encourages the consolidation and growth

related legislation and has its own separate and distinct legal existence, separate from that of its partners. It is the LLP which enters into legal agreements, not the individual partners and generally has the following features:

- The law relating to General Partnership (i.e. Indian Partnership Act, 1932) is not applicable.
- LLP permits individual partners to be shielded from joint liability created by other partner's decision or misconduct. Thus every partner of an LLP is the agent of the LLP but not of other partners.
- An LLP has a perpetual succession.
- Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the LLP.
- An LLP has at least two partners. There is no limitation on the maximum number of partners.
- An LLP and Company can also be a partner in an LLP.
- An obligation of the limited liability partnership whether arising in contract, or otherwise is solely the obligation of the LLP. However, the personal unlimited liability of a partner for his own wrongful act or omission remains which are not done for and on behalf of LLP.
- LLPs enjoy the same tax status as that of a general partnership.

of Indian firms i.e. the SMPs, in view of international competition especially with regard to non audit services.

The Council of ICAI has recommended the change to the Government in clause (4) of Part I of first schedule to the CA Act, 1949 which allows formation of separate partnerships with other professionals. It is expected that this change in the CA Act will precede the formulation of separate legislation of LLP.

LLP and its features

An LLP is a body corporate which is formed by being incorporated under the

- LLPs are an extremely flexible business vehicle too. LLP partners, unlike a company, are both the shareholders and directors. The partners are free to organise themselves internally e.g. how to share profits, who is responsible for management and how decisions are to be made.
- Every LLP shall have a manager, who will be responsible for all the acts as required to be done by the LLP and personally be liable to all penalties imposed on the LLP for any contravention of the related legislation.
- An LLP shall have either the words “limited liability Partnership” or the acronym “LLP” as the last words of its name.
- The mutual rights and duties of the partners of a LLP and the mutual rights and duties of LLP and its partners, shall be governed by the agreement between the partners, or between the LLP and its

partners. The agreement needs to be filed with the Registrar of Companies to the extent stated in the related legislation.

- Every LLP lodges with the Registrar of Companies an annual declaration of solvency.
- A firm /company may apply to convert to a LLP, if LLP to which it converts comprises of all the partners of the firm/ shareholders of the company respectively.
- LLP shall maintain proper books of account on accrual basis, to give a true and fair view.
- The winding up of LLP may be either by the tribunal or voluntarily.
- The administration of LLPs, like a company, will be through Ministry/ Registrar of Companies.

LLPs are already in existence and are popular in countries like USA, UK, Germany, Canada, Australia and Singapore.

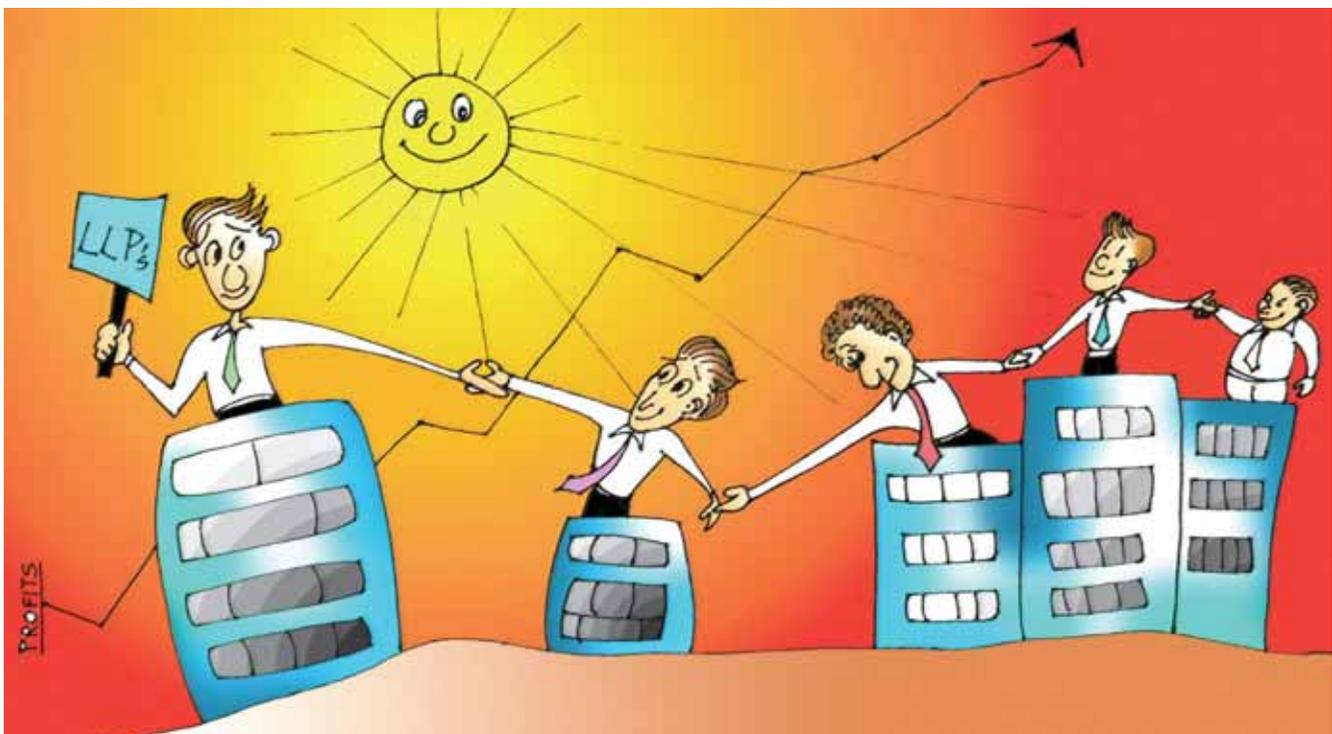
Pros and Cons of LLPs for SMPs

- The growth and success of General Partnerships is hampered by unlimited liability which puts the personal assets of each partner at risk for liability incurred by another partner for whom they have no responsibility. In a LLP there is a redistribution of risks from partners who have no responsibility to LLP, from the point of view of third party claims.

LLPs may take on remunerative assignments involving risks that would be too high for a general partnership, given the personal exposure of individual partners.

- The liability of partners over wrongful acts or omissions is not quite so clear in the sense that the third party will need to prove in the court of law that the partner has assumed personal responsibility for advice and that the party relied on the aforesaid responsibility. None of these will need to be proved in the court of law by the third party in case of general partnership, where a part-

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ner is always personally liable.

- LLPs will foster networking of various kinds i.e. among SMPs, and International Accounting Firms and among specialists in diverse field of practise. These networkings will in turn promote the development of world class methodologies, human resources, non audit services, pooling of infrastructure, locational reach, brand building. Consolidation of Firms, Single window services provider etc. Thus, LLPs will be able to deliver value added and remunerative services to the client resulting in increase their confidence.

The above will lead to Global opportunities and competitiveness in a WTO environment without the apprehension of unlimited liability.

The limited partners amount of liability and share of profits can be freely agreed between the partners in the agreement.

- The ability to attract outside investment to fund practice development rather than relying on the partners personally or the bank. This means the firms can fast track their de-

velopment to keep pace with client demands and compete effectively.

- SMPs often face serious succession problems, one of which is their lack of ability to attract high caliber individual into partnership. Becoming an LLP will make the Firm considerably more attractive to potential partners or incoming partners of an LLP who are not responsible for practice debts or financial liabilities that were sustained prior to their arrival.

- There could be following additional compliance costs to:

- (i) Convert a general partnership to LLP or start up relating to formation of LLP depending on size and complexity.
- (ii) Comply with the regular compliance requirements similar to that for company i.e. filing annual returns, accounts etc.
- (iii) Pay fee to the Regulatory bodies (i.e ICAI etc.) for setting up new administration and disciplinary structures.

Although it is difficult to quantify the above costs, at

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this juncture, the concerned officials of the Ministry of Company Affairs and Regulatory bodies (ie ICAI etc.) should ensure that these are not prohibitive to make LLPs unattractive option for SMPs.

- The liability of the partners being limited, it is argued that the partners in SMPs could be asked for personal guarantees by lenders, which would place them in the same position as if they were partners of general partnership. This could affect people whose partnerships find themselves in financial difficulties.

- An enhanced and comprehensive administration and disciplinary mechanism will need to be designed especially for LLPs by the respective regulatory bodies having a clear understanding/co-ordination among themselves

- An LLP may need proper professional Indemnity Insurance Cover. Indeed, many contracts will require proof that LLP have a specified minimum level of aforesaid insurance for a fixed period. Meeting the cost of premium, may be difficult in the cases when the LLP is experiencing downturn in practice or due to retirement of partners.

Conclusion

The decision to go for LLP would be a purely voluntary decision that should be taken only if the benefits outweigh the costs. At present, it is difficult to quantify & value these costs and benefits. However, the advantages of combining the characteristics of both company and partnership, acceptance in the international business arena and the promise to convert the SMPs into world-class advisors merits a serious consideration in favour of LLPs. □